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Trends and outlook for the international market

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Trends

Pricing vs. Volumes

Although all full-year data is not yet available, it seems clear that nearly all major suppliers saw improvements in 2010 compared to 2009. France, Italy, Spain, the US, Chile and Argentina all registered substantial increases in export volumes. The one exception appears to be South Africa, with a 4% decline in export volumes.

A key escape valve for excess supply of many major global exporters in 2010 has been emerging markets, many of which are posting strong growth in wine imports. Australia, Argentina, Chile, Spain and others reported double digit growth in export volumes to China, Russia, Brazil and/or Mexico. Of course, for most suppliers, even with the astounding growth rates of wine consumption emerging markets, it will take years for the volumes purchased there to match traditional import market volumes. Furthermore, in many cases the prices suppliers receive from emerging markets, and from Russia in particular, are below those received from developed markets, and pricing was indeed a challenge for many suppliers in 2010.

Figure 1: Export prices for selected suppliers in key markets, 2010 (USD/l)

Destination Market	Australia	Spain	Chile	Argentina	Bordeaux
UK	$ 1.78	$ 2.88	$ 1.86	$ 2.94	$ 15.80
US	$ 2.52	$ 4.37	$ 2.03	$ 3.58	$ 10.64
Canada	$ 3.35	$ 2.57	$ 2.84	$ 3.63	$ 9.66
Brazil	$ 4.83	n.a.	$ 2.84	$ 3.16	$ 10.33
Russia	$ 4.14	$ 0.44	$ 2.52	$ 2.40	$ 5.50
India	$ 4.44	n.a.	n.a.	n.a.	n.a.
China	$ 2.51	$ 0.92	$ 1.29	n.a.	$ 9.20
Total Average	**$ 2.39**	**$ 1.39**	**$ 2.07**	**$ 3.33**	**$ 11.28**

Sources: Australian Wine and Brandy Corp. (AWBC), Observatorio Español del Mundo de Vino (OEMV), Instituto Nacional de Estadísticas de Chile (INE), Instituto Nacional de Vitivinicultura de Argentina (INV), and Conseil Interprofessionel du Vin de Bordeaux (CIVB), 2010

Although pricing in emerging markets is generally below average for many suppliers, Australia appears to be quite successful in this area. While in recent years, ongoing discounting has hurt Australia's pricing power in its traditional export markets of the UK and the US, pricing for Australian wines has been far stronger in nearly all the emerging markets (Figure 1). A look at other key exporters, such as Spain, Chile, Argentina and Bordeaux, reveals that their average per-litre prices for wines sold to Brazil, Russia and China were below the group's average export price by 2%, 40% and 23%, respectively. For Australia, the per-litre prices of wines sold in Brazil, Russia, India and China were 102%, 73%, 86% and 5% above its average export price, respectively. Indeed, Australia receives some of its highest average prices from emerging markets.

Given that emerging markets are not traditional wine-drinking cultures, they generally have few preconceived notions about wine-producing regions. Suppliers that invest in educating consumers, promoting their region and building their brands in emerging markets can be expected to extract improved pricing in the long run. Some suppliers appear to be using emerging markets to unload excess supply at low prices, but the Australian example demonstrates that this may represent a missed opportunity.

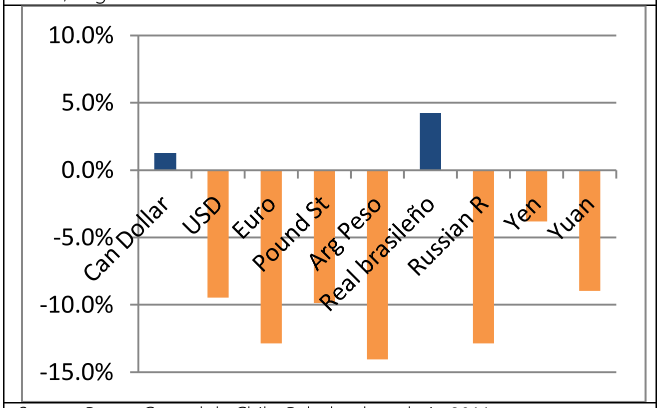
Pricing has been a major challenge for many suppliers throughout 2010, but there are signs that pricing trends are levelling out and perhaps improving for some suppliers. Average per-unit price for bottled wine imported into the US fell 15% through the first nine months of 2009, but only 3.8% during the same period in 2010. Similarly, Spain's export data through October 2010 shows sequential improvement in average unit price, with pricing down 6.6% for the last twelve months, 6.0 % for the last ten months and up 8.1% for October. For some suppliers, such as the US, Chile and Argentina, average export prices (USD/l) actually improved in the first nine months of 2010 compared to. 2009.

Pricing vs. Exchange Rates

The light global crop of 2010, the improving global economy and the unloading of excess stocks over the past year appear to be taking some of the pricing pressure off major suppliers, but clearly the improvement in pricing power of some suppliers is as much due to favourable exchange rates as to an improving pricing environment. European, Argentine and other suppliers may be deriving some pricing benefits from weak local currencies, but other major suppliers, such as Australia, are facing more adverse currency conditions. Australia saw its average export price fall an additional 11% through September 2010, and while oversupply played a role in this trend, the lion's share of the decline appears to be due to exchange rate variations. During the same nine-month period, the Australian dollar appreciated roughly 7.7% and 10.7% vs. the US dollar and the British pound sterling, respectively—the two trade currencies most relevant to Australian wine exports.

Adverse foreign exchange rates are also becoming a burden for Chile, as minor pricing improvements in export markets have not been enough to offset the negative impact of the strengthening of their home currency (Figure 2). The strengthening of the Chilean peso is putting stress on the Chilean wine industry, particularly for smaller, less efficient operators. Many small and medium-sized wineries are said to be actively seeking alliances, partnerships and/or joint ventures to improve scale and operating efficiency in order to survive. There is increasing speculation that a number of smaller Chilean wineries may be forced to exit the market if the exchange rate does not improve in the near term.

Figure 2: Change in value of key currencies relative to the Chilean Peso, avg. Jan-Oct 2010 vs. Jan- Oct 2009



Source: Banco Central de Chile, Rabobank analysis, 2011

International Supply

Southern Hemisphere Review

Production in Australia has faced considerable challenges this year. Growers in the warm inland areas have faced significant problems with downy mildew, and although estimates of the impact vary widely, it is likely to have a significant negative impact on the upcoming harvest. Given the challenges in production, continuing low prices for grapes and the government's ongoing offer to buy back water licenses in the Murray Darling Basin, vineyard removals will likely continue in 2011 at a similar pace to 2010, when approximately 6,750 hectares (net) of vineyards were removed. However, it remains to be seen how vineyard removals will be split between the warm-weather regions and the cool-climate regions, where the situation with structural supply is most dire.

Early indications point to a significantly larger New Zealand wine grape harvest in 2011 than the 266,000-tonne crop harvested in 2010. While wine companies continue to temper production decisions, growing conditions in the season to date have been largely conducive to high fruit yields. Even though vineyard plantings have dramatically slowed in more recent years, the productivity of New Zealand vineyards is still expected to rise gradually as prior plantings continue to mature.

In South America, preliminary estimates indicate that the Chilean harvest should be roughly similar to last year's harvest, and the Argentine harvest appears to be on target to exceed last year's crop by about 6%, but this is still well below the massive 2008 harvest.

South Africa is on target to produce a healthy crop in 2011, likely to reach an estimated 1.35 million tonnes. Though not as good as the record crop of 2008, these numbers still represent an increase of 7.3% over 2010.. Unfortunately, the healthy crop size is coupled with a challenging export environment and, according to official estimates, stock levels in South African wineries are expected to rise nearly 13% through December 2011.

Northern Hemisphere Review

US: Wine grape production in California was down approximately 15% in 2010 from 2009 production levels due to cool weather through much of the growing season. In the north coast (Napa and Sonoma) the cool weather and untimely rains have had an adverse effect on quality for some growers. While contract prices for grapes were mostly respected, spot prices in the north coast were soft: down more than 30% from pre-recessionary spot prices. However, this year's light crop, wineries' trend of using just-in-time inventories and improving sales of super-premium wines in the US have already led to improving prices for north coast bulk wine moving forward. Turrentine Brokerage indicates that demand for North coast 2009 bulk Cabernet Sauvignon has increased substantially from one year ago and is more in balance with supply, which should help support grower pricing next year.

EU: The 2010 EU crop will likely be flat to slightly below that of 2009, with some variations across regions. According to data from the Observatorio Español del Mercado del Vino, Spain's wine production is set to decline an estimated 0.8% compared to last year, and Italian production is expected to decline by a similar amount: 1%. In France, several regions report expected production declines compared to the 2009 harvest (Beaujolais, Rhone, Bordeaux, Burgundy) while some expect production increases (Champagne, Provence).

International Trade

Exports for most of the major suppliers through the first three quarters of 2010 improved significantly over 2009 levels. This is partly a reflection of the improving performance of the global economy, but also to some degree a reflection of the poor conditions in the same period in 2009, when export volumes were extremely soft due to the global recession. While data through September suggests that 2010 was a much better year than 2009 for export volumes, pricing for many suppliers saw additional deterioration (Figure 3).

- French exports showed strong recovery in the first ten months of 2010, with growth in value (14.7%) outpacing growth in volume (7.6%), reflecting solid pricing improvement of 6.5%, but still not completely compensating for the 29% average pricing decline of 2009. Notably, Champagne export volumes were up 27%, Bordeaux up 11% and Burgundy was up 20%.
- Spanish exports rose 30% by volume and 18% by value, with average prices declining 9% through the first ten months of the year. Export volumes are now roughly back in line with pre-recession levels, but pricing is below even 2006 levels. It is worth noting, however, that pricing for nearly all individual categories of wine has been improving in recent months. The challenge arises from the fact that most of the growth in exports has been in the cheapest wines.
- Total US exports through September were up 4% by volume and 27% by value, led by a strong increase in exports of higher value bottled wine to key markets such

as Canada and Japan, as well as increases in bulk wine sales to the UK and Italy.

- South Africa saw total export volumes decline 4% through November 2010, as improving sales to non-core markets such as Canada (23%), eastern Europe (36%) and South America (105%) were not enough to offset declining sales to the UK (-15%), its largest market.
- Argentina continues to buck the trend of declining average export prices. Volumes of bottled wine exports increased 10% while values increased 18%. Wine that used to be exported as cheap bulk is now being bottled, resulting in a decline of bulk exports. For all of its major export destinations, Argentina has seen growth in volumes, growth in average prices or both. Even for Russia, an extremely price-sensitive market, Argentina managed to improve average bottle prices by over 10% through the first ten months of 2010.
- Chilean wine exports grew 10% by volume and 12% by value (measured in US dollars) through the first ten months of 2010. Average bottle prices remained relatively stable, but growth in bottled wine exports outpaced exports of bulk wine, leading to better average revenues for Chilean exporters. Chile saw volume growth in sales of bottled wine to all of its major export destinations with the exception of Germany, and managed to improve pricing for sales to Russia and the UK, traditionally its lowest paying markets.
- Australia continues to face significant pricing pressure, with export volumes rising 1.4% while values fell 10% for the first nine months of 2010. Data for the 12 months through November 2010 suggests that the decline in pricing is the result of the continued trend of bulk wine exports outpacing bottled wine exports, coupled with ongoing declines in average per-bottle price. Major increases in export volumes to the UK, New Zealand, Canada and China were offset by an 18.5% decline in exports to the US.
- New Zealand saw double-digit increases to nearly all of its major markets, Denmark being the exception (down 15%), to achieve 26% growth in export volumes in the first nine months of 2010. The total value of exports grew by a relatively modest 7%, with strong volumes of bulk wine exports being fuelled by small New Zealand wine companies struggling to access distribution.

Figure 3: Changes in exports for key exporters, 2010

Country	Volume change (%)	Value change (%)	Period of measure
France	+7.6	+14.7	Jan- Oct
Spain	+18.4	+9.2	Jan- Oct
Italy	+6.1	+8.6	Jan- June
US	+4	+27	Jan- Sept
South Africa	-4	n.a.	Dec '09- Nov '10
Argentina	+10	+18	Jan- Oct
Chile	+10	+12	Jan- Oct
Australia	+1.4	-10	Jan- Sept
New Zealand	+26	+7	Jan- Sept

Sources: Australian Wine and Brandy Corp., 'The Gomberg-Fredrikson Report', Instituto Nacional de Vitivinicultura (Arg), Observatorio Español del Mercado del Vino, South Africa Wine Industry Information System, French Federation of Wine and Spirits Exporters, Wines of Chile, The New Zealand Winegrowers
Note: Value changes in local currencies

US Imports

Imports into the US continue to grow at a healthy pace, with value growth outpacing volume growth. This is mainly because bottled wines are gaining share from bulk wine imports, leading to an improved price mix (Figure 4). It is important to flag, however, that the average unit price of bottled wines saw further declines in 2010.

- Total import volumes through the first nine months of 2010 were up 3%, but value increased 8%.
- Volumes of imported bulk wine declined 22%, while bottled imports grew 9%.
- Most of the decline in total bulk wine imports were the result of the decline in bulk imports from Australia (down 36%) and to a lesser degree Chile (down 18%) compared to the first nine months of 2009.
- Every major US supplier, with the exception of Australia, experienced an increase in exports of bottled wine volumes to the US.
- Average unit price for imports is up 4.8% from 2009 levels due to the decline in bulk wine imports, but the average per-bottle price is down 3.8% from 2009.
- Currently, bottled wine prices for the first nine months of 2010 are down over 18% vs. the same period in 2008, when the greatest impacts of the recession began to be felt.

Figure 4: US imports by country of origin, Jan 2010-Sept 2010

	Value (USD million)	Change (%)	Volume (million cases)	Change (%)
Italy	906.1	8	20.5	9
France	670.7	4	7.2	-2
Spain	189.3	13	4.6	18
Australia	447.9	-5	17.2	-14
New Zealand	140.2	24	2.5	31
Chile	194.8	2	9.3	-6
Argentina	198.3	25	7.1	19
World total	3,047.7	8	77.4	3

Source: 'The Gomberg-Fredrikson Report'

Currency Commentary

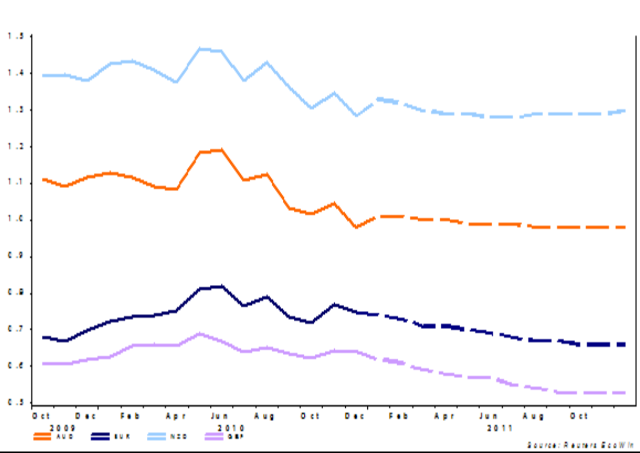
USD: The final weeks of 2010 brought higher stock prices, higher oil prices and a positive bias in long-term interest rates. These moves were suggestive of greater optimism concerning the outlook for world growth. Higher bond yields lent support to the US dollar through November, though the US dollar index has remained range-bound since early December. Improved appetite for risk in 2011 suggests that the US dollar may trade lower during the course of 2011 due to a reversal of safe haven demand. Despite a modest improvement in some US labour market indications, the US unemployment rate remains shockingly high. By the Fed's own reckoning, it could take years for this to correct to more normal levels. The implication is that US policy will remain relatively accommodative for a prolonged period, which undermines the outlook for the US dollar

AUD: By contrast, the Reserve Bank of Australia has hiked rates by 1.75% since September 2009. This, combined with strong Asian demand for its commodity exports, resulted in a 14% gain for Australian dollar/US dollar for the full year 2010. Flooding in Queensland threatens to lower GDP potential this year, which may lower the risk of further rate hikes. This suggests that the trajectory for Australian dollar/US dollar gains this year is likely to be far flatter than in 2010.

NZD: The New Zealand economy is based around dairy and agriculture rather than mining and metals and lacks the underlying strength of its western neighbour. We foresee only moderate upside potential for the New Zealand dollar vs. the US dollar this year.

EUR: The euro remains embroiled in the Eurozone sovereign debt crisis. Fears about debt-refinancing, particularly in the Eurozone, are intense. That said, the market was reluctant to aggressively short the euro in recent months, which is in contrast to market positioning at the peak of the Greek crisis. For now, the market appears to be trusting that the Eurozone authorities have the capacity to see the euro through the crisis. If they do, the Eurozone will eventually become a far more coherent system and the euro will strengthen against the US dollar. In the meantime, however, there are many potential pitfalls for the euro and the euro/US dollar is therefore set to remain volatile.

Figure 5: Currency forecasts vs. the US dollar as of October 2010



Source: Rabobank, Reuters EcoWin

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