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COVID-19 – Market insights and implications discussion paper

Executive summary

There is considerable uncertainty surrounding the extent and duration of the COVID-19 pandemic in health and economic terms. However, there are some clear trends emerging and what is certain is that businesses will need to be agile and responsive to survive and prosper in this environment. This paper provides the latest available information around the impacts of the COVID-19 pandemic on key markets for Australian wine and considers what the implications may be for Australian grape and wine businesses. It draws on briefings received from domestic and international experts and our own analysis.

Overall, demand for wine and wine consumption has held up in most markets around the world. The biggest impact has been on how consumers have purchased wine, with the shutdown of the on-premise channel (such as restaurants and pubs) and a shift to purchasing more wine online. In the off-trade channel, there has been growth across all price points. The trend away from commercial/value sales has reversed and there has been a significant lift in sales for this category since March.

The average value of unpackaged (bulk) exports has remained high at levels not seen since late 2005 due to the relative short supply of Australian wine in an already constrained global supply situation.

The impacts on producers depend on their individual business model and the markets in which they operate.

This paper explores what has happened in:

- the domestic off trade
- the domestic on trade
- domestic ecommerce
- domestic cellar door and tourism, and
- exports.

Domestic market

Those with a heavier reliance toward the domestic on-trade channel have, relatively, been harder hit due to the closure of all licensed venues in Australia on 22 March and their gradual and restricted reopening. This has also had negative flow-on effects for distributors and others in the supply chain.

Domestic off-trade

The domestic off-trade has been a beneficiary of the closure of the on-trade. Panic buying saw spikes in sales from mid-March to mid-April. Those with a portfolio weighted toward value/commercial wines have been in a better position as the growth in value/commercial wines has been stronger than for fine wines in the domestic market.



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Domestic on-trade

The near complete loss of the on-premise sector has not been replaced by an increase in sales in other channels, especially by value compared to volume. While there has been an easing of restrictions in some States, a second wave of infections in Victoria has seen the on-premise shutdown again and heightened restrictions in other States.

Domestic ecommerce

The ecommerce channel, allowing consumers to buy online, has been beneficial for wine sales in all formats – brick-and-mortar/ecommerce grocery hybrids, marketplaces, dedicated alcohol ecommerce, shopper apps/on-demand as well as Direct-to-Consumer (DTC).

Domestic cellar door and tourism

The banning of international visitors, domestic travel restrictions and social distancing requirements have severely impacted cellar door sales and tourism in wine regions. However, with the exception of Victoria, the easing of restrictions has been a boon for domestic tourism over the last few weeks, including cellar doors.

Exports

The figures for the year ended 30 June 2020 reflect a decline in volumes compared to last year. This is largely due to three consecutive lower vintages, rather than a slowing of demand, with the last couple months more positive. Most of Australia's key export markets have increased exports month-on-month since April. However, while the USA, UK, and Canada imported more in the quarter ended June 2020 than the same quarter in 2019, China, Hong Kong, New Zealand, and Singapore all lag behind where they were a year ago.

Enduring changes

While some of the changes from the COVID-19 pandemic may not last, we anticipate that others will endure.

The increasing importance of ecommerce as a route to market is likely to continue in a post-COVID-19 world. Already well developed in China, other markets including Australia and the USA are needing to expand their ecommerce channels to reach customers. This channel will rapidly become saturated and will require new brand strategies. The threat for smaller producers is that the ecommerce channel will be dominated by larger operators, as is the case with off premise retail.

The changing routes to consumers are putting the traditional distribution model under threat. How quickly the on-premise market recovers, together with how well distributors adapt to and embrace new distribution options, will dictate the future shape of the model.

On the domestic front, the social distancing and hygiene measures have seen a swift rise in paid tastings at cellar doors, which is a change we expect will endure.

On the supply side, the International Organisation of Vine and Wine (OIV) reported that the volume of global wine production decreased by 3.4 billion litres in 2019, with production declining from the big three: Italy, France and Spain, as well as Chile. Overall, the 2020 harvest from the southern hemisphere producers is expected to be lower than in 2019, mainly as a result of prevailing dry conditions. Certainly, Australia's vintage was lower than average.



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The northern hemisphere is moving into summer. To date there have been few reports of issues affecting crop potential, meaning that the major producers are on track for at least an average season. However, it is still early days.

The year 2020 has already put enormous strain and pressure on the Australian grape and wine sector. Many factors, including the speed of economic recovery, are largely out of our control and there will be different rates of recovery depending on a company's business model and the State(s) in which it operates. Likewise, the on-premise will recover and people will return to restaurants, but how restaurants source wine in future is open to speculation. What is certain is that our sector must recover – it holds true that Australia produces exceptional wines desired around the world – and those who do best will show agility, accommodating changes in the way that business is done and how they reach their consumers.



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DISCUSSION PAPER

Introduction – scene setting

The advent of the COVID-19 pandemic has resulted in unprecedented disruption to wine markets around the world. In response, there has been a constant stream of analytical reports, webinars and presentations from a wide range of sources covering the market impacts. This paper summarises the key insights and highlights the possible implications for the Australian wine sector.

Global estimates

The latest estimates of global growth from the International Monetary Fund (IMF) are sobering. In its June World Economic Outlook¹, global growth is projected at –4.9 percent in 2020, 1.9 percentage points below the April 2020 forecast. Consumption growth, in particular, has been downgraded for most economies, reflecting the larger-than-anticipated disruption to domestic activity. The projections of weaker private consumption reflect a combination of a large, adverse aggregate demand shock from social distancing and lockdowns, as well as a rise in precautionary savings. Moreover, investment is expected to be subdued as firms defer capital expenditures amid high uncertainty. Policy support partially offsets the deterioration in private domestic demand.

Global activity is expected to bottom out in the second quarter of 2020, recovering thereafter. In 2021, growth is projected to strengthen to 5.4 percent, 0.4 percentage point lower than the April forecast. Consumption is projected to strengthen gradually next year, and investment is also expected to firm up but to remain subdued. Global GDP for the year 2021 is forecast to just exceed its 2019 level. The adverse impact on low-income households is particularly acute, putting at risk the significant progress made in reducing extreme poverty in the world since the 1990s.

Obviously, there is considerable uncertainty surrounding their forecasts. These principally relate to:

- the length of the pandemic and required lockdowns
- voluntary social distancing, which will affect spending
- displaced workers' ability to secure employment, possibly in different sectors
- firm closures and unemployed workers exiting the workforce, which may make it more difficult for activity to bounce back once the pandemic is controlled
- the timing and extent of government stimulus /support measures
- the impact of changes to strengthen workplace safety—such as staggered work shifts, enhanced hygiene and cleaning between shifts, new workplace practices relating to proximity of personnel on production lines—which incur business costs, and
- global supply chain reconfigurations that affect productivity as companies try to enhance their resilience to supply disruptions.

Different countries will show different rates of recovery, depending on:

- health impacts and ability of the health system to cope with the pandemic
- economic responses to reduce the spread and impact of COVID-19

¹ IMF World Economic Outlook June 2020

<https://www.imf.org/en/Publications/WEO/Issues/2020/06/24/WEOUpdateJune2020>



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- economic costs of transitioning businesses to manage enhanced workplace safety and hygiene standards
- supply chain impacts, and
- the size and strength of key markets.

The impact on Australia

A weak domestic economy, bushfires, BREXIT and geopolitical tensions already created rising levels of business volatility, complexity and uncertainty. However, the pandemic and resultant lockdown of economies has added a whole new dimension.

Australia's economic recovery depends upon how successful we are in containing the virus. According to economic forecasts from the Reserve Bank of Australia² they are expecting the Australian economy to contract by around 6 per cent this year, and then grow by 5 per cent next year and 4 per cent in 2022. It is possible that we will do better than this if there is near-term success in containing the virus or there are medical breakthroughs. On the other hand, if we were to see further setbacks in containing the virus, the recovery would be delayed even further.

Businesses have navigated the first phase of the COVID-19 pandemic by making short-term tactical decisions around cash-flow protection and supply chain nimbleness. In the medium term, success will come to those organisations that can address immediate recovery aspects while reinventing their business and operating models to be positioned for the 'new normal' that awaits.

The future scenarios

Preparing for an economic and business environment that is no longer the same as that for which your current business strategy was developed requires scenario-based thinking rather than prediction. Choices and actions that would hold true irrespective of the scenario are largely 'no-regret' moves, whereas actions that have some commonality across the scenarios can be advanced with regular checkpoints.

The May 2020 Deloitte Access Economics research scenarios³ indicate Australia's economic recovery could come in waves:

- (i) Mild scenario (the future we hope for)

Rapid containment measures result in a short, sharp infections peak. Physical distancing measures are replaced by effective testing, tracking and containment. Domestic economic recovery begins mid-2020, reaching pre-COVID levels as productivity enhancing ways of working and economic reforms are effectively implemented. The world economy recovers faster than expected and global supply chains mend as the outbreak recedes in Asia.

² <https://www.rba.gov.au/publications/smp/2020/aug/>

³ <https://www2.deloitte.com/au/en/pages/economics/articles/economic-scenarios-covid-19-recovery.html>



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(ii) Harsh (the future we prepare for)

Australia flattens the curve, but without enhanced detection/tracing technology, physical distancing is still required. Domestic economic recovery begins in late 2020 but remains below pre-COVID expectations as business investment falters. The world economy faces a lengthy recession with persistently weak supply and demand. Global containment remains a problem, limiting the movement of goods, people and capital.

(iii) Severe (the future we want to avoid)

With ineffective detection/tracing and a lack of compliance with physical distancing, a major second wave of infections occurs. No vaccine is available until July 2022. Domestic economic activity weakens as a result of the second outbreak. Recovery starts in late 2021, the economy lacklustre, hampered by financial distress and weak business/consumer confidence.

Many countries see a resurgence of the pandemic or struggle to contain it. The global economy faces a more severe and prolonged slump.

What has changed?

COVID-19 is creating a number of shifts that will impact on global markets and societies. Some of these will be long-lasting and others may be weakened as the global economy recovers and the pandemic eases. These include both shifts in society, for business, and by government.

Government

Within the government sector, we are seeing the creation of more agile government, leading to an acceleration of public policy development and more agile legislative processes. This is also leading to an increased probability of central market intervention, increased emphasis on social policy, a shift towards nationalist policies and protectionism and a possible realignment towards sustainability goals and policies.

In Australia, the creation of National Cabinet in response to COVID-19 and the prominence of State premiers is leading to a wide-ranging change in the interaction between the States and the Australian government. On 29 May 2020, the Prime Minister announced that the Premiers, Chief Ministers and he had agreed to continue the National Cabinet established to coordinate Australia's response to COVID-19, to form a new National Federation Reform Council and cease the Council of Australian Governments. Recommendations on a streamlined structure, scope and reporting arrangements and on focused regulatory and policy work programs will be provided to National Cabinet by September 2020. These changes are likely to increase the strength and power of the State and Territory governments in the national policy process.

International trading environment

The multilateral trading system has contributed significantly to unprecedented economic development over the last few decades. Greater certainty over trade policies has created predictability, creating the conditions for long-term business planning and investment.



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However, a rise in trade-restrictive measures since 2019 - especially between major economies - and the suspension of activities of the WTO's Appellate Body have created new challenges for the multilateral trading system. In addition, the COVID-19 crisis is having a major impact on global supply and demand, leading to disruptions in global supply chains for both goods and services.

Prior to COVID-19, the structure of global trade was already undergoing a substantial shift when some governments imposed more restrictive policies led by trade tensions, sagging growth, and a backlash against globalisation. Global supply chains were also witnessing major shifts driven by technological advances such as 3-D printing, artificial intelligence (AI) and automation. These advances in technology, a renewed focus on ethical and sustainable sourcing, as well as the trade tensions in recent years, have led producers to reassess from where they source their products.

The Peterson Institute for International Economics⁴, has estimated that global trade will drop by 24 per cent year-on-year in 2020, mostly reflecting the compression of supply chains, running down of inventories, and drops in final demand. Over the next two to three years, we will probably see a rise in protectionist responses, which in turn will limit the rebound in trade once COVID-19 is arrested. Even the one facet of globalisation that may not be so adversely affected of digital flows, e-commerce and data flows, may also come under pressure as concerns about privacy and data security are raised.

Domestic overview

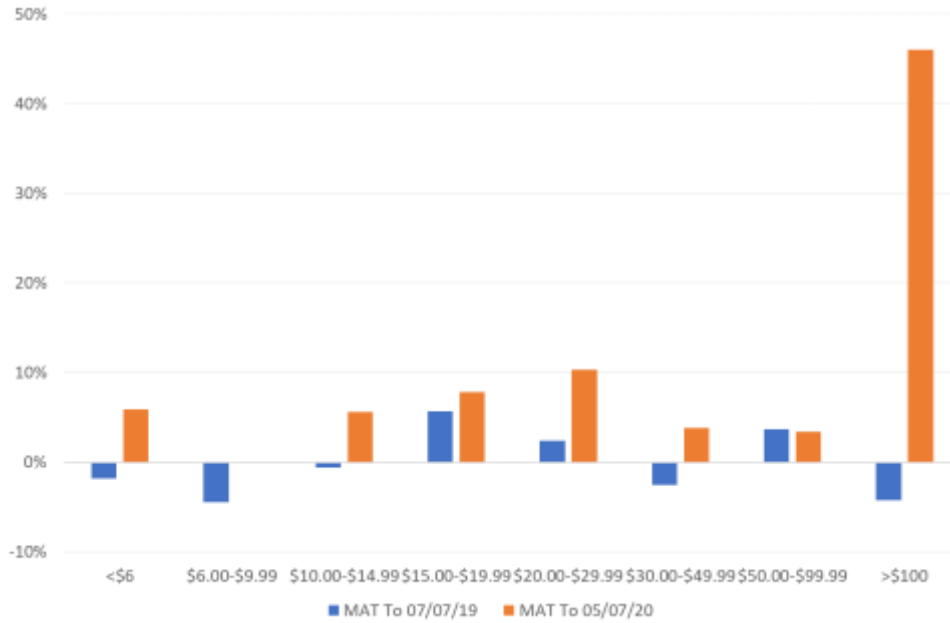
Domestic market

The impact on individual producers depends on their product and channel portfolio. Those with a heavier bias toward the on-trade channel have, relatively, been harder hit due to the closure of all licensed venues in Australia on 22 March.

All price points benefitted from the surge in sales (see figure 1). At below \$10 per bottle, declines from the year prior were reversed or halted over the 12 month period ending 5 July 2020. While for most price points above \$10 per bottle, the growth rates accelerated. This was most notable at \$100 or more per bottle, albeit off a small base.

⁴ <https://www.piie.com/research/economic-issues/coronavirus>

Figure 1: Sales value growth rates by price point in the Australian off-trade market

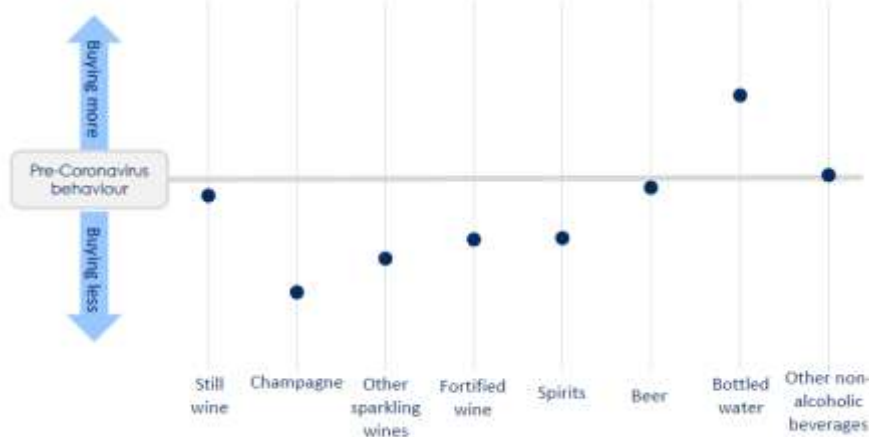


Source: IRI MarketEdge

Figure 2: Australia: COVID-19 Impact Report (April 2020)

Category purchase behaviour change during lockdown March 2020 compared with pre-virus behaviour

Index: Change in purchase quantity of the following categories due to the impact of Coronavirus



Domestic off trade

Demand for wine has remained strong within off-premise, but there has been a clear trend toward trading down the value chain and returning to ‘trusted’ brands. Although there is this movement to trusted brands, reducing experimentation and trading down, premium brands are likely to be even more valued as permissible luxuries.

Domestic on trade

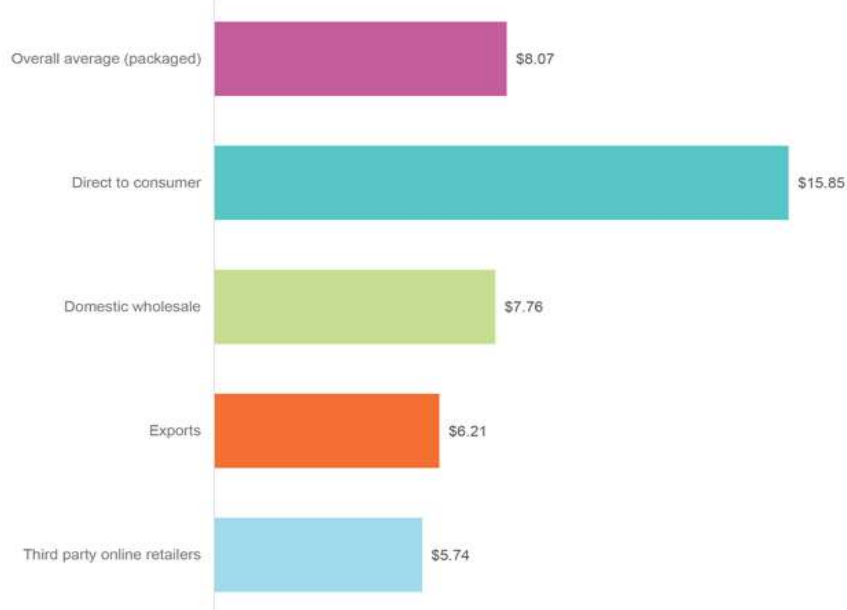
In Australia, as in most countries, restaurants, pubs, clubs etc. were closed down in response to the pandemic. This resulted in the near complete loss of the on-premise sector, which has generally not been fully compensated for by an uptick in other channels, especially by value compared to volume.

Domestic ecommerce

The online channel has helped maintain sales of wine (and alcoholic beverages more broadly) in all formats – brick-and-mortar/ecommerce grocery hybrids, marketplaces, dedicated alcohol ecommerce, shopper apps/on-demand as well as Direct to Consumer (DTC). Given restrictions on movement, home delivery (rather than click-and-collect) would be the natural choice.

DTC is critical to many smaller wineries (see for example, Wine Australia’s DTC survey⁵). In 2019, DTC accounted for an estimated 17 per cent of total Australian wine sales value, significantly over-indexing in value compared with its volume share of 3 per cent. The smaller the wine business, the larger the reliance on DTC for sales revenue. For wineries producing under 5000 cases, DTC represented more than half their revenue. The average value per bottle in the DTC channel was found to be more than double the next highest value channel (see chart below).

Figure 3: Average sales value per bottle



Source: Wine Australia

⁵ <https://www.wineaustralia.com/report-downloads/bff6eb15-4111-43f7-87d4-f3a9d4f9359b>



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Those brand owners with good ecommerce structures (a policy body at head office level, execution teams at regional/country level, perhaps even their own marketplace) have consistently fared best during this crisis so far. This is a challenge for Australia's smaller producers who may not have appropriate ecommerce structures in place.

Ecommerce has certainly developed and flourished through the pandemic. Home delivery, and even click-and-collect services, have helped on a multitude of fronts, including stay-at-home orders, crowd control in supermarkets, uncomfortable queueing systems outside shops, a reduced number of shopping trips and cumbersome one-way systems.

Retailers have moved quickly to dominate the on-line space, and it is likely that, as for other grocery products, there will be an increase in private label wines.

Domestic cellar door and tourism

The recent school holidays, coinciding with social distancing requirements, have demonstrated that the premiumisation of cellar door offerings with paid tastings and sit-down tastings has been to date well received. This high demand during this period has accelerated the adoption of these strategies and helped profitability for those able to open cellar doors. Consumers, at least in the short term, have shown a real desire to explore domestic tourism opportunities.

Exporters

Some key observations about international markets:

- premium and fine wine price points continue to grow but Australia under-indexes in these market segments
- the importance of the online channel has dramatically accelerated
- younger consumers remain a key target to drive growth in Australian premium and fine wine
- it is more vital than ever to have a strong, clear value proposition that brands can put to distributors in all target markets, especially the United States of America (USA) where new product development is crucial
- the perception that Australian wines are only 'cheap and cheerful' is still prevalent
- smaller producers are likely to require market entry support as they face a tough road ahead with increasing consolidation at the distribution level
- the big volume commercial/value wine producers are in a relatively stronger position due to this increasing consolidation
- the move away from on premise sales has benefited Australian exporters in the UK and USA, where we are under-represented on restaurant wine lists
- in the United States, COVID-19 impacts vary between States, which may require a shift in focus, and
- seek opportunities locally as 'localism' becomes more prevalent.

Price points

All markets saw a temporary element of panic buying and out-of-stock situations in the off-premise. This panic buying saw an uplift in the sales of the big volume, commercial/value wines.



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For example, in the domestic market, there was a reversal of a long-term downward trend in cask wine sales and in bottled wines below \$10 per bottle. Growth in commercial/value wines has continued but the extreme rates of growth have subsided as panic buying ceased.

In Australia's four biggest export markets - mainland China, the USA, the United Kingdom (UK) and Canada – the IWSR reports that the commercial, big-volume end of the market declined in the four years to 2019 and this trend has been forecast by the IWSR to continue to 2024. On the other hand, the premium and fine wine end has been growing and IWSR forecasts this will continue to grow, albeit at generally lower growth rates than previously.

The COVID-19 pandemic has somewhat disrupted these trends, with sales at the commercial end boosted by a combination of panic-buying and the lockdown of the on-trade. However, the growth in premium wine sales has continued. Wine Australia's marketing activities should continue to focus on growing Australia's share in the premium/fine wine segment of these markets. With the exception of mainland China, Australia's share of the premium and above market is much smaller than its share of the commercial end of the market. For example, in the UK, Australia dominates the commercial end with a 24 per cent volume share but, in contrast, holds only a 10 per cent share of the premium and above segment. In mainland China, Australia holds a 31 per cent share of the premium and above segment and the focus going forward is to maintain this strong position in the market.

Economic modelling from Kym Anderson and Glyn Wittwer suggests that Australian premium and fine wine sales will face some pressure in the next few years as result of the pandemic, thus it is crucial that as a sector we focus on confronting this challenge. Elevating the perception of Australian wine at all price points, especially at the premium and fine wine end where Australia under-indexes, is more critical than ever to achieve sustained growth in value to drive profitability in the sector.

Wine Intelligence has also provided some insights into buying habits pre- and post-pandemic (see Appendix I).

United States

Wine sales have grown strongly in the off-trade market since the pandemic hit the USA. According to IRI, in the year to date ending 1 March 2020, the value of wine sales was flat compared to the same period a year ago. However, in the April to June quarter, the value of wine sales increased 24 per cent and for the full year ending June increased by 10 per cent. And for Australian wine, the value of sales increased by 17 per cent for the quarter and 3 per cent for the full year.

Figure 4 shows that there has been strong growth across all price points. The biggest turn-around has been in sales in the commercial/value end of the market, but importantly the long-term premiumisation trend has continued in the USA.

Some of the assessments provided for the market were:

- many restaurants potentially will close;
- consumer behaviour will change in many ways in the short term; consumers will be hesitant to travel and may become more accustomed to dining at home. This may be beneficial for wine sector;
- in the long-term, the on-premise share of wine consumption is estimated to drop from 16 per cent to 12 per cent of volume, and
- it is clear the market will not be in a position to achieve a 'new normal' until an effective treatment or a vaccine is broadly available.

Figure 4: Growth rates by price point in US off-trade market



Source: IRI

While COVID-19 has increased consolidation in the USA, the three-tiered system is not likely to be dismantled in the short term. This will still provide opportunities for market-ready smaller Australian producers. There is no doubt that it will be harder for smaller producers to gain shelf space in the big volume grocery stores and with the large distributors. But this has always been the case. The key takeaway is that, for our smaller producers to have any chance in the US, we need now more than ever to understand what the younger consumer is looking for and what will drive them to buy Australian premium wine. We need a strong, clear value proposition that we can put to the distributors through our business development and market entry activities.

Some US States have been more impacted than others. California and New York have been impacted the most in terms of cases and as the two biggest wine markets in the US, they remain crucial targets for Australian wine producers. While cases in California have started to accelerate, New York has stabilised. There has been a significant increase in on-premise visits in New York, while visits in California are beginning to decline as the number of cases rise, and visits in Texas and Florida stay flat.

United Kingdom

While the country is slowly emerging from lockdown and the on-trade is resuming, sales in the UK off-trade are strong. There is unlikely to be any fundamental shift in the UK market because sales are already more heavily weighted to the commercial/value end.

According to IRI, in the 12 months ended June 2020, the value of sales in the UK off-trade market increased by 7 per cent in value, with Australian wines sales up by 4 per cent. All price points between £4 and £20 per bottle grew for both Australia and the total market (see Figure 5).

Figure 5: The growth rate in the value of wine sales in the UK off-trade market by price segment



Source: IRI

China

As the first country to be hit by COVID-19, China is also the first country to recover, though this has come at the cost of a strict lockdown that has caused the country's first economic contraction since the Cultural Revolution. Although smaller bars are now open, large clubs remain closed. Things are far from back to normal, as many people are afraid to mingle. The most optimistic scenario is that things return to normal by the summer, although the country is likely to remain largely sealed off to foreigners for longer, depending on how the pandemic evolves around the rest of the world. Chinese New Year, the largest drinking occasion of the year, was basically cancelled, leaving retailers and consumers with large stocks of unopened alcohol that could take them a while to clear.

The Chinese are social drinkers and do not drink at home much, so social-distancing measures are likely to have a big impact, and it remains to be seen if consumer behaviour changes enough to have an effect.

China's wine consumption is likely to have been hard hit, as on-premise consumption makes up a relatively large share of the market (34 per cent compared with 13 per cent in Australia) and consumers did not engage in stockpiling or panic buying of alcohol, as they have done in other countries such as the UK and the USA.



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The IWSR reports growth across all channels, alcohol categories and price segments in April compared with March – although only small percentages.

A survey conducted by McKinsey & Company during the lockdown found that 60–70 per cent of Chinese consumers expected to resume or slightly increase their consumption of alcohol after the outbreak, while 10 per cent expected to 'notably increase' consumption. Wine Intelligence reports that wine is holding its own, while purchase quantity of spirits have declined during the lockdown in China. The online wine channel was very strong in China prior to the impacts of the virus; the lockdown has increased its reach and grip on some of the highest spending wine consumers.

Wine Intelligence has also provided some insights into buying habits pre- and post-pandemic. Generally, still wine consumption has held up in the face of the pandemic and economic turmoil.

Demographics

In general, across our focus markets, younger consumers are more experimental and more inclined to consume imports (including Australian wines). It is this demographic that must be targeted to drive sustained growth in premium and fine wine sales in the USA and China. Engagement with the younger audience needs to be done in a way that closes the commercial loop with online and traditional bricks-and-mortar retail engagement.

We know from the data collected during the campaign that *Far from Ordinary* resonated with US millennials and that we have the ability to reach this group of consumers. The key questions are, has the pandemic changed the behaviour of younger consumers and do we need to adjust our marketing to them accordingly?

Conclusion

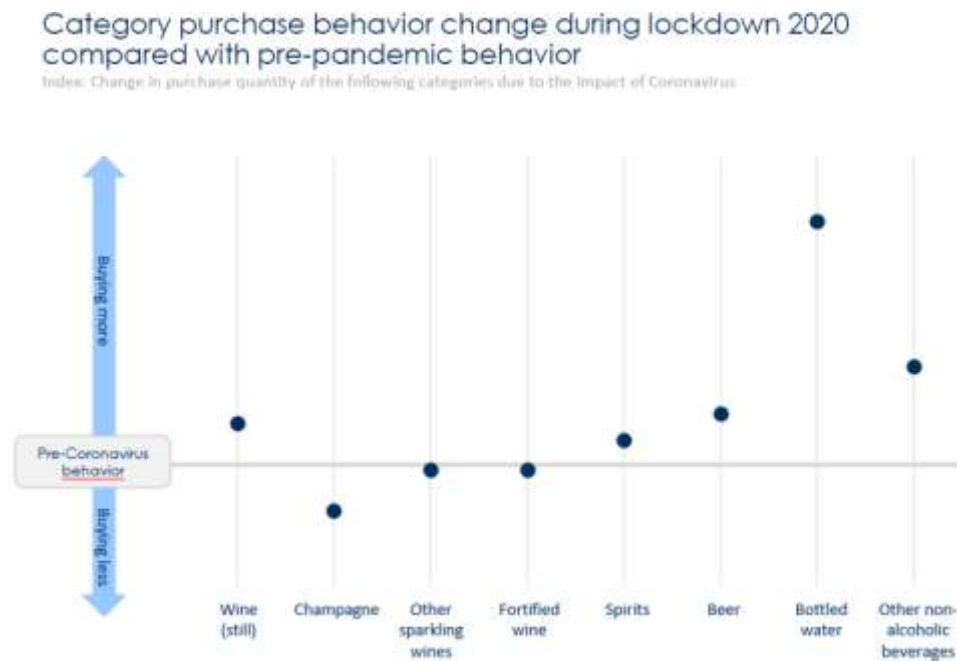
The COVID-19 pandemic is the latest disruption in a period where there were numerous trends and disruptions at the macro environment level, across industries, and at a business and operating model level. This means it has overlaid a weak world economy, beset by trade tensions with faltering business and consumer confidence. While none of us can predict the future, business decisions can, and should be made that will be based on building resilience into a business that can respond to a number of alternative scenarios.

Appendix I: Wine Intelligence data showing category purchase behaviour over time

China: COVID-19 Impact Report (May 2020)



USA: COVID-19 Impact Report (May 2020)



UK: COVID-19 Impact Report (May 2020)

Category purchase quantity change during lockdown March 2020 compared with pre-virus behaviour

Increased change in purchase quantity of the following categories due to the impact of Coronavirus

