

STATE OF THE SOUTH AFRICAN WINE INDUSTRY 2018/19

SMALLER, STREAMLINE READY TO GROW

The South African wine industry has entered a new phase of repositioning, consolidation and reinvestment. Climate change, shifts in production and demand and financial pressures have led to the industry becoming smaller and required producers and wineries to rethink the way they do business.

“Our wine industry has gone through a tough time in the past decade. Although many of our producers and wineries are still under tremendous financial pressure, I believe as a collective, the industry is turning a new corner with renewed energy and focus,” says Rico Basson, MD of the wine industry organisation Vinpro, which represents 2 500 South African wine grape producers, wineries and wine-related businesses.

The annual *State of the South African Wine Industry* takes a look at the factors that drove these changes during 2018 measured against the 2025 targets the industry set for itself through WISE (Wine Industry Strategic Exercise), and what lies ahead in 2019.



2019 CROP AT A RECORD LOW

According to the 2019 South African Wine Grape Harvest Report issued on 6 May, the 2019 wine grape crop will at 1 225 620 tonnes be 1.4% smaller than last year's drought-hit crop, and the smallest crop since 2005.

Berries and bunches were smaller and lighter than normal due to unfavourable weather conditions during flowering and set, as well as above-average winds early in summer. Regions such as the Olifants River and Klein Karoo are still feeling the after-effects of the three year drought, while rainfall in other areas in March also contributed to losses due to rot.

At the same time, vineyards are ageing and the wine grape area shrunk by nearly 6% in the past five years as wine grape producers who were under financial pressure planted less vines than were uprooted. Producer profitability remains a concern at an average return on investment (ROI) of 2%, albeit an improvement from 1% in 2017.

MAINTAIN UPWARD PRICE SHIFT

The second successive small harvest, along with limited carry-over stock from 2018, means wine pricing will most likely remain steady and robust this year, building on increases in wine prices of 24% on average for bulk wine and 5% for packaged wine in the market in the course of 2018.

This could also be seen in an increase in the value of both exports and domestic wine sales in the year ending February 2019.

While global competition remains strong and pricing will depend on availability, especially from South Africa's counterparts in the Southern Hemisphere, the industry now needs to maintain this upward shift in price-point per litre.

Sales volumes were down in both the local and domestic markets in 2018, in part due to a 15% drop in production as a result of the drought.

"Stock levels are expected to remain at an equilibrium for the remainder of the year, although shortages have been recorded of certain varieties and price categories, in which case wine has been, and will be, imported to meet the demand," says Yvette van der Merwe, executive manager of SA Wine Industry Information & -Systems (Sawis).

At export level, an 11% increase in value to R9.06 billion from 1 January to 31 December 2018 reflects the positive sentiments towards South African wine in international markets, despite a 6% decrease in volume to 420.2 million litres of wine sold internationally during the same period.

According to Siobhan Thompson, CEO of Wines of South Africa (WoSA), the industry will continue to focus on driving both value and volume growth in high potential wine markets in Asia, Africa and North America while maintaining market share and growing value in the traditional European markets. "Strategically these markets each require a very different approach, however we are seeing good growth in terms of recognition and building Brand South Africa, especially driving our premium offering."

Vinpro and South African Liquor Brand Owners' Association (Salba) will continue to secure preferential trade in these and other prominent export markets through its WineBiz stakeholder manager.

REINVESTMENT ON THE CARDS

"Many wine grape producers and wineries are ready to reinvest in the industry," Basson says. The vines that have been ordered for the upcoming planting season are still less than the 5 000 ha required to maintain the industry's area under vines, however virus-free, market-driven cultivars will be planted that are destined for specific brands through contracts.

"The industry is continuously learning to adapt to climate change by turning research theory and technology into practical, innovative solutions in the vineyard or winery," Gerard Martin, executive manager of Winetech says.

Wine tourism is expected to build on a solid foundation laid in 2018, boosting South Africa's image even further as the world's premier wine destination. The industry continuously strengthens its core by promoting ethical trade.

Transformation is likely to gain momentum in 2019, through focused support, funding and programmes of the South African Wine Industry Transformation Unit (TU), a new business unit operating alongside WoSA, Winetech and Sawis.



"The TU remains committed to the wine industry's transformation targets by providing support to black-owned enterprises, black farmers and entrepreneurs in the wine value-chain," says Wendy Petersen, operational manager of the TU. Limited funding is one of the major challenges facing these entities and the TU is instrumental in helping them gain access to funding and support, in alignment with other industry stakeholder programmes.

"People are the cornerstone of our industry. We therefore aim to improve the well-being and development of those living and working in the wine industry through various initiatives at industry and farm level that address harm reduction, socio-economic and training and development," Basson says.

RETHINK YOUR BUSINESS MODEL

Although there is a trend towards higher prices and premiumisation, most businesses still need volume in order to maintain its operations. The fact that the harvest is smaller and sales volumes have dropped, undoubtedly puts pressure on these businesses to rethink their models and consider mergers, acquisitions and partnerships.

"We are smaller, but more focused, confident and ready to invest in our future. It starts with every link in the wine value-chain. Forge and maintain relationships with the right partners and work together towards an adaptable, robust, profitable and globally competitive South African wine industry," Basson says.

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Return on investment still low

South African wine grape producers are still under financial pressure despite a slight increase in the average return on investment in 2018 to just below 2%. The industry aims to reach CPIX plus 5% by 2025.

According to the annual Vinpro Production Plan survey, the majority of wine grape producers on average still realise a net farm income much lower than the R30 000/ha needed to farm sustainably. This has been the norm for more than a decade, which has contributed to many wine grape producers not replacing older, unproductive vines when uprooted.

The shrinking area under grapevines and a three year drought culminated in a smaller wine grape harvest in 2018, with Olifants River and Klein Karoo being hit the hardest. On the plus side, there has been some improvement due to value-adjustments on price and greater cost-efficiency at farm-level, which the industry hopes to build on in 2019.



Stock levels reach equilibrium

South African wine stock levels were deemed acceptable at the end of 2018, with a carry-over stock of 370.4 million litres into the 2019 production year.

According to Sawis, the industry's wine stock is at equilibrium, in line with the 2025 target. A trend towards premiumisation led to scarcity in certain varietals at specific price-points which resulted in upward price shifts, but also necessitated imports where demand could not be met locally.

The 2018 wine grape crop was down 15% compared to the previous year due to the drought and shrinking area under grapevines, which in turn contributed to the decline in available stock. Although this had a positive effect on value-growth, a second consecutive smaller harvest in 2019, increase in demand and weaker exchange rates might amplify this situation towards the end of the year. This could push prices up even more, and/or necessitate further imports in those categories or varietals where the industry is not able to meet demand.





Land reform slow, but people & business development grows

The South African wine industry has managed to grow the percentage of black-owned land and water to 3% in 2018. Progress has been slow towards the ownership target of 20% by 2025, but the industry has taken transformation forward through various other initiatives to ensure sustainable growth.

A fifth of the statutory levies paid by wine grape producers and wineries are allocated towards supporting transformation. This investment ranges between R19 and R20 million per annum. The industry assisted 25 black wine brand owners with pre-shipment finance, legal mentorship and global trade promotion, and 20 black-owned wine businesses were supported through access to grants from the Western Cape Department of Agriculture, as well as technical services.

Cellars received advisory services to improve their black-economic empowerment (BEE) scores, and a linkage project was established to bring together emerging and commercial entities with mutually beneficial interests.

HORTFIN was also launched in 2018, a ring-fenced loan facility for the fruit and wine industry, which has the potential to afford R200 million in blended finance to B-BBEE ventures.

People development remains a priority, with a learning and development strategy driven by a dedicated desk at Winetech. Close on 1 500 farm employees were trained through the annual Vinpro Vineyard Training Courses and more than 400 cellar assistants honed their skills in the annual Winetech Cellar Assistant Study Groups, which opens up new career opportunities and growth for these individuals.

Local wine sales steady

Local sales of still wine reached 387 million litres at the end of 2018, down from 406 million litres the previous year, and compared to the 2025 target of 450 million litres per annum.

Sales value increased by 1% in 2018, despite a 5% decline in volume. Encouragingly, it seems as though the market is trading up, with sales volume and value remaining steady at the top end of the price spectrum and a decline in sales volumes in the lower price ranges.

Although the WISE local wine sales target applies to still wine, it is noteworthy that sparkling and fortified wines have experienced a steady increase in sales volumes, and around double digit growth in value during the past two years.



New markets remain a priority

The South African wine industry identified the USA, China and Africa as three priority markets, aiming to grow the share of exports to these countries to a quarter of total exports by 2025, while driving value growth in both packaged and bulk wines. These new markets received 11% of South African wine exports in 2018, amounting to 19% of the total export value.

Both the volume and value of exports to Africa have increased in the course of 2018 compared to the previous year, specifically in Kenya, Tanzania and Zambia. The African market constitutes 5.6% of South Africa's total export volume and represents 8% of the total export value.

Although exports to China and the USA have remained flat, it is encouraging to see good value growth in packaged wine to China and in the USA the continued procurement of more premium-priced wine. Nearly 2.5% of total exports were destined for China in 2018, contributing 5% to the total export value, and the USA received more than 3% of South Africa's export volume contributing 6% to the total value.

The industry will continue to forge partnerships and work with the SA Government and trading partners towards securing greater trade beneficiation to gain traction in these new and existing markets.



Bulk volume dominates, but value up

Bulk wine sales still dominate South African wine exports in terms of volume at 60% compared to 40% packaged wine exports, in contrast to the industry's turnaround strategy of 40:60 for the bulk:packaged export volume composition by 2025.

While total export volumes were down 6%, value grew by 4%, driven by global short supply and stronger international demand in the first six months of 2018. Bulk wine sales value grew by 7%

in the course of the year and packaged wine was exported at 3% more compared to 2017.

The good growth in bulk wine value is encouraging; however the prices for some of these wines remain below sustainable levels and bulk wine still only contributes less than a quarter to the total export value – an issue the industry aims to address further during the course of 2019.





Commitment to ethical trade grows

South Africa remains committed to ethical trade, with 61% of total wine grape production ethically certified (12% in 2015). The country also remains the largest producer of Fairtrade wine in the world.

This implies that producers and more than 40 000 farm employees are working under ethically certified conditions, as per the guidelines of the Wine and Agricultural Ethical Trading Association (Wieta) and Fairtrade.

Wieta introduced a new grading system for ethical accreditation during the course of 2018, which holds producers to a higher standard, as required by increasingly ethically conscious wine buyers from around the globe.

The industry continuously participates in social dialogue between all relevant stakeholders to ensure ethical trade is promoted and practiced throughout the industry, working towards the 2025 target of 100%.

Wine tourism implemented in full force

Wine tourism is a major game changer that would enable the South African wine and brandy industry to become more adaptable, robust, globally competitive and profitable. In 2018 Vinpro established a Wine Tourism Desk and signed MOU's with Wesgro and the SA Wine Routes Forum (representing 21 routes), which paved the way for a collaborative strategy.

An objective of the Wine Tourism Strategy is to grow both the share of tourism expenditure on the wine industry, as well as the spread of this income across the respective wine routes.

Visitwinelands was launched as the official digital and social platform, with a Wine Tourism Toolkit and further web development underway in 2019. Another highlight is international arrivals by air to Cape Town and the Western Cape which increased by 9.6% during the course of 2018.

A study into the economic value of wine tourism in South Africa during 2019 will enable the industry to better measure and manage its actions, to reach its 2025 target of contributing R15 billion to the Western Cape's economy and to create more jobs at the same time.



STATE OF THE INDUSTRY

AT END 2018



RETURN ON INVESTMENT

2% 2015 BASELINE	<2% 2018 ACTUAL	CPI + 5% 2025 TARGET
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- Profitability still under pressure.
- Silver lining due to upward price adjustments and greater cost-efficiency.
- Regional variations due to the after-effects of a three year drought.



PRODUCTION TO MARKET DRIVEN

80,000 ton surplus 2015 BASELINE	Short supply 2018 ACTUAL	Equilibrium 2025 TARGET
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- Holistically stock levels are at equilibrium.
- Scarcity in certain varietals and price categories.
- Wines imported to meet demand.



LOCAL WINE SALES

350 m litres 2015 BASELINE	387 m litres ESTIMATE 2018 ACTUAL	450 m litres 2025 TARGET
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	VOLUME SHARE	VOLUME 17/18	VALUE 17/18
Low Price <R30	53%	0	+3
Basic >R30 – R48	32%	-11	0
Premium >R48 – R72	4%	-14	-8
Super premium >R72 – R108	7%	-3	+2
Ultra premium >R108	4%	-4	+2
TOTAL*	100%	-5%	+1%

*Sales of still wine only



TRANSFORMATION: LAND & WATER

1.5% 2015 BASELINE	3% 2018 ACTUAL	20% 2025 TARGET
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- 20% of industry levies allocated to support transformation.
- 25 black brand owners assisted with finance, legal mentorship & trade promotions.
- 20 black-owned wine businesses gain access to WCDoA grants & technical services.
- HORTFIN launched, potentially R200 m in blended finance to B-BBEE ventures



BULK: PACKAGED RATIO

60:40 2015 BASELINE	60:40 2018 ACTUAL	40:60 2025 TARGET
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	VOLUME (m litres)	TREND 17/18	VALUE (R bn)	TREND 17/18
Bulk	251	-8%	2,2	+7%
Packaged	169	-3%	6,9	+3%
TOTAL	420	-6%	9,1	4%



WINE TOURISM

R6 bn 2015 BASELINE	Roadmap executed 2018 ACTUAL	R15 bn 2025 TARGET
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- Wine Tourism Desk established, with MOUs with Wesgro & the SA Wine Routes Forum.
- Visitwinelands established as digital platform & Wine Tourism Toolkit underway.
- International arrivals by air to Cape Town & Western Cape up by 9.6%.
- Economic Value of Wine Tourism in South Africa study launched.



NEW MARKETS: (USA, CHINA, AFRICA)

10% 2015 BASELINE	11% 2018 ACTUAL	25% 2025 TARGET
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	VOLUME (m litres)	VOLUME SHARE	VALUE (R bn)	VALUE SHARE
USA	12,9	3%	544,9	6%
China	10,2	2%	459,4	5%
Africa & Africa Islands*	23,6	6%	722,7	8%
TOTAL	46,7	11%	1 727,0	19%

*Excluding SACU countries



ETHICAL ACCREDITED VOLUME

20% 2015 BASELINE	61% 2018 ACTUAL	100% 2025 TARGET
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- Largest Fairtrade wine supplier in the world
- 61% of total production ethically certified
- > 750 000 tonnes
- > 1 500 producers
- > 40 000 employees
- Continuous improvement & social dialogue.

SOUTH AFRICAN WINE

INDUSTRY OVERVIEW

WINE PRODUCTION 2019 EST



1.23 m tonnes

Grapes crushed

↓ -1,4%



952 m litres

Wine produced

↓ -0,9%

WINE SALES 2018



Total sales

R25.5 bn ↑ 2,5%

Exports 50.7% volume



Volume

420 m litres ↓ -6,3%

Value

R9,1 bn ↑ 4,2%

Local 49.3% volume



Volume

431 m litres ↓ -4,1%

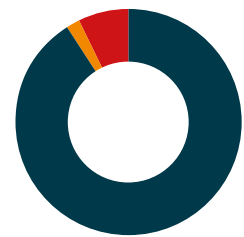
Value

R16,4 bn ↑ 1,7%

- Red 36%
- White 51%
- Sparkling 1%
- Blanc de Noir/Rosé 12%



- Still 90%
- Sparkling 2%
- Fortified 8%



19 million glasses of South African wine are enjoyed world-wide **every day**

COMPOSITION 2008-2018



Producers

2 873 ↓ -33,6%



Cellars

543 ↓ -7,7%

Production vs area under vines

