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The post recessionary face of the West European wine market

2013 edition

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Introduction

The West European wine industry is facing a challenging period in its evolution. Already suffering from over supply it has subsequently been hit by the global recession and must now suffer the impact of higher taxes and other austerity measures as the region attempts to achieve economic recovery. This scenario is leading to changes in consumer buying patterns and an accelerated shift in favour of at-home consumption, already supported by drink driving laws and the implementation of on-premise smoking bans. Anxious consumers are cautious about spending their tight budgets on out of home entertainment but still feel the need to enjoy ‘r and r’ time with friends and family.

Across the scope of countries covered by this report, wine has been predominantly more accepted amongst Mediterranean populations and generally less so further north, where beer has been the preferred alcoholic beverage. But the status quo is under constant pressure. Consumer wine choices are influenced by environment and the norms of society. But both are in a state of flux influenced by climatic change, economic and political circumstances, lifestyle choices, migration and the media. Wine tastes are changing, not just by price and colour but also in favour of new wines, fruiter tastes and lower alcohol. Are these highlighting a new breed of wine products that will help shape the industry going forwards?

Producers themselves, faced by climate change, wine gluts and increased competition, are going through a phase of contracting supply and consolidation. Small scale enterprises remain the norm but as some players retire can the survivors increase their bargaining power and benefit from scale economies? Tradition is fine but innovation is essential. We have already seen cork seals being replaced by screw caps and the emergence of organic wines, where next will the industry seek to take us?

This report investigates the wine markets of the seventeen markets comprising the defined region of Western Europe (see accompanying list) from both a wine production and wine consumption view point. Coverage is from 2005 to the present day with forecasts thereafter, up to and including 2015. Critical market aspects are analysed at individual country level illustrating market dynamics in each market.

Chapter 1 The effect of oversupply and the West European wine industry

Viticulture is both a traditional and major activity in Western Europe, particularly in the south of the region. In 2005 Western Europe accounted for well over half of global wine production. But, as has been well documented in other sources, the wine market is in a serious state of oversupply. This is reflected in the level of consumption monitored across the region since 2005 (see tables). Such a situation would not be of such major concern if exports were able to absorb the difference. But although export tonnage has been increasing it is not nearly enough to compensate for the excess wine volume being generated here. Moreover, increased competition from producers outside the region limit export expansion opportunities. The onset of the global economic crisis and its aftermath has only exacerbated the problem.

In response to this situation, in 2008 the European Union agreed changes in the Common Market Organization (CMO) for wine. These are intended to improve the economic prospects of European Union wine producers by reducing overproduction and increasing their competitiveness. The proposal was to remove vineyards from production on a voluntary basis and initially to give grape growers a financial incentive to pull up their vines. There is also a prohibition of new plantings until the end of 2015. During the period 2008-2011 permanent abandonment premiums were offered and, according to the European Union Commission, xxxxxxx hectares were taken out of service between 2009 and 2011. Despite this incentive having ended, the vine surface area continued to decrease between 2011 and 2012.

Thousands of hectares of vines have been destroyed in Western Europe to deal with over-production, yet vineyard area (including crops devoted to non-wine grapes) has actually been in a state of contraction for some time, negatively impacted by shrinking world demand but also as a positive reaction to improved production methods. For the xx countries covered by this report the average annual reduction since 2005 has been xxx% per year, but with the peak reduction occurring between 2009 and 2011. An interesting outcome of this contraction in vineyard area is that the average output per hectare is also apparently falling. Unfortunately data on table and raisin production is unavailable for all years but assuming that all vineyards are devoted to wine, average output across Western Europe dropped from xx hectolitres per hectare in 2005 down to xx hectolitres in 2012 with the most dramatic reduction occurring last year (xx hl).

Chapter 2 Leading suppliers within traditional wine producing countries

Total region (ranked by 2012 turnover)

- LVMH (France)
- Cantine Riunite & CIV (Italy)
- Vranken Pommery (France)
- Lanson BCC (France)
- Sektkellerei Schloss Wachenheim (Germany)

Austria

- Lenz Moser (largest Austrian producer of still light wine)
- Henkell & Söhnlein (a leader in sparkling wine production)
- Schlumberger (a leader in sparkling wine production)
- Wegenstein (supplies Rewe retail group)
- Domäne Wachau (among the largest wineries in Austria)

France* (based on turnover)

- LVMH
- Vranken Pommery Monopole
- Lanson-BCC
- Laurent –Perrier
- Advini

Pernod Ricard* is a global leader in the production and distribution of wines. It produces and markets wines from Australia, New Zealand, Spain and Argentina. Although headquartered in France, Pernod Ricard does not produce French wine and is consequentially not considered above.

Chapter 3 The impact of climate change

According to the International Organisation of Vine and Wine (OIV), global wine production covered xxxm hectares in 2012. Although this may seem a substantial area, vine coverage is decreasing. After wavering at round xxxm hectares from 1995 until 2005 the area under vines has shown a definite decline subsequently, since when xxxm hectares have ceased to be cultivated. This process has resulted from a combination of factors including the re-structuring of vineyard area and over supply, as already mentioned. It has also been influenced by climatic change.

Climate change is not a new phenomenon, as is readily borne out by the recurrence of ice ages throughout the earth's history. What is new is that today our agricultural systems are far more permanent. Vineyards, for example, take years to mature with the vines expected to have a productive life of half a century or more. Moving them, even if this were feasible, would represent both a major upheaval and a heavy financial cost.

Meanwhile grape, vine wine are all susceptible to even small variations in climate. While a day of high temperatures, for example, is relatively harmless, a repetition over several successive days or weeks will seriously damage the vine and impact on the quality of the wine. A 2005 study headed by a climatologist at the University of Southern Oregon found that the average growing-season temperature in xx prime wine-producing regions around the world had risen xxx degrees Fahrenheit in the previous fifty years. In addition, the study found that some warmer regions were already reaching a heat threshold beyond which quality began to decline. The most dramatic decline is predicted for Europe.

In France, now the largest wine producer in Europe, higher temperatures in recent years have already led to grapes with lower acidity and raised sugar content. This is resulting in high alcoholic content and fruitier tasting wine. This is all well and good for those consumers partial to such products but France has a strong tradition based upon identifiable regional styles and specific wine types. It also has a rigid system of quality control - appellation d'origine controlee (AOC) or controlled designation of origin (DOC) - that ascribes a wine's uniqueness to the soil, conditions and viticulture practices of the place where it is produced. Similar classifications apply in other countries including Greece, Italy, Portugal and Spain. But as temperatures climb, it will get increasingly difficult to grow the right grapes in those regions whilst alternative grapes will lose their unique value and classification and declassification means lower prices and less profit.

Chapter 4 External competition

West European wine production has exceeded regional consumption for more than two decades resulting in a major surplus. Exports provide a logical alternative source of demand and traditionally France, Italy, and Spain have been key wine providers on the world stage, and not just in their home region. But European viticulture is facing intensifying competition through a mix of increasing trade liberalization and the rise of the New World wine producers. In 1995 France, Italy, and Spain combined accounted for xx% of global supply. Ten years further forward and that contribution had dropped to xx%. Today it is just xx%. As global consumption has decreased so the production of alternative suppliers has expanded.

Table 3: Wine of fresh grape - exports of main producing countries, 2005-2015 (% Volume)

% Volume	2005	2006	2007	2008	2009
Austria					
Germany					
Switzerland					
USA					
Netherlands					
Czech Republic					
Other					
France					
Germany					
UK					
Belgium					
China					
Netherlands					
Other					
Germany					
NL					
UK					
Sweden					
USA					
Poland					
Other					

Sources: just-drinks, Press, Trade

Chapter 5 Innovation in the wine industry

The wine industry is subject to continuing innovation. Three major innovative themes observed involve improved production techniques and product packaging, interlinked with increased consideration for the environment. With climate change altering the character of wine, techniques like micro-oxygenation present a valuable way of correcting less desirable features. Adding oxygen during key points of the fermentation process can enhance flavour and help mellow the taste of wine from an inferior grape harvest as it softens harsh tannins. The first experiments with micro-oxygenation began in the 1990s, but it really caught on in the early 2000s. Though not without its traditionalist critics, today the technique is widely employed, even in France.

x% of winegrowers in Europe produce organically grown grapes but numbers are rising. The largest total acreage of organic vineyards is in Spain but the number of French wineries going organic has doubled between 2009 and 2012. It has been estimated that at least x% of all French vineyards are now producing wines organically. In Italy there are over xxx wineries responsible for xxxxxx hectares across xxxxxx estates. Organic growing practices focus on limiting synthetic inputs, such as manufactured chemical fertilizers and pesticides and puts greater emphasis on natural compost and biological pest control. Biodynamic techniques go further and consider the vineyard and surrounding area as an interconnected ecosystem in order to determine the optimum means to control pests and achieve the best yields. More and more winemakers are turning to biodynamic viticulture believing that the grapes make better wine. Biodynamics started gaining recognition in the wine industry in the early 2000s. French vineyards such as Domaine Leroy in Burgundy and Chateau de la Roche-aux-Moine in the Loire were amongst the first to start producing biodynamic wine. Since then the idea has taken off in other wine-growing countries including Austria, Germany, Italy and Switzerland.

Care for the environment has become a big social and political issue in recent years and winery waste can cause serious environmental problems. But it can also be a reservoir of useful resources. A large component of winery waste is pomace, or the skins, seeds, and stems left after the wine is pressed. The most traditional way of dealing with this is to make pomace brandy. European Union regulations actually mandate that grape pomace be sent to alcohol distilleries where the residual can be extracted for use in fortifying spirits or in other industrial applications. But some waste still remains. Animal feed is not a totally practical solution because the skins, seeds and stems etc… are difficult to digest and also relatively nutrient-poor. Though still a challenge, composting presents one answer but oils, sugars and acids can also be stripped from the waste for further processing. Wineries are now even trying to turn the waste into biofuels.

Chapter 6 Domestic wine demand in Western Europe

The degree of trade in wine varies significantly between West European countries. As one would expect, those countries with a climate suitable for viticulture, tend to import very little, relative to their total consumption needs whilst countries further north rely heavily on external supplies to meet demand. Thus imports represent less than xx% of Italian and Spanish wine consumption but xx% of UK and Nordic demand. Of course there are exceptions. Germany, for example imports over half of its wine as climatic conditions still restrict the range of wines required by its citizens.

Wine consumption in Western Europe is in a state of constant long-term decline, falling from xxxm hectolitres in 2005 down to xxxm hectolitres in 2012, though mainly thanks to a slight recovery in the French market (provisional data only), the region actually experienced a nominal level of growth last year. The main loses are coming from traditional wine producing countries including France, Greece, Portugal and Italy but particularly Spain. Interestingly German consumption has managed to maintain a strong level of stability. Meanwhile most non-traditional wine producing countries – including Belgium, Netherlands and the Nordic countries – have seen demand grow.

Table 5: Wine of fresh grapes, consumption by country, 2005-2015 ('000 Hectolitres)

000 Hectolitres	2005	2006	2007	2008	2009
Austria					
Belgium					
Denmark					
Finland					
France					
Germany					
Greece					
Italy					
Luxembourg					
Netherlands					
Norway					
Portugal					
Republic of Ireland					
Spain					
Sweden					
Switzerland					
UK					
Total of above					

Sources: HM Customs & Excise, just-drinks, OIV, Press, Statistik Austria, Trade

Chapter 7 Retail vs. on-premise wine trends across Western Europe

Changes in legislation and consumer behaviour are transforming wine buying patterns across the region. The retail market is seeing its share increase at a cost to bars, cafes, restaurants and pubs. The rate of change is dependent on the country in question.

In Austria, a high proportion of wine consumption still occurs in on-premise establishments. The legal drinking age for wine here is 16 and with restaurants and bars allowed to have smoking rooms there is still a strong on-premise culture. Just over xx% of wine sales occur on-premise but there is a definite, if gradual, shift in favour of retail. In Belgium/Luxembourg three-quarters of wine volume already filters through the retail sector. In Belgium wine has tended to be consumed during a meal, though it is developing as a drink to be taken on its own. In the adjacent Dutch market the retail trade has achieved an even greater proportion of sales. These high shares are an established feature within each country although the economic slowdown has generated additional retail growth as consumers have restricted their out of home spending and increased at-home drinking.

The wine markets of Denmark, Finland, Norway and Sweden are also heavily focused on the take-home market where high prices have traditionally deterred consumption in bars and restaurants. Almost xx% of volume in Denmark is bought through retail with the main three supermarket chains (COOP, Dansk Supermarked and Super-Gros) accounting for the majority of such sales. In the remaining Nordic countries the wine trade is largely controlled by state-owned monopoly retailers –Alko in Finland, Vinmonopolet in Norway and Systembolaget in Sweden.

Chapter 8 Legislation and the added impact of recession

The recession in Western Europe hit wine sales hard and there has been limited subsequent improvement. While pockets of consumer optimism are appearing across the region, many inhabitants are still cautiously counting the coins in their pockets before deciding where, when and what to buy. A catalogue of concerns, including weakened job security, inflated prices and tough austerity measures are hitting wine, along with numerous other non-essentials. Economic adversity has intensified price sensitivity and reduced brand loyalty. More and more consumers are making buying decisions based purely on value for money. At the same time various governments have been forced to introduce austerity measures to reduce budget deficits. These and other legislative measures have had a dramatic impact on spending power and consumption trends.

Since the onset of the recession in 2007/8 over half the governments across the region have seen fit to raise VAT rates with the most recent to date occurring in Finland (plus x% in 2013). Whilst personal taxes have similarly been raised more wine specific tax increases have also been employed. In Denmark the excise duty on wine was raised by a staggering xx% in 2012. At the end of the same year Ireland also suffered a xx% increase in wine excise duty. Since 2008 the UK government has increased excise tax on wine by x% above inflation, every year but reduced levels of tax do apply to wine below xxx% abv. Reduced rates also apply in countries like Denmark, Germany (sparkling wine only), Netherlands and Sweden. But many traditional wine producing countries in Western Europe do not impose excise duties on wine. More wide reaching legislation has come in the form of smoking bans in public places. This has had a direct impact on on-premise wine consumption.

While on-premise drinking has suffered the effects of drink drive regulations for some time (see maximum permitted BAC levels in the accompanying chart), the trade has suffered a more recent setback as smoking bans have been progressively introduced across Western Europe. The Irish Republic was one of the first to introduce such a restriction (2004); most other countries have followed suit. Luxembourg is in a minority where the ban is currently not compulsory, though it is being introduced here in January 2014. The impact so far has been pretty dramatic. In Northern Ireland over 100 pubs had shut within a year following the ban being introduced in the UK in 2007. According to a 2013 report by CAMRA (Campaign for Real Ale) traditional pubs are disappearing at a rate of eighteen per week. Of course, the smoking bans are not totally responsible for such business failures, but they have had an enormous impact.

Chapter 9 Duties, taxes and legislation

Most of the countries covered by this report, with the exception of Norway and Switzerland, are in the EU. Import duty is only applied on goods imported from a country outside the union. Within the EU, no import duties are levied.

Current Standard VAT Rates (2013)

Austria	xx%	(since 1984)
Belgium	xx%	(since 1996)
Denmark	xx%	(since 1992)
Finland	xx%	(since 2013)
France	xx%	(since 2000)
Germany	xx%	(since 2007)
Greece	xx%	(since 2010)
Ireland	xx%	(since 2012)
Italy	xx%	(since 2011)
Luxembourg	xx%	(since 1992)
Netherlands	xx%	(since 2012)
Norway	xx%	(since 2005)
Portugal	xx%	(since 2011)
Spain	xx%	(since 2012)
Sweden	xx%	(since 1990)
Switzerland	x%	(since 2011)
UK	xx%	(since 2011)

Chapter 10 Shifts in population and consumer tastes

Consumer wine choice is influenced by their environment and this is in a state of permanent flux influenced by a plethora of factors including the climate, economic issues, lifestyle choices, health, migration and the media. As a result of such issues wine tastes and availability are changing.

Consider the issue of wine supply. It may be hard to comprehend but a hundred years ago Algeria was the largest international supplier of wine, exporting twice as much as the other three major exporters - France, Italy and Spain – combined. Today Algerian wine production is down to just x-xxxxxxx hectolitres, less than % of French annual volumes. There is now an on-going swing in Western Europe away from domestic wines, towards products from the Americas, Australasia and South Africa. However, it may not be long before Chinese wines become everyday purchases in Europe. For, whilst its wine exports are currently limited, China is, in fact, the fastest growing wine-producing region in the world. It has more than doubled its production volume over the past ten years. The big question is whether Chinese grape wine will prove acceptable to Western palates.

But tastes are changing. Climate change in traditional wine growing areas of Western Europe is leading to sweeter wines. Whilst this is not wholly welcomed by those producers eager to retain the traditional and established characteristics of their products, it does fall in line with a developing consumer passion for fruitier wines. One of the fundamental changes seen in the UK over the past few decades is that consumers have developed a "sweeter tooth", probably due to the increasing amount of hidden sugar consumed (such as three tea spoons of sugar in a tin of baked beans). Research suggests that progressive generations have biologically less developed palates which predisposes them to sweeter wine, hence the popularity of New World offerings in Europe. Traditionalist wine producers who fail to recognise this and fail to adapt are potentially alienating a large segment of potential customers.

Migration trends also come into play here. Immigration has increased significantly in recent decades as a result of natural disasters, oppression, poverty and war. Most European countries today have a sizeable immigrant population and the wine tastes of these incomers can differ significantly from resident populations. Consumers in the Baltics, for example, enjoy New World American wines, Moroccans predominantly drink red wine whilst Indians and East Europeans lean towards sweeter wines.

Chapter 11 Company profiles

LVMH

Address

22, avenue Montaigne, 75008 Paris, France

Tel: 33 (0)1 44 13 22 22 Fax : 33 (0)1 44 13 22 23

Ownership

The main shareholder is the Arnault family group with xxxx% in 2012. Foreign institutional investors held xxxx %, French institutional investors xxxx%, the Bulgari family xxx% with the rest made up of individuals and Treasury stock.

Recent company history

1987 The company was formed by the 1987 merger of fashion house Louis Vuitton with Moët Hennessy

1991 Acquisition of Pommery (sold to Vranken Pommery 2002)

1996 Acquisition of Château d'Yquem, Krug

2003 Acquisition of Cloudy Bay vineyards

2008 Acquisition of Numanthia Termes

2009 Acquisition of a xx% stake in Château Cheval Blanc

2012 Announcement that LVMH will start producing red wine in China

Company structure (affiliates, subsidiaries)

Moët Hennessy Louis Vuitton S.A., better known as LVMH, is a French multinational luxury goods conglomerate covering wines & spirits, fashion goods, cosmetics, jewellery etc. It consists of around sixty subsidiaries including several Champagne houses. LVMH is the world leader in Champagne and also produces still and sparkling wines both in France and abroad. Its oldest wine brand is Château d'Yquem, which dates back to 1593.