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HD **Hangover, part II**

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Retail Paul Rayner has gambled on Treasury **Wine Estate** to survive in a crowded Australian market – and lost, writes Simon Evans.

Paul Rayner's worst nightmare is coming true. The former tobacco executive who stepped up to become chairman of Treasury **Wine** Estates in September 2012, exerted clear authority a year later when he axed chief executive David Dearie in September.

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Dearie was blamed for the sloppy inventory controls in the United States at the heart of an embarrassing profit downgrade and $160 **million** in writedowns that were revealed by Treasury in July, 2013. When he received his marching orders, Rayner relied on one of his own boardroom colleagues, Warwick Every-Burns, to step into the driver's seat and run the **company** while a long search continued to find a successor.

As so often happens when a **board** of directors takes control of a **company**, some of the **commercial** nous, gut feel for the industry and relationships with the trade may slip and suffer.

Rayner, a former chief operating officer of British American Tobacco Australasia and a former finance director of British American Tobacco for six years until 2008, and his right-hand man Every-Burns, a former Clorox cleaning products executive, are in the spotlight for all the wrong reasons.

A 20 per cent share price plunge on Thursday, after a $40 **million** profit downgrade in December as the Australian **business** hit the skids and **China** sales slumped as government-imposed austerity measures hurt sales of higher-priced wines, has dragged investor confidence in Treasury to rock bottom.

Every-Burns and Rayner quickly instituted a management shake-up soon after Every-Burns took over the top job on an interim basis. A simplified structure was put in place after being announced on November 27. But the troubles this time have emerged in the Australian **business**, which had previously been a strong performer and was a shining light in the Treasury stable. Much of the management focus has been on the serious problems in the United States, but in a perverse situation, Australia is now a trouble spot.Gambled and lost

Treasury has a glittering collection of **wine** brands in its portfolio which are the envy of rivals. They include Penfolds, Wolf Blass, Lindemans, Wynns and Rosemount. Every-Burns and Rayner have backed the power of those brands to continue to thrive in a crowded market where hundreds of brands compete for the drinkers eye on retailer's shelves.

They have gambled and lost. In December, sales and profits slumped badly in Australia in the crucial month of December. Treasury lifted prices on a number of brands in the **commercial** category of $5 to $10 a bottle and thumbed its nose at being part of the aggressive promotional drives and discounts with the big liquor retailers of Woolworths and Coles in the **lead**-up to Christmas.

It has turned into a disaster. The heat is also on Treasury in the form of a class action planned by lawyers Maurice Blackburn over last year's surprise profit downgrade in July. The latest downgrade raises more questions about management systems and disclosure. Maurice Blackburn's Ben Slade said the latest downgrade raised further questions about transparency in Treasury's **operations**.

Bank of AmericaMerrill Lynch analyst David Errington warned in late October of the dangers of focusing too much on the United States, in a note that seems to have eerily come true. He said at the time that Treasury should sell its US **wine business** because it would be too much of a management distraction. He added it was a "material drag" that needed to be **sold** off, with the risk being that a poor-performing **business** might negatively influence the better performing parts.

Rayner has been strident in his view that the US **operations** are an integral part of the Treasury**business** and won't be offloaded.

However, the new element that has since been injected is the different strategy implemented by those managing the Australian **business** when it comes to discounting and enforcing price rises at such a difficult time in pre-Christmas trading.

It has simply caused mayhem. The latest share price slump wiped $590 **million** from the market capitalisation. It also makes Treasury much more vulnerable to an offshore predator, particularly a cashed-up buyer from **China** or a private **equity** operator eyeing a quick turnaround, just as industry conditions appear to be improving and the Australian dollar falls, making exporting **wine** a more profitable proposition.A bad time for the industry

Industry conditions have been very difficult for Australian **wine** companies generally over the past few years.

Ferrier Hodgson partner John Hart, a **wine** industry expert, said it should be remembered that at its heart, **wine** is an agricultural industry with a long **lead** time. For each of Australia's 2500 **wine** companies, whether they be large or small, it is difficult to consistently produce solid profit increases.

"There are long cycles," Mr Hart said.

The three to four years' **lead** time for vineyard plantings, the capital investment required in plant and equipment that is only being utilised for part of the year and the prospect of being tripped up by changing consumer demand for different **wine** varieties and styles means it is a difficult industry.

He cited the example of a slow wane in demand for sauvignon blanc in white wines, which means producers heavily weighted towards that variety would come under more pressure.

"Sauvignon blanc now seems to be going out of fashion," he said.

Mr Hart said the biggest factor in the overall success of the **wine** industry was the Australian dollar. When the currency was trading around US50¢ more than a decade ago, Australian exports surged.

But when it reached parity with the US currency then rose to US$1.10 it was a substantial squeeze on margins. Combined with a grape oversupply (which has now largely diminished) there was an extended period of difficult times.

The Australian **wine** retailing market can be a fickle beast.

Long-time observers who throw their minds back to around 2002 will recall the flipside of being too aggressive with discounts and promotions and the problems that can bring, so perhaps Treasury management need a touch of sympathy.

Strangely enough, that involved some of the very brands in the spotlight now. In 2002, former Southcorp boss Keith Lambert went on a discounting rampage to try to expand market share for brands including Rosemount after Southcorp and the former privately-held Rosemount merged.

That too turned out to be a disaster, costing Lambert his job and ultimately paving the way for Southcorp to be taken over by Foster's in 2005 to form an even bigger **wine business** alongside the Foster's beer **business**.

For long-time Treasury shareholders who are glass half-full types, there is one interesting point to cling on to for a tiny sliver of happiness.

When Treasury split from former parent Foster's **Group** in May 2011 to become a stand-alone **wine company** that was largely debt-free, its share price on the first day of trading – May 9, 2011 –was $3.45.

Treasury shares finished on Thursday at $3.64 so those who were there at the start are still in front on paper. But this will be small consolation, because Treasury has been as high as $6.47 in mid-May 2013, before its troubles began.

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