THE AUSTRALIAN

SE Business

HD **TOP DROP COMES FIRST FOR TWE**

BY STEPHEN BARTHOLOMEUSZ
WC 860 words
PD 26 June 2014
SN The Australian
SC AUSTLN
ED Australian
PG 22
LA English

LP

Treasury plans changes to the way it markets its wines

It may appear incongruous that the sharemarket's initial response to Treasury Wine Estate's latest bout of impairment charges was to mark up the group's share price. That may be related to reports of a lengthening queue of potential bidders, but it's also possible that the market was relieved by what wasn't in the announcement.

TD

Even though Treasury has previously lowered this year's guidance for its earnings before interest, tax and SGARA (the industry's treatment of inventories) this financial year by $40 million, its ability to meet the revised range of $190m to $210m has been severely questioned and new chief executive Michael Clarke has studiously avoided committing to it.

As the end of the financial year nears, it would have made sense for Treasury to disclose any downgrade of its earnings with the announcement of the $260m of non-cash impairment charges. It didn't, so the obvious assumption is that it is on track to deliver something close to or within the foreshadowed range.

If that is the case, Kohlberg Kravis Roberts, the private equity firm that approached Treasury in April with a proposal for a $4.70-a-share scheme of arrangement offer, would be disappointed. Another downgrade of earnings for this financial year would make Treasury more vulnerable.

KKR might also be concerned about reports that a host of other parties are running the numbers on a bid for Treasury. However, in the near term, the traction Clarke appears to have gained both within the business and the market is probably the biggest obstacle to a successful offer.

Clarke, in the role for less than three months, has hit the ground running. Last month he announced plans to take $35m out of the group's cost base in the 2014-15 financial year; yesterday he announced a fundamental change in the way Treasury sells its flagship Penfolds brand.

Traditionally Treasury has released its Penfolds wines in the final quarter of the financial year, creating considerable pressure for the group to offload its inventories by offering discounts or extended credit terms in order to book the revenue before June 30.

As Clarke indicated yesterday, that's not the way to treat an iconic brand with respect. It's also not the way to maximise the value of the releases.

Treasury is now going to move the release date for Penfolds to October, starting this year. As he said, that will give the group a longer selling period, reduce the pressure to sell the wine ahead of an artificial deadline and make more of the wine available for key festive periods such as Thanksgiving in the US, Christmas, New Year and Chinese New Year.

It might also improve Treasury's negotiating position with distributors and retailers, and will give first-half earnings an extra kick next year during its period of maximum vulnerability. It could buy time for Clarke to demonstrate his ability to structurally improve Treasury's performance.

Treasury has built up a big reserve of premium non-current inventory and latent profitability that it could draw on to manage the impact of two release periods this calendar year.

To support its key brands Treasury is planning to lift its marketing spend by 50 per cent, including year-round support for Penfolds.

The impairment charges relate, it said, to acquisitions made before the demerger of Treasury from Foster's **Group** and are mainly related to **commercial wine** brands, with most of the charges against its US brands.

They come against the backdrop of a restructuring of Treasury's portfolio to separate its luxury and "masstige'' portfolio from its **commercial** wines, which will now be managed separately. Treasury is also separating its Asia, Europe, Middle East and African operations from its Australasian **business**.

The rationale for the split of **commercial** and premium wines is that their markets are different and require different focuses.

Their separation would also make it easier if, at some point, Clarke wanted to take the "premiumisation'' strategy, to which he has recommitted Treasury, to its logical conclusion and hive off the **commercial** portfolio, which has a lower growth profile and lower margins than the premium brands. With last year's $160m of impairments, Treasury has now carved a massive chunk out of the book value of its **commercial wine** portfolio, most of it in the US.

The market for low-end wines is ultra-competitive and crowded, and demand is volatile, whereas there is growth at the premium end and an improving supply-demand equation.

The changes Clarke announced yesterday, including the latest impairments, will help its management and the market to focus on the value and prospects of its luxury and masstige portfolio and on the jewel within it: the Penfolds **brand**.

That's an intelligent evolution in its strategy, both for the **business** itself and for a **company** targeted by actual and potential suitors, largely because of the latent value in the Penfolds **brand**.Stephen Bartholomeusz is a columnist for **Business** Spectator. Visit businessspectator.com.au

NS gvtre : Treasury Department | gcat : Political/General News | gpir : Politics/International Relations | gpol : Domestic Politics | gvbod : Government Bodies | gvexe : Executive Branch

RE austr : Australia | apacz : Asia Pacific | ausnz : Australia/Oceania

PUB News Ltd.

AN Document AUSTLN0020140625ea6q00014

