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Andrew Peller Limited: An Investment opportunity[[1]](#footnote-1)

Melissa Jean wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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In March 2017, Andrew Peller Limited (APL), a producer and marketer of quality wines and Canada’s only publicly traded winemaker, presented an interesting investment opportunity for someone looking to diversify into the food and beverage sector. Would APL make a good investment? In February 2017, APL’s share price hovered around $10.75.[[2]](#footnote-2) An assessment of the organization’s past financial performance using information from its annual reports, its corporate strategy, and, finally, the risks and opportunities associated with the industry, would provide adequate information to help potential investors make such a decision.

THE CANADIAN WINE INDUSTRY

Overview

The Canadian wine industry was fragmented and growing, with numerous local and international competitors vying for a share of the market. In 2012, there were 476 winemakers operating in Canada, the majority of whom were located in Ontario (234) and British Columbia (171).[[3]](#footnote-3) The Canadian wine market experienced a compound annual growth rate[[4]](#footnote-4) (CAGR) of 3.8 per cent between 2011 and 2015 and anticipated a CAGR of 4.4 per cent between 2014 and 2020.[[5]](#footnote-5) In 2013, 30 per cent of the wine sold in Canada was produced domestically while 70 per cent was imported.[[6]](#footnote-6)

The demand for Canadian wine was strong: only 29 per cent of consumers felt that imported wine offered better quality while 49 per cent preferred to support local wineries. In addition, 57 per cent of consumers viewed wine as being healthier than other types of alcohol, which may have contributed to the shift away from beer consumption to wine and spirits. Eighty per cent of consumers over the age of 20 indicated that they had consumed wine over the past six months. Consumers over the age of 55, meanwhile, indicated that they were more likely to drink wine on a weekly basis than other age groups.[[7]](#footnote-7)

Sales Channels

The Canadian wine industry was also heavily regulated. Provincial control boards oversaw most aspects of production, labelling, retailing, and advertising. Wine was available for sale through different channels in each province.

In Ontario, wine was primarily distributed through the Liquor Control Board of Ontario’s (LCBO) 650 retail outlets.[[8]](#footnote-8) Wine was also sold outside of the LCBO distribution network through 210 independently-owned outlets adjacent to grocery stores and online through such websites as mywinecanada.com. In October 2015, the Ontario government regulated the sale of beer in select grocery stores, and by October 2016, wine was available for sale at 67 grocery stores across the province. The plan was to have wine in 300 of the province’s 1,500 grocery stores by 2025.[[9]](#footnote-9)

In British Columbia, the Liquor Distribution Branch was the sole buyer and reseller of wine in the province’s mixed public-private model. It was one of the largest retailers in the province and also sold to bars, restaurants, and private retailers.[[10]](#footnote-10)

In Québec, wine was widely available from Société des alcools du Québec (SAQ) outlets, grocery stores, corner stores, and provincial wineries. The SAQ had approximately 840 points of sale including 440 agency stores across the province. It also offered an online ordering service.[[11]](#footnote-11)

The Sales Process

Although new sales channels were beginning to emerge (for Ontario in particular), working with provincial control boards to get products approved for sale was a complicated, competitive, and time-consuming process. In Ontario, the LCBO preferred to work with agents hired by the manufacturer or supplier. According to the LCBO, “being a supplier’s agent requires extensive resources. Agents are responsible for marketing, promoting, and the sales distribution of the products they represent.”[[12]](#footnote-12)

For listing with the LCBO, qualified submissions were subjected to a multi-stage evaluation process. In the pre-submission stage, applications were reviewed by the relevant product manager under the supervision of the category manager. At this stage the winemaker’s application, marketing plan, and product image were evaluated in accordance with the product needs criteria and other general factors. If the application moved on to the submission stage the application was evaluated with relation to price/quality ratio; product differentiation; innovation; panel tasting and grading results; inventory availability; third party endorsements; environmentally friendly packaging; and sustainable agriculture and production processes.

When these conditions of purchase were met, the LCBO would initiate a purchase order and provide shipping instructions. Initial distribution was usually limited to particular regions or stores. At that time, agents could begin approaching store managers directly to encourage them to order their product. If sales targets were not met or if there were issues with marketing, product quality, packaging, or labelling, the product would be discontinued.

Key Competitors[[13]](#footnote-13)

Constellation Brands Inc. (Constellation) was the top competitor in the field with a 6.5 per cent volume share of the Canadian market, followed by APL with 5 per cent, Treasury Wine Estates (Treasury) with 4.3 per cent, Casella Wines with 2.1 per cent, and numerous other wineries making up the rest of the market. For a summary of selected Constellation and Treasury ratios see Exhibit 1.

Constellation was a multi-category supplier of alcohol headquartered in New York that focused on two segments—wine/spirits and beer. The company operated 18 wineries in the United States, nine in Canada, five in Italy, and four in New Zealand. It had a presence across all price points with brands including Robert Mondavi, Arbor Mist, Kim Crawford, Wild Horse, Ruffino, and Inniskillin.

Treasury and Casella Wines were both Australian owned and operated. Treasury’s portfolio of over 80 wines from the United States, Australia, Canada, New Zealand, Italy, and Argentina included such brands as Beringer, Lindemans, Penfolds, Rosemount, and Wolf Blass. Casella was family-owned since 1969, with five different brands including Yellow Tail.

Backward integration was common in the industry, with most winemakers owning or leasing vineyards. It was unusual for wineries to integrate forward to bricks-and-mortar stores although some engaged in online retail. Many large producers, including Constellation, used grapes from their own vineyards in their high-end products and grapes sourced from third parties in their low-priced products. Constellation purchased grapes from approximately 1,000 U.S.-based and 200 international, independent growers.

ANDREW PELLER LIMITED

APL, originally named Andrés Wines Ltd., began operations in Port Moody, British Columbia, in 1961. Over the next decade, the company expanded across the country, by starting or acquiring wineries in Alberta, Nova Scotia, Ontario, Quebec, and Manitoba. John E. Peller, third generation, took over as president in 1993 and chief executive officer in 1995. In 2006, the company changed its name to Andrew Peller Limited, in honour of the company's founder. APL received numerous awards, including 2014 Winery of the Year⎯the highest distinction bestowed by WineAlign National.[[14]](#footnote-14) APL’s financial performance was strong (see Exhibits 2, 3, and 4).

In addition to owning and operating wineries in British Columbia, Ontario and Nova Scotia, APL operated two import divisions, two retail divisions, and four consumer-made wine subsidiaries. APL produced vintners quality alliance (VQA)[[15]](#footnote-15) wines as well as wine-based liqueurs, cocktails, and spritzers. APL brands included Peller Estates, Trius, Hillebrand, Thirty Bench, Sandhill, and Red Rooster.

The import divisions, Andrew Peller Import Agency and Small Winemakers, imported, warehoused, and marketed product from the major wine regions around the world to provincial liquor monopolies, hotels, restaurants, and private retailers. The retail divisions included over 100 outlets of The Wine Shop and two Wine Country Vintners locations, selling VQA wines and other Canadian favourites. The consumer-made wine subsidiaries included the Vineco, Winexpert, Wine Kitz, and Artful Winemaker lines. Vineco and Winexpert were the world’s largest manufacturers of premium wine, beer, and other alcohol beverage kits. Wine Kitz manufactured its own wine kits and was one of the largest and most respected winemaking retailers in the world. Finally, Artful Winemaker sold personal winemaking systems.

Over the past year, APL successfully introduced new products, including Black Cellar and Wayne Gretzky Estates wines. It planned to open a Wayne Gretzky Estate Winery and Distillery in Niagara-on-the-Lake in the spring of 2017. Initiatives to grow its export business generated solid gains in fiscal year 2015 with APL ice-wine sold in 20 countries around the world.

APL was committed to growth based on building sales of its blended premium and ultra-premium brands through its winemaking capabilities, sales and marketing initiatives, and quality management program. The company expected to support organic growth through new product development, innovative packaging, growth in export markets, its consumer-made wine business, and a strong distribution network.

According to its annual report, APL expected to make additional investments in capital expenditures to increase capacity and improve productivity in the coming years. It also planned to dedicate further resources towards rectifying unfair trade practices and taxes by continuing to work closely with other Canadian wine industry organizations and governments.[[16]](#footnote-16)

CONCLUSION

An assessment of APL’s historical financial performance, corporate strategy, and industry analysis would provide information to help determine whether an investment in APL was a wise decision.

Exhibit 1: SELECTED FINANCIAL RATIOS—YEAR ENDING MARCH 31

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Constellation Brands, Inc.** | | **Treasury Wine Estates** | |
|  | **2015** | **2016** | **2015** | **2016** |
| Net profit margin | 13.9% | 16.1% | 14.4% | 9.0% |
| Gross profit margin | 42.8% | 44.9% | 31.9% | 35.6% |
| Revenue growth | 8.6% | | 18.9% | |
| Debt to assets | 61.0% | 60.3% | 26.5% | 32.4% |
| Return on assets | 5.6% | 6.2% | 6.8% | 3.9% |
| Age of accounts receivable | 36.3 days | 40.8 days | 93.5 days | 94.0 days |
| Age of inventory | 193.3 days | 187.4 days | 191.4 days | 218.6 days |
| Age of accounts payable | 97.4 days | 102.0 days | 125.2 days | 162.4 days |

Note: Calculations based on 360 days.

Sources: Created by author from Treasury Wine Estates, *Annual Report 2016*, 65–66, accessed January 16, 2017, www.tweglobal.com/~/media/Files/Global/Annual-Reports/2016-Annual-Report.pdf; Constellation Brands, *2016 Form 10-K*, 54, April 25, 2016, accessed January 16, 2017, www.cbrands.com/investors/financial-information.

Exhibit 2: APL’s CONSOLIDATED STATEMENT OF EARNINGS—year ending March 31

(in thousands of Canadian dollars)

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2014** | **2015** | **2016** |
| Sales | 297,824 | 315,697 | 334,263 |
| Cost of goods sold1 | 194,821 | 206,687 | 217,368 |
| Gross profit | 103,003 | 109,010 | 116,895 |
|  |  |  |  |
| Selling and administration | 74,253 | 79,685 | 82,048 |
| Depreciation of equipment and intangible assets used in selling and administration | 3,316 | 3,435 | 3,639 |
| Interest | 5,386 | 4,847 | 3,575 |
| Restructuring costs | 1,409 |  |  |
| Operating earnings | 18,639 | 21,043 | 27,633 |
|  |  |  |  |
| Net loss on financial instruments | (750) | 572 | 1,558 |
| Other income | 145 | (301) | (40) |
|  |  |  |  |
| Earnings before income taxes | 19,244 | 20,772 | 26,115 |
|  |  |  |  |
| Income tax | 5,223 | 5,548 | 6,916 |
|  |  |  |  |
| **Net Earnings** | **14,021** | **15,224** | **19,199** |
|  |  |  |  |
| Earnings per share | $1.01 | $1.09 | $1.38 |
| Dividend per share | $0.40 | $0.42 | $0.45 |

1 Includes depreciation of plant and equipment of $4,979 in 2014, $5859 in 2015, and $6,069 in 2016.

Source: Andrew Peller Limited, *2016 Annual Report*, 26, accessed February 9, 2017, www.andrewpeller.com/UserFiles/File/Annual%20Report%202016%20-%207-26-16%20Final.pdf; Andrew Peller Limited, *2015 Annual Report*, 2, accessed February 9, 2017, www.andrewpeller.com/UserFiles/File/FINANCIALS/

Annual%20Report%202015.pdf.

Exhibit 3: APL’s Consolidated Balance Sheet—year ending March 31

(in thousands of Canadian dollars)

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2014** | **2015** | **2016** |
| **Assets** |  |  |  |
| **Current Assets** |  |  |  |
| Accounts receivable | 22,693 | 25,616 | 28,223 |
| Inventory | 120,751 | 117,812 | 119,666 |
| Prepaid expenses and other assets | 2,443 | 3,336 | 2,978 |
| Income tax recoverable | 240 |  |  |
|  | 146,127 | 146,764 | 150,867 |
| **Long-lived Assets** |  |  |  |
| Property, plant, and equipment | 104,206 | 104,951 | 108,929 |
| Intangible assets | 13,209 | 12,331 | 11,040 |
| Goodwill | 37,473 | 37,473 | 37,473 |
|  | 154,888 | 154,755 | 157,442 |
| **Total Assets** | **301,015** | **301,519** | **308,309** |
|  |  |  |  |
| **Liabilities** |  |  |  |
| **Current Liabilities** |  |  |  |
| Bank debt | 54,407 | 32,522 | 33,701 |
| Accounts payable and accrued liabilities | 37,371 | 36,712 | 36,772 |
| Dividends payable | 1,391 | 1,460 | 1,553 |
| Income tax payable |  | 1,902 | 2,425 |
| Current portion of financial instruments | 1,002 | 992 | 645 |
| Current portion of long-term debt | 7,392 | 4,194 | 4,106 |
|  | 101,563 | 77,782 | 79,202 |
| **Long-term Liabilities** |  |  |  |
| Long-term debt | 38,328 | 52,269 | 48,202 |
| Long-term financial instruments | 268 | 1,447 | 1,529 |
| Post-employment benefit obligations | 6,132 | 6,165 | 5,947 |
| Deferred income | 910 | 506 | 102 |
| Deferred income tax | 15,811 | 15,975 | 15,591 |
|  | 61,449 | 76,362 | 71,371 |
| **Total Liabilities** | 163,012 | 154,144 | 150,573 |
|  |  |  |  |
| **Shareholders' Equity** |  |  |  |
| Capital stock | 7,026 | 7,026 | 6,967 |
| Retained earnings | 130,977 | 143,847 | 154,605 |
| Accumulated other comprehensive loss |  | (3,498) | (3,836) |
|  | 138,003 | 147,375 | 157,736 |
| **Total Liability and Shareholder Equity** | **301,015** | **301,519** | **308,309** |

Source: Andrew Peller Limited, *2016 Annual Report*, 25, accessed February 9, 2017, www.andrewpeller.com/UserFiles/File/Annual%20Report%202016%20-%207-26-16%20Final.pdf; Andrew Peller Limited, 2015 Annual Report, 26, accessed February 9, 2017, www.andrewpeller.com/UserFiles/File/FINANCIALS/

Annual%20Report%202015.pdf.

Exhibit 4: APL’s Consolidated statement of cash flows—year ending March 31

(in thousands of Canadian dollars)

|  |  |  |
| --- | --- | --- |
|  | **2014–2015** | **2015–2016** |
| **Operating Activities** |  |  |
| Net income | 15,224 | 19,199 |
| Adjustments for |  |  |
| Loss on disposal of property, plant, and equipment | 429 | 397 |
| Depreciation of plant, equipment, and intangible assets | 9,294 | 9,708 |
| Other | 2,126 | 788 |
|  |  |  |
| Changes in non-cash working capital items related to operations |  |  |
| Accounts receivable | (2,923) | (2,607) |
| Inventories and current portion of biological assets | 2,872 | (1,921) |
| Prepaid expenses and other assets | (229) | (272) |
| Accounts payable and accrued liabilities | (956) | (3,499) |
| **Net Cash Flow from Operating Activities** | **25,837** | **21,793** |
|  |  |  |
| **Financing Activities** |  |  |
| Bank indebtedness | (21,885) | 1,179 |
| Long-term debt | 11,260 | (4,088) |
| Deferred financing costs | (617) | (96) |
| Dividends | (5,770) | (6,153) |
| Repurchase of Class A Shares |  | (2,254) |
| **Net Cash Flow from Financing Activities** | **(17,012)** | **(11,412)** |
|  |  |  |
| **Investing Activities** |  |  |
| Proceeds from disposal of property, plant, and equipment | 10 | 20 |
| Purchase of property, plant, and equipment | (8,466) | (10,401) |
| Purchase of intangible assets | (369) |  |
| **Net Cash Flow from Investing Activities** | **(8,825)** | **(10,381)** |
|  |  |  |
| Net Cash Flow | 0 | 0 |
| Beginning Cash | 0 | 0 |
| Ending Cash | 0 | 0 |

Source: Andrew Peller Limited, *2016 Annual Report*, 26, accessed February 9, 2017, www.andrewpeller.com/UserFiles/File/Annual%20Report%202016%20-%207-26-16%20Final.pdf.

1. This case has been written on the basis of published sources. Consequently, the interpretation and perspectives presented in the case are not necessarily those of Andrew Peller Limited or any of its employees. [↑](#footnote-ref-1)
2. All currency amounts are in CA$ unless otherwise specified. [↑](#footnote-ref-2)
3. “Agriculture and Agri-Food Canada: Canada’s Wine Industry,” Government of Canada, March 7, 2016, accessed August 26, 2016, www.agr.gc.ca/eng/industry-markets-and-trade/statistics-and-market-information/by-product-sector/processed-food-and-beverages/canadas-wine-industry/?id=1449859691976. [↑](#footnote-ref-3)
4. Compound annual growth rate is the average annual growth rate over a specified period of time longer than one year. [↑](#footnote-ref-4)
5. “MarketLine Industry Profile: Wine in Canada, October 2016” MarketLine, accessed April 13, 2017. [↑](#footnote-ref-5)
6. Canadian Vintners Association, *Canadian Wine and Grape Industry Fact Sheet,* March 2013, accessed August 16, 2016, www.canadianvintners.com/wp-content/uploads/2013/03/Canada-Fact-Sheet.pdf. [↑](#footnote-ref-6)
7. “Wine-Canada-October, 2015,” Mintel, accessed August 16, 2016. [↑](#footnote-ref-7)
8. “About the LCBO,” LCBO, accessed April 13, 2017, www.lcbo.com/content/lcbo/en/corporate-pages/about.html#.WO-1NvnyvIU. [↑](#footnote-ref-8)
9. Rob Ferguson, “Wine Available at Selected Grocery Stores in Ontario Starting Today,” thestar.com, October 28, 2016, accessed April 13, 2017, www.thestar.com/news/queenspark/2016/10/28/ontario-grocery-stores-begin-selling-wine-today.html. [↑](#footnote-ref-9)
10. “Who We Are,” British Columbia Liquor Distribution Branch, accessed April 13, 2017, www.bcldb.com/about/who-we-are. [↑](#footnote-ref-10)
11. “Doing Business with the SAQ,” SAQ, accessed April 13, 2017, www.saq.com/content/SAQ/en/a-propos/faire-affaire-avec-la-saq.html. [↑](#footnote-ref-11)
12. LCBO, “Product Management Policy and Procedures,” September 2012, accessed January 16, 2017, www.doingbusinesswithlcbo.com/tro/Forms-Documents/pmpp/index.html#/1/. [↑](#footnote-ref-12)
13. “MarketLine Industry Profile: Wine in Canada, October 2016,” MarketLine, accessed April 13, 2017. [↑](#footnote-ref-13)
14. “Peller Estates: Peller Estates Awarded ‘Canadian Winery of the Year’ at the 2014 WineAlign National Wine Awards of Canada,” WineAlign 2014, July 30, 2014, accessed April 13, 2017, www.andrewpeller.com/UserFiles/File/PRESS/

    PellerMediaRelease\_July30\_FINAL.pdf. [↑](#footnote-ref-14)
15. VQA was an independent authority that established and monitored the quality of wine produced in Ontario. VQA wines needed to meet a number of standards, the most well-known being that every VQA wine needed to be made using 100 per cent fresh, Ontario grapes. [↑](#footnote-ref-15)
16. Andrew Peller Limited, *2016 Annual Report*, 17, accessed April 13, 2017, www.andrewpeller.com/UserFiles/File/

    Annual%20Report%202016%20-%207-26-16%20Final.pdf. [↑](#footnote-ref-16)