Investor update
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Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the TWE business update. — ***Operator Instructions*** —

Please be advised that today's conference is being recorded. I'd now like to hand the conference over to your speaker today, CEO and Managing Director, to Mr. Tim Ford. Thank you. Please go ahead.

Tim Ford

Good morning, everybody, and thank you for joining today's call. With me today on the call is Matt Young, our Chief Financial Officer. So I'll start with expressing my – it's a pleasure to speak to everyone as the first time as CEO of Treasury Wine Estates. As we move into our new financial year, I wanted to take this opportunity to provide you with some insight into our recent business performance and the market trends that we are currently observing, along with a progress update on the implementation of a number of the strategic initiatives that we announced back in April. We recognize that these are unique times and that requires an increased level of transparency and insight around our business performance, which we are now able to provide at this early stage after the financial year close. Before I talk through today's announcement, I would like to take a few moments to touch on a couple of points.

Firstly, I'm genuinely excited and proud to have stepped into this role, as CEO, just over a week ago, today. I can say, with great confidence, that this is a company led by an outstanding team across the globe, with a portfolio of great brands that our customers and consumers alike love and operating models that we have worked incredibly hard in recent years to fix and position for sustainable long-term success and growth, and that work will continue. The dedication and resilience our team has shown in recent months, working very closely alongside our customers and suppliers, gives me every confidence that our business is well placed to navigate the near-term challenges and become an even stronger business. I'll definitely have more to say on our long-term vision, strategic outlook and some of the immediate priorities for F '21 as part of next month's full year results update.

Secondly, I would also like to thank and acknowledge Mike Clarke for the significant contribution that he made to TWE over the past 6 years. And on a personal note, the invaluable support and guidance he's provided to me over the recent transition period. The extraordinary transformation of our business and improvement in our operating and financial performance over this period were in no small part, a direct result of Mark's strong and decisive leadership, and TWE is a much stronger and well-positioned business today than when he first joined the company, for that there's no doubt. So turning now to today's announcement. And starting with our preliminary F '20 performance outcomes, which, as noted in the release, all remain subject to audit completion over the coming weeks. We expect our fiscal year '20 EBIT of between $530 million to $540 million with the world documented disruptions due to the global COVID-19 pandemic, having had a significant impact on our operating performance through the second half of this financial year, just gone.

Each of our regions have been impacted, albeit the nature and degree of those impacts vary across each geography. Compared to the prior year, across each region, we expect EBITs decline of approximately 14% in Asia, 16% in Australia and New Zealand, 18% in EMEA. And in the Americas, where, in addition to the COVID-19 impacts, we continue to navigate the challenging U.S. market conditions that we talked through in our January results announcements. We expect the EBITs decline to be approximately 37%, year-on-year. I'll now talk and give some color to the current trading environments across our key markets. I'll start with China, where we continue to see positive signs of both consumption and depletion recovery with the continued reopening across the country. Treasury Wine Estates depletions across the portfolio pleasingly returned to modest growth in April and May, up 1% versus the prior year, which is a strong recovery from being down more than 50% through the March and – sorry, February and March period.

Throughout the half, TWE's portfolio of brands has also continued to perform ahead of the category in e-commerce, a channel Chinese consumers have been increasingly turning to for their wine purchases, and we see it as a priority focus for us to strengthen what is already a leadership position to take advantage of the shift in purchasing behavior. Whilst these recent trends are certainly very positive, we do remain cautious around the short- to medium-term outlook, given that the social and celebration consumption occasions do remain muted, and these are a key driver of luxury wine consumption in China.

Across our other markets, there are a number of consistent trends that we have seen across the U.S., Australia and Europe. The first major one of these is that we continue to see strong performance across the retail channel specifically, both the bricks-and-mortar outlets, but also increasingly online and e-commerce channels, as consumers increasingly purchase wine through grocery and liquor outlets to consume at home but also have delivered to their home. The second consistent trend has been the closure and then restrictions in some instances, as things have reopened across our on-premise channels globally, our seller doors and also any travel- and tourist-related retail. There have also been nuances by markets, however, within these trends, and I'll talk about some of those now.

We'll start with the U.S. We have seen the strong retail channel growth across all price points and premiumization trends continue with value and volume growth of over 20% in Luxury and Masstige price points. Our priority brand portfolio continues to perform strongly in this channel, having grown by more than 35% across the portfolio of priority brands in the 13 weeks to mid-June. In Australia, we have seen double-digit value and volume growth through retail across the recent months, with our performance in this channel over the period weighted more towards our Masstige and lower-priced Luxury portfolios.

Away from the traditional retail channels, particularly in the U.S. and Australia, on-premise cellar doors and global travel retail have been closed for a significant proportion of second half '20, but pleasingly have started in a number of markets to reopen of late, albeit with the continuation of restrictions. As we've previously stated, but to reiterate, sales in these channels are weighted towards higher-margin luxury wine. And their closure in recent months has certainly had an adverse impact on our portfolio mix in the half, particularly in the U.S., and therefore, being a key driver of the decline in EBITs we've outlined today.

To provide a bit more context around this impact, these channels broadly represent 12% of our volume, but 25% of our revenue and also have a lower cost of doing business in comparison to the retail channels, hence, our higher-margin channels for our business. Across all of our markets, we continued our disciplined approach to managing the level of shipments to customers to ensure that they remain appropriately calibrated to depletions rates. This is critical to ensure that the long-term health of our brands and particularly our pricing structures in the markets remain as we see sustainable for the medium and long term. In China, as at the end of May, our forecast for days cover are lower than what they were a year ago.

And in the U.S., our shipments were below depletions in F '20. Our capital structure remains strong, flexible and efficient. At — ***Technical Difficulty*** —, we had total liquidity of approximately $1.4 billion, comprising cash on hand of approximately $448 million and undrawn committed debt facilities totaling $920 million. Cash conversion is expected to be above 80%, and net debt-to-EBITDA is expected to be approximately 2.2x. This strong capital structure and our liquidity position will support the maintenance of our long-term dividend policy, which consistently targets a payout ratio of between 55% and 70% of net profit after tax. And finally, given the current uncertainty around trading across all of our markets, we will not provide earnings guidance for F ’21 at this point in time.

Turning to the 2020 Australian vintage, which has been well documented. As we called out, at our half year results’ update, the Australian vintage was impacted by extreme heat conditions through key stages of the growing season, which we highlighted as likely to lead to higher cost of goods across our Australian sourced Commercial and Masstige portfolios, in particular. With the vintage now complete, we confirm that the total intake is down approximately 30% when we compare to our previous 2019 vintage intake, and it will be a higher cost vintage for Treasury Wine Estates, with global cost of goods expected to increase by 3% per case or approximately $50 million in F ’21. These impacts will be most notable in our ANZ and EMEA regions, given the cost of the Commercial and Masstige portfolios and intake.

Importantly, work had already begun and commenced on the restructuring of our global supply chain cost base, which will support the lowering of our cost of goods per case over time as we do on an annual basis. Notwithstanding the commentary on the Australian vintage ’20, we are well positioned, we believe, through the flexibility of our luxury wine allocation program, which is a key strength of our business model, allowing us to manage through short-term changes in both demand or single-vintage variation. Also supporting this is Treasury Wine Estate’s multiregional sourcing strategy, which provides further flexibility to deal with single-vintage variation and supports the sustainable long-term earnings growth of the business. Using this flexible allocation model, we have already put in place actions and plans and adjusted these plans to carry forward unsold luxury wine that was previously allocated to the second half of fiscal '20, in addition to further reallocation of luxury wine that had previously been reallocated to the next year and future years.

To our strategic agenda, which we outlined to the external community on the – in early April. I'll start with the U.S. business restructuring. Since that update in April, we have completed the design and implementation of a new operating model and organizational structure. And as a result of these changes, we'll deliver annualized cost savings of at least $35 million commencing in F '21. We've also commenced the work on the potential divestiture of specific Commercial brands and the related assets, and along with the restructuring of the supporting supply chain behind that. This program, when fully executed, will deliver a significantly improved business model in the U.S., a growth business model, with a strong portfolio of differentiated growth brands, an improved shape of the P&L, delivering improved margin and a strong platform from which to grow over the long term in what remains an attractive wine market to TWE.

As I noted earlier, the strong trend to premiumization in the U.S. wine market remains intact, and our priority portfolio of Masstige and Luxury brands in this market continues to perform well in the second half in those channels, not impacted through closures. On the potential demerger of Penfolds, the work we have completed since the April announcement has validated our expectation and belief that value will be created through a separate focus for Penfolds and Treasury Wine Estates' other brands. Optionality exists as to the best operating model to unlock that value, including a demerger, and we'll continue to explore thoroughly the best option to drive the long-term growth and value creation for this business. However, important to note, whilst this work is ongoing and a significant body of work, our focus, rightly, right now is on managing our business through the market conditions and constraints that we see in our markets, whilst also driving at pace the execution of the U.S. business restructuring I've outlined. They are our 2 key priorities in quarter 1 of this fiscal year.

So in closing and to sum up for you the key takeaways from our announcement today. Our F '20 EBIT result reflects the impact of COVID-19 throughout second half '20 as well as the continuation of challenging market conditions in the U.S. previously outlined in our half year results commentary in January of this year. In China, we are seeing positive signs of recovery, but remain cautious on the outlook. In our other regions, we continue to see positive momentum through traditional retail sales channels and e-commerce and are encouraged by the progressive reopening of key channels for higher-margin luxury wine. Our balance sheet remains a fundamental strength, leaving us very well placed to manage through the period ahead and continue to invest as appropriate for the future.

Our ability to flexibly allocate luxury wine across multiple financial years as well as our multiregional sourcing strength will allow us to manage through the impact of the smaller Australian vintage. Our restructuring program in the U.S. is progressing very well, and once complete, will deliver, we expect a significantly stronger U.S. business with a much improved shape of a P&L with a strong growth platform. We remain convinced that there is value in separate focus for Penfolds and TWE's other portfolio, and we will pursue the future operating model that will best deliver that value over the long term, including a potential demerger. And whilst we remain cautious on the outlook, given the market uncertainties around the globe, and will not provide forward guidance at this point in time.

What we do expect is to manage through and then come out of the current operating environment an even stronger business given the fundamental strengths of our brands, our business models and our teams around the globe. I and the TWE leadership team, who I have immense confidence in, continue to adapt to the constantly changing consumer landscape and the operating environment we find, ensuring that we focus on both the delivery and execution of our current business plans, while still focusing on delivering the plans for future growth of Treasury Wine Estates.

We see challenges creating opportunities on a number of fronts, and we'll continue to embrace these, and I look forward to sharing these plans in more detail as I provide further business and performance updates into the future as the CEO of this organization. So thank you for joining the call today. And I trust this has given our investors in our business and analysts insight into our performance, challenges, opportunities and the plans, and I look forward to be able to provide greater detail at our next scheduled market update on the 13th of August. At this update on the 13th of August, investors and analysts will also hear from the regional MDs, who will provide further insight themselves into their regional business unit performance; sales channel, in particular, detail; and strategies and plans to drive their businesses as part of the total treasury business.

So I'll now open up the line for any questions to Matt or myself, noting that we will only be able in a position to cover the content that has been included in today's ASX announcement, but clearly, we will be talking again in another month's time when we release our final audited full year results.

So with that, operator, I'll open up the line for questions, please.

Question and Answer

Operator

— Operator Instructions —

We have multiple questions in the queue. Our first question is from Andrew McLennan from Goldman Sachs.

Andrew McLennan

Congratulations, Tim, for stepping up to the CEO role. I'm just wondering – a lot of questions, obviously. I'll just start with the direct retail and come back. The restructurings you're making in the U.S., obviously, it's a very dynamic market over there, but you've alluded to the restructuring charges and also the potential for asset sales. Can you just talk about how significant the headcount reductions are? It sounds like there's a lot of activity going on over in the U.S. market at the moment. And also, just what you're planning on doing from an asset sale perspective? It certainly sounds like there's a bunch of treasury assets on the market at the moment. And if you can confirm that you won't be selling any sort of Luxury or premium brands in that process, please?

Tim Ford

Thanks, Andrew, and morning. I'll start with the, I guess, the reorganization and restructuring we've done in the U.S., which we did over the course of the month of May. We have significantly changed the overhead base and the cost structure of our U.S. business. And it wasn't just purely a cost-cutting exercise, but as we've said in the announcement, it is going to deliver cost benefits going forward, output of $35 million starting now from the start of F '21. The reorganization has been designed with a specific endgame in mind with a focus, a specific focus, of our Commercial organization, in particular, around 3 key pillars of our business going forward. The first one will be around the dedicated luxury wine sales focus, the second one around distributor management, and the third around a dedicated focus around our retail customers and our strategic retail accounts.

So what we have done as part of that reorganization, as I said, has shifted the business model in how we go-to-market with our distributor partners and also with different partners throughout the different channels in the U.S. and that, to be honest, is the most exciting side of it is that separate focus we will have going forward, linked to what the portfolio of the future and our priority portfolio for the U.S. is and will be. To link that then to the potential divestitures of assets and brands, I'm not going to talk through the detail of what they are, clearly, given we are currently undertaking negotiations with parties of interest for those brands and assets in particular. So as we get to a point where we can talk more broadly and announce those, clearly, we're going to do that firstly internally, within our own business, and then talk to the external community about that.

However, it's fair to say if you look at our priority brand portfolio, we see that as the portfolio to take forward – going forward as well as potentially augmenting that through innovation and other brands where you see the price points and the consumers, based on all the data we see in the U.S., even through the COVID-19 period, continue to grow and continue to buy higher price wines, not just high-priced luxury ones but certainly between that $10 to $30 range as well within the U.S., which is where a real sweet spot in that market is that we'll continue to drive our portfolio towards as well, that's the luxury portfolio.

Andrew McLennan

And so Tim, as part of this, are you sort of stepping away from the direct-to-retail strategy in its prior form?

Tim Ford

No. At this stage, we have distributor partners we are working with, and our direct model within the United States continues to be the model that we're operating with. As we work through and we see what we finally do end up with in terms of divested portfolio, divested brands, divested assets, we'll continue to review our route to market and what is the most appropriate route to market going forward. But that's not to say, and I've had this conversation with all of our distributor partners in the U.S. over the last 6 months and particularly over the last 3 months when we've announced this. We are very happy with our partnerships we have in the U.S. at the moment, and we'll continue to drive those.

And all of our distributors are driving this priority portfolio, as we can see from the results very well.

Andrew McLennan

Got you. And just if I can, in relation to your cash conversion, it looks like a reasonable number for the end of financial year. But given your intake's going to be down by about 30% by volume and possibly impacted by costs and maybe down 25% by value at a guess there. That's obviously going to make a pretty – or has made a pretty material impact to the value of your intake in fiscal '20. I'm just wondering if you could talk to how much of a benefit that's been to cash conversion?

Matthew Young

Andrew, it's Matt here. Good morning, and morning everyone. Yes, look, the cash conversion, it will be above 80%. We haven't given the sort of the final number now. There are 2 main trends in there. First is, as you can see, sales are down, and they're down in the fourth quarter compared to prior year. So that's probably the primary driver of the cash conversion. So not something that we're celebrating it, but that's the main driver. Certainly, inventory, there will be 2 drivers. The smaller vintage, but also the lesser sales of luxury wine that are somewhat offsetting within that factor as well. So we haven't got the breakdown of that this year today, but those will be the 2 main trends driving it.

Operator

Our next telephone question is from David Errington from Bank of America.

David Errington

Good presentation. The one business that I'm concerned with, as you know, because I think today, the performance of Asia was certainly better than I was expecting. And the green shoots coming out of China is particularly pleasing and positive. Positive depletions in April and May are certainly very welcome. But the U.S. business, Tim, we've discussed this for a while, is certainly the problem that I see. Now I know you've got plans, but I don't want to throw – I don't want to be seen as just throwing numbers at you here, but when you look at your second half performance, in terms of Aussie dollars, you went from $106 million in the second half of '19 to $39 million in the second half of '20. And my observation is you probably would have had close to a 10% currency tailwind. So roughly, on a U.S. dollar basis, you've probably gone from about USD 75 million to around USD 25 million EBIT contribution from the U.S. business.

Now my concern is, I understand what you're trying to do, with restructuring and what-not. But there's obviously some serious headwinds in that business right now. And I just can't understand, given the strength of the retail part of the business, which is still a large chunk – the retail part in the U.S., with all Nielsen data and whatnot was very strong through that first half. I'm just struggling to comprehend and correlate how the business performance could drop that much in the second half. And if you could give us a bit of background as to, well, why it dropped that much, given that the retail side was so strong and why you couldn't enjoy it? And then the second point is that, okay, you now own the U.S. strategy, why should we – I'm struggling to understand, why you're still committed to the U.S.? And my opinion is, for 20 years–and I've said this publicly–for 20 years, TWE is the dog always eats your homework, always eats the homework in the U.S.

There comes a time where you just end up shooting the dog. Why are you sticking with having a strategy in the U.S. when the numbers are just really pretty poor? Because today was good – the numbers are good, but the U.S. numbers are really not really that good. So can you give a couple of insights as to why you believe, with you in charge, we should back you for a bit longer in the U.S.?

Tim Ford

Yes. Good morning, David. Thank you for that, and thank you for the feedback on the presentation, too. Look, the – I have a very clear vision and picture of what I believe the shape of our U.S. business needs to be as quickly as possible. And I also have a very strong belief that once we achieve that shape, that we have a growth platform in a market that continues to grow. So the opportunity for TWE, and everybody involved with TWE is still a strong and, I believe, in existence in that marketplace. And that's for a couple of reasons. The shape that I see in the future of our business is, and I'll talk in broad terms here, is a much lower volume business than what we have today; a business that has a similar EBIT level to what we have today, which then gets us much, much closer to our stated ambition around margin structures in the U.S. and that is achievable with the steps that we've outlined and the steps that we've started.

First one was, we needed to get cost out of that business and reshape our commercial model to allow us to achieve that future shape that I talk about. So that's point one that gives me confidence. Point two is, the brands and the portfolio that will form that future shape of the U.S. business are all growing significantly ahead of the market in the channel, as you talk about that we should be and have been performing very well in over this period of the pandemic. So that also gives confidence. The third part of it is, I guess, from my perspective, when you look at the opportunities for growth and as we outline those across the globe, the U.S. is still and can be, and I believe will be, a profit engine for this business.

Now I'll certainly take the feedback and the proof is going to be in the delivery, so I absolutely accept that. But the picture I want to see as a U.S. business is a successful component, as a leading component, of Treasury Wine Estates. I firmly believe we can achieve with the steps we are working through and that we have outlined. In terms of the performance over the first half, and we plan to give a much more granular level of detail around the makeup of our Americas business, how we report it, not only in F '20 but also historically. When we get underneath the hood of the U.S. structure and the different channels within the U.S. business, those channels that have been closed, most channels that have been severely interrupted, are very strong profit contributors for us over and above what most people probably expect now.

We can't expect you to assume that because you haven't gone through that in the level of detail, but you should expect at our full year results announcement, and we're going to get Ben Dollard as the President of the U.S., who's been in that market for 6 months now with us, as Treasury Wine Estates, to talk through that in a great deal, more detail. And also the construct of how we report U.S. trade, how we report Latin America, Canada, the other components that make up our Americas business because I believe that's going to give a lot more insight and provide everybody with a better ability to track our progress over the next 12 to 18 months because I fully appreciate that this is going to be watched very closely over that period of time. I don't know you personally, Dave. I'm going to judge a lot of my success of whether we can actually achieve that. So Matt, do you want to add anything to that?

Matthew Young

Yes. Look, the other builds I'd have would be around the – it's that channel mix. So David, the market will have seen it. When we came out at the half year result, we had seen some – the challenges in the industry that were – have been – we're not going to back up over those, but around the level of discounting and the private label, et cetera. And we had seen 17% decline for that first half, and we did say at the time, we expected those trends to continue. So really, the challenge from there has been around COVID-19 and the well-documented commentary that Tim has already gotten around the performance, particularly in retail channel was great. But those nonretail channels, and so think direct-to-consumer cellar doors, which are a strong and profitable part of our business. Latin America, which is mostly travel retail is being closed.

There and on-premise, which is important and particularly for Luxury sales. We've tried to give a sense of that channel split of sort of 25% revenue, 12% volume. And we've tried to sort of make that clear. They are profitable channels. So when you think about gross profit, those are important factors to remind. And Tim's right, we haven't given that level of detail before. And hopefully, that gives the context that when you dimensionalize that on the second half, it will help you understand. It will also, I think, help you understand, as Tim said, the strength of what's going on in retail is great. And that once those channels do progressively reopen, they are still strong and they are still profitable, and they are important and valuable part of our business, which gives us that confidence.

David Errington

Matt, did you say 12% volume. So this is the off-premise market in 12% volume, 24% revenue. So what would gross profit be at 40%, 45% of it? Would – is that what has been closed? Is that roughly...

Matthew Young

There's definitely an improved leverage. We haven't given that number today, David. We – it's a bit early for us to do that, but you can certainly assume an improved leverage right down the channel. You can also assume lower cost of doing business. So I think less A&P is required, less cost of – less overheads in those channels as well. They are Luxury channels, and you can probably dimensionalize based on other Luxury parts of our business, the strength of those. But it is not just on-premise, just to clarify. It does include direct-to-consumer cellar doors, Latin America and the travel retail. And I know we've previously given a few years ago the split of what Latin America is to our business as we moved it across segments. So there are elements there that so just give you that sense of what the strength of profitability of those channels are.

Operator

Our next telephone question is from Shaun Cousins from JPMorgan.

Shaun Cousins

Just a question further on the Americas. Should we dimensionalize this in terms of – is your retail EBIT down in terms of – is the pressure from private label and the pressure of discounts, are you seeing a decline in EBIT sort of similar to what that 17% decline you incurred in the first half? Is that the way we should think about it? Or was the strength in that market, probably within that channel, sufficient for you to get flat EBITs in that retail sort of the area of the market where you commented on some good performance, please?

Matthew Young

So very strong depletions, very strong IRI performance. You can assume that the earnings of that channel, I won't give the detail, but you can assume it was down given those reflected trends as well as depletions being below shipments, say, for our result. But certainly from an external depletions IRI, that strength. And that – again, that goes to strength of the brands and the ongoing momentum of those – that focused priority. But from our earnings perspective, yes, you can assume that those trends have driven a decline in the earnings for the U.S. retail trade.

Tim Ford

Yes. So Sean, I'll answer that as well. I think we do need to reference back to sort of the market dynamics that we explained around the U.S., and yes, as we said in January, we forecast and build-out, I guess, revised business plan forecasts in the pre-COVID world, which are hard to remember at this point in time. But the – that plan outlined a couple of key factors around the oversupply and the industry driving certain dynamics, one being the growth in private label and price points we hadn't seen previously, as you said, between that 8 to 15, we've seen that continue to grow, $8 to $15, which suggests that the oversupply and the inventory levels within supplies is still very high. So that's, I guess point one.

And secondly, whilst the demand certainly has increased through IRI and through the retail channels over the period of time, which would, you would argue, reduce the over-supply to a degree, that's a component of it. And I think it's only once we get through the next vintage in the U.S. and people and suppliers have had the rightsizing opportunity around their vintage intake, and we truly then will understand how long the dynamics in the U.S. will continue. So I think there's still a number of those factors that are still live and are still being experienced within the marketplace today.

Operator

The next telephone question is from Richard Barwick from CLSA.

Richard Barwick

I wanted to ask around the $35 million of cost savings. You describe them as annualized cost savings in FY '21. So does that mean that's the exit rate? Or will there be a $35 million impact in FY '21? And how do we think about the flow-through into FY '22?

Matthew Young

Yes. It's Matt here Richard. The – it is a $35 million. It is a run rate, and it is live and running from 1st of July. So you can expect that, that is, in our expectations, for next year to deliver and on an ongoing basis.

Richard Barwick

All right. So full $35 million in '21, and that's – then flow-through. Okay. And can I just check, I mean, obviously, you've given some extra disclosure around the impact of the on-premise cellar door, travel retail for the Americas in terms of volume and revenue. We can draw our own conclusions on GP and EBIT. Can you give us a sense of just how important those channels are within ANZ? I understand it would be less than what you're talking to in the Americas, but how much less?

Tim Ford

Now it's actually quite similar. When you look at it, we put sort of 12% – approximately 12% of our volume and 25% of our revenue – it's similar in the ANZ P&L, if you like, versus what it actually is in America, a slightly different mix channels. Cellar doors are stronger in the U.S. than they are in Australia versus on-premise in Australia versus U.S. And as I said, we're really keen to take the opportunity at the full year to go through this in a lot more detail because I think this is a key construct for everyone to understand the shape of our sales channels. But broadly, the ANZ business, the numbers are quite similar at a macro level.

Operator

Our next telephone question is from Michael Simotas from Jefferies.

Michael Simotas

Can I start with the vintage. I mean the commentary is fairly down bathed in it. Seems like about the worse one I can remember since 2011. Your intake is down 30%. Firstly, that's a lot more than the overall crush which I think is down about 12% according to Wine Australia. So just interested in the reasons for that. And the secondly if you could comment on the difference in trends across Luxury, Masstige and Commercial intake as well, please?

Tim Ford

Yes, I'll start and then Matt can build on it as well, I think, is a good way to put it. The vintage intake, I must admit I can't picture the document you referred to Michael – sorry, good morning, Michael, too, by the way. I can't recall the document that said the vintage crush was down 12%, overall. So apologies for that. Most of the commentary that I've certainly seen is that the vintage intake across the board in Australia. Again, it depends on your mix as an organization, but is broadly in line with that 30% where we've ended up as well. So – that's the facts, as we know it, in terms of our vintage, and I don't think we would be any vari – variation of great difference to others within the industry at all.

The key dynamics, there are a couple of key dynamics from a cost point of view. So clearly a lower vintage intake across the board through a fixed cost base has a one-off impact of doing that. And believe me, the 30% reduction, we weren't planning for it to be a 30% reduction either. And it actually through the month of, when we were receiving the final fruit in and were processing, it ended up being a lower tonnage than what we'd planned based on what we saw come out of the vineyards. So that did slightly surprise us in that last month to a degree, and combined, adds up to the cost base we've talked about here.

The other key point, which we had talked about previously, but for the second vintage in a row, the price of fruit and the price of bulk wine from a commercial portfolio perspective, has continued to raise and continued to rise, I should say. So the pricing, if you like, of not just the lower vintage but the pricing of what we bought in, in the commercial portfolio, has also had a significant impact into that as well. And that, as you know, with our age of release, et cetera, when it's commercial wine, it would generally then impact the next fiscal year as we sell through that product.

Matthew Young

And I might just build it up a little bit. We – I don't need to build the first point that – we haven't given and we're not going to give sort of a split of the various Luxury, Masstige, Commercial. There's probably enough data out there around our general intake and what we have as a sourcing base. The only thing I'd add as substance is, certainly, we're not going to sit on our hands. We recognize that challenge. We recognized it before we announced in April, the plan to look at our global supply chain and address cost of goods, that was before the vintage. This is enhanced and sort of focused the mind. And I'm pretty positive that the piece of work there we'll continue to do if you think sort of back 4, 5 years when we did a similar exercise. That's how we're tackling it, and that's the right thing for us. It was the right thing before the vintage, and it will be the right thing after.

Operator

Our next telephone question is from Ross Curran from Macquarie.

Ross Curran

Just firstly, are you able to talk us through the dynamics on volume as you've been able to lower that retail price point of, say, of those entry-level brands like 19 Crimes and Koonunga Hill from mid-teens down to low double digits? And can we assume, with a lower intake on this year and with those cost pressures, that those retail price points are likely to drift up again? And how that's going to impact demand do you think over the next year or so?

Matthew Young

I might start, Ross. And I might get you to back up over the first question a little bit, but I'll start firstly, at this stage, we have – we're not – we haven't given the data on volume or price in terms of the performance [to date]. And that will be something we give in more detail when we get to August.

On an outlook for pricing, it's too early to tell. The one thing is, obviously, the vintage that we've just taken in the most important part of that will be Luxury, which will be released in 3 to 5 years. So there is still an exercise given the vintage is fresh for us to go through and think through what that means. We've got to understand multiple dynamics before you think through pricing on that. So it's too early to say that. But Ross, can I just get you to sort of repeat the dynamics you mentioned on 19 Crimes, Koonunga Hill, and just so I can understand the question?

Ross Curran

Sure. If you go back – well, if I go back 12 months ago, in my local bottle shop, both of those are $15, $16 bottles of wine, and they are now about both, sort of, about $10, $11 a bottle at my local bottle shops. Does that then drive up a lot of volume? And I was wondering if you're forced then to move away from that $10, $11 price point on that by rising input costs, what impact do you think that has on demand for the products?

Matthew Young

I might start with 19 Crimes. I think that's been a pretty consistent price point or at least a target price point, certainly, there, in Australia and America, it tends to hang around that $10. It's been pretty consistent in both markets. So I think that's relatively consistent. And on Koonunga Hill…

Tim Ford

Yes. I'm not aware of – certainly, I'm not aware of any, what I would call, either strategic or systemic price reductions across that part of the portfolio, Ross. I must admit – I was thinking, "I wouldn't mind knowing what your local outlet is and actually going and have a look what he's doing around pricing."

Matthew Young

So – sorry, we can pick. So not to feel like that we've batted that away. I will pick that up with you separately off-line, but they're not quite price points that I recognize, Ross. So happy to do some more work and come back if we need.

Operator

Our next telephone question is from Larry Gandler from Crédit Suisse.

Larry Gandler

Congratulations, Tim, again, for taking the role. Look, in North America, you guys gave some useful assistance on the contribution from premium and Luxury to profit. In China, you're indicating, again, that volumes are flattening, which is great news, but it seems like you're very cautious about Luxury. Which statement should we emphasize in thinking about profitability? Is it that Luxury is not really recovering yet or that volumes are [earning] flat? Can you give us some assistance in Asia as you did in America?

Tim Ford

Yes, sure. Morning, Larry, thank you for that. Good to talk to you again. Look, I mean, Asia and China, in particular, is essentially a luxury market. So our portfolio, you could argue Rawson's Retreat fits in with the Masstige portfolio. So the depletions trends that we outlined can be a read-through in terms of what the luxury depletions are looking like, that's across our total portfolio. And given the center of gravity in Luxury and then the profit pool of luxury in that market, they're a pretty good readthrough, I think, from that point of view.

My point on the – I guess, the – the optimistic view, but also having some caution around it, is we're tracking quite closely, and there's so much information around at the moment. Our sales – and one of the beauty of having so many salespeople on the ground in the different cities and working with our partners in China is that we get a lot of information directly from them. And we're actually tracking consumption on occasions on a weekly basis, and we do see every week, they are continuing, but they are not back to the same level. So when we talk about the celebration, the business dinners, the functions, the big expos that China is famous for, they are only just starting to come back in. And you see now, I'm sure you see it, Larry, a number of other people watch China very closely. We're starting to see those expos, starting to see those conferences, starting to see those events starting to kick-off now.

The other part of China, which is interesting is, there's been a different ramp up rate across the north versus the south versus the east versus the west. The north of China is lagging the other regions across China. So our data that our guys are capturing on a weekly basis and sharing with us suggests that there's still more of a longer recovery in the northern parts of China than there is in the south and the east, in particular, which is sort of the 3 major parts of our business.

So there is a lot of reason to be optimistic in regards to that recovery. However, as I said, the caution should be just on those consumption occasions. So hopefully, that gives you a good guide on how to use the explanation we've given today.

Operator

The next telephone question is from Phillip Kimber from Evans & Partners.

Phillip Kimber

So first question was just trying to triangulate the comments around the U.S. You mentioned the $35 million cost savings from the reorganization. But then you talked about significantly lower volume and selling brands, which I assume had some sort of profit contribution. And then you talked to similar dollar EBIT level going forward, but obviously, higher percentage margin. But just wanted to get a sense of whether the sale of the brands could see a material hole in the numbers? And I guess when you're talking about similar EBIT, are you referring to similar EBIT a year ago? Are you referring to similar EBIT in the second half ? Just because things are moving around so much.

Tim Ford

Yes. Yes. Yes. It's a fair question. Good morning. I think the first part of – I'll answer your last part of your question first. So when we explained the shape and I explained the shape of the, I guess, the vision of what the P&L of the future U.S. business looks like, it is on a pro forma basis, as we exit – as we implement and then exit the parts of the business that we want to. In saying that – and it is a path that we will actually go through. In saying that, I think the key way to think about the U.S. business is the construct of what we have today and the divestiture of brands and assets will have a gross profit component to those brands and assets. However, what you need to be rest assured about is that we will only divest those assets and brands if it is the right financial decision for the business on that balance. So that's a really important point to make as we go through.

If the divestiture doesn't occur and we don't achieve the right price or value as we go through the discussions and negotiations with potential partners. We will, as we've said before, shrink quicker that component of the business over time. So that will get us to the end destination. It's just going to take longer.

I think when I talked about it in April, we gave a timeframe of between sort of 15 to 18 months, I think, 12 to 15 months, something along those lines. And that timeframe allows us the optionality. The quicker path is for us to divest. However, we're not solely reliant on that on achieving the endgame we want to achieve in the U.S.

And with that, in the interest of time, we might take one more question. So apologies, we might have to cut this short today, but also recognize that we'll obviously do another market update in a month's time as part of the full year results. So we'll take one more question, operator, and then I'll wrap up.

Operator

Our last question today is from Niraj Shah from Morgan Stanley.

Niraj-Samip Shah

Just a couple of quick ones for me. One is just that the end state in the U.S. Commercial business. Presumably, there will be a Commercial business ongoing going forward. Just curious on your thoughts on how big that will be relative to what it has been or maybe what it was in fiscal '19? And then my second question is, just around the cost to implement on the $35 million. Just curious as to what that is? And just to confirm, that will be taken below the line in fiscal ’20?

Tim Ford

So I’ll answer the first part, and then I’ll hand over to Matt for the second. Yes, the future shape, and if you go through our priority portfolios that we talk about with the U.S., you’ll see there’s a couple of key brands that are performing – were performing well ahead of the market, which I would classify as differentiated commercial brands, and they would be 19 Crimes and Matua, one out of Australia, one out of New Zealand. Now they are growing significantly ahead of the market. A very good margin contributors, very good profit contributors, and that’s because they are differentiated in the market. And I’m sure you’ve picked up some of the fantastic innovation we’re doing around 19 Crimes in the market in the U.S. over the next 6 months to continue to drive that and the Sauvignon Blanc in the Matua brand category continues to grow.

Now from a price point of view, it’s sort of borderline Masstige, Commercial, from my point of view, the answer to your question is we will have price point one somewhere between that sort of $9, $10 a bottle in the U.S., but they will be differentiated brands, growth brands and solid contributors from a margin percentage going forward, still part of our portfolio on business. It does form a very large volume base still in the U.S. market for us.

Matthew Young

And Niraj, I’ll just touch on the question. There will be costs that we’ve taken in F ’20, they are excluded from the earnings range we’ve given today, so likely be included in material items. And as of today, likely to be around in the $5 million to $10 million range.

Tim Ford

Okay. So before we finish the call, I just wanted to do a quick wrap up, if I could. Firstly, thank you at, obviously, short notice. I know we interrupted some people's plans this morning. So hopefully, it was worth your while. I guess, I just wanted to frame a question I wasn't asked, but I want to answer, which was the reason why we wanted to do a call today, and it was certainly we talked about this with the Chairman and our Board earlier this week with my first Board meeting as CEO was an opportunity just to be proactive and explain the business and where we're at with the business, not only the performance but also some of the market dynamics because I fully appreciate that it is difficult to analyze over the last 3 months as well and it's been difficult to analyze from internally.

So I've got the complete appreciation for the external challenges in doing so. So hopefully, what we've done today is start that ball rolling in terms of coming out. When we had the right information, we could share to give some color, and we certainly will plan to continue to build out that detail as we go through the next month as we get to the August full year results announcements, which will be in more detail.

So I hope we have achieved that goal. I appreciate everyone taking the time and look forward to talking to you again soon into the future. So thank you.

Thanks, operator.

Operator

Ladies and gentlemen, that does conclude the call for today. Thank you for all participating. You may all disconnect. Have a great day.