

Strategic Priorities Update

Report to Town Hall
January 26, 2011

Today

- ▶ Update on Government Activities
 - Industry Performance
 - KPMG Economic Impact Analysis
 - Retail Access Discussions
 - Program Reviews
 - VQA Support Program
 - Marketing Partnership
- ▶ Grape Price Discussions
- ▶ Icewine Definition – CFIA

Industry Performance

- ▶ Focused on how VQA is doing vs imports and ensuring that we are continuing to grow value
- ▶ Also interested in how WCO wineries are performing versus industry
- ▶ Wine Council wineries leading the way

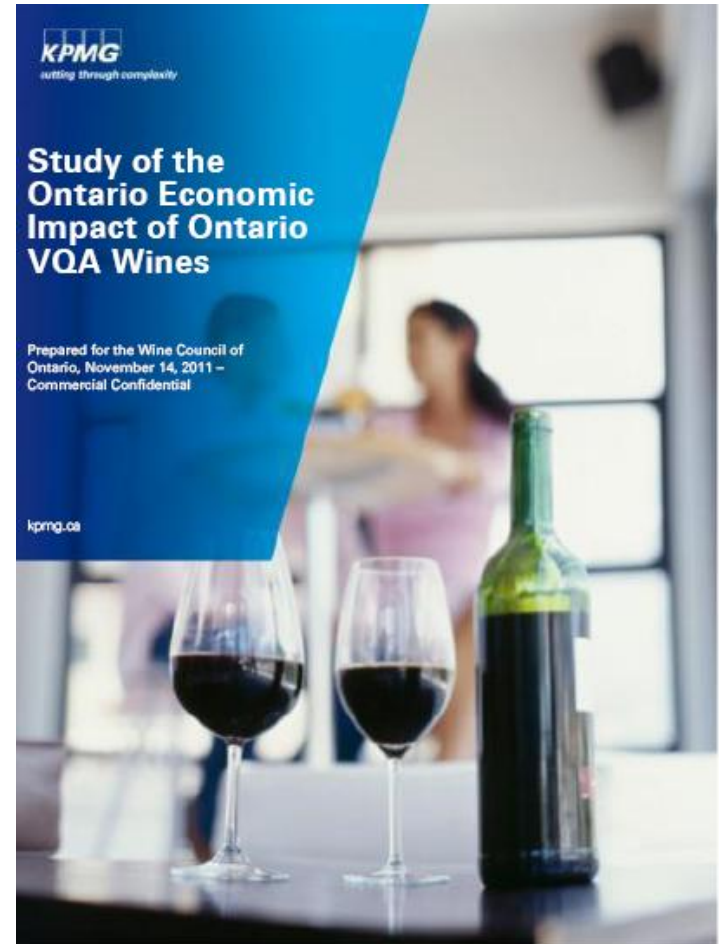
| Fiscal 2010–2011 | Dollar Sales VQA (all channels) | Share \$ | Volume Sales VQA (all channels) | Share Volume | vs Last Year |
|---------------------|---------------------------------------|-------------|---------------------------------------|-----------------|--------------|
| WCO | \$143,984,501 | 51.6% | 7,424,650 | 49.2% | + 10% |
| WGAO | \$135,265,413 | 48.4% | 7,651,367 | 50.8% | – 3% |

Shared Goals for Growth of VQA

- ▶ Agreement across all stakeholders that our success going forward will require us to all:
 - Expand the platform for success of VQA wines and Winery Tourism that supports VQA wineries and wine sales
 - Grow the marketplace for VQA wines
 - More opportunities where all wineries compete
 - Reduce regulatory burdens that challenge business
 - Build on successes in the LCBO to maintain and grow gains in that marketplace
- ▶ Solid foundation for the future
 - Quality platform and investments to support
 - Track record of success for the province

Economic Impact – KPMG Analysis

- ▶ 2011 the Wine Council commissioned KPMG to conduct a new economic impact analysis focused solely on VQA production
- ▶ Required a “start from scratch” approach – previous models too dated to be relevant
- ▶ KPMG utilized the Statistics Canada Interprovincial Input–Output Model 2007 (released in November 2010)
 - Collected new primary data
 - Worked with Stats Can to conduct a model run
- ▶ Developed an analysis and was submitted to the Wine Council in November 2011



Economic Impact – Results

- ▶ KPMG analysis and observations have validated as strong performance for VQA wines for Ontario
 - **1300 incremental jobs** in the past 4 years
 - **Value add of \$191 million** in fiscal year ended March 31, 2011
 - KPMG observed that VQA wines were growing economic impact where other industries were status quo

Ontario Direct and Indirect Value-Added Generated by the Ontario VQA Wine Industry 2010 (\$ millions)

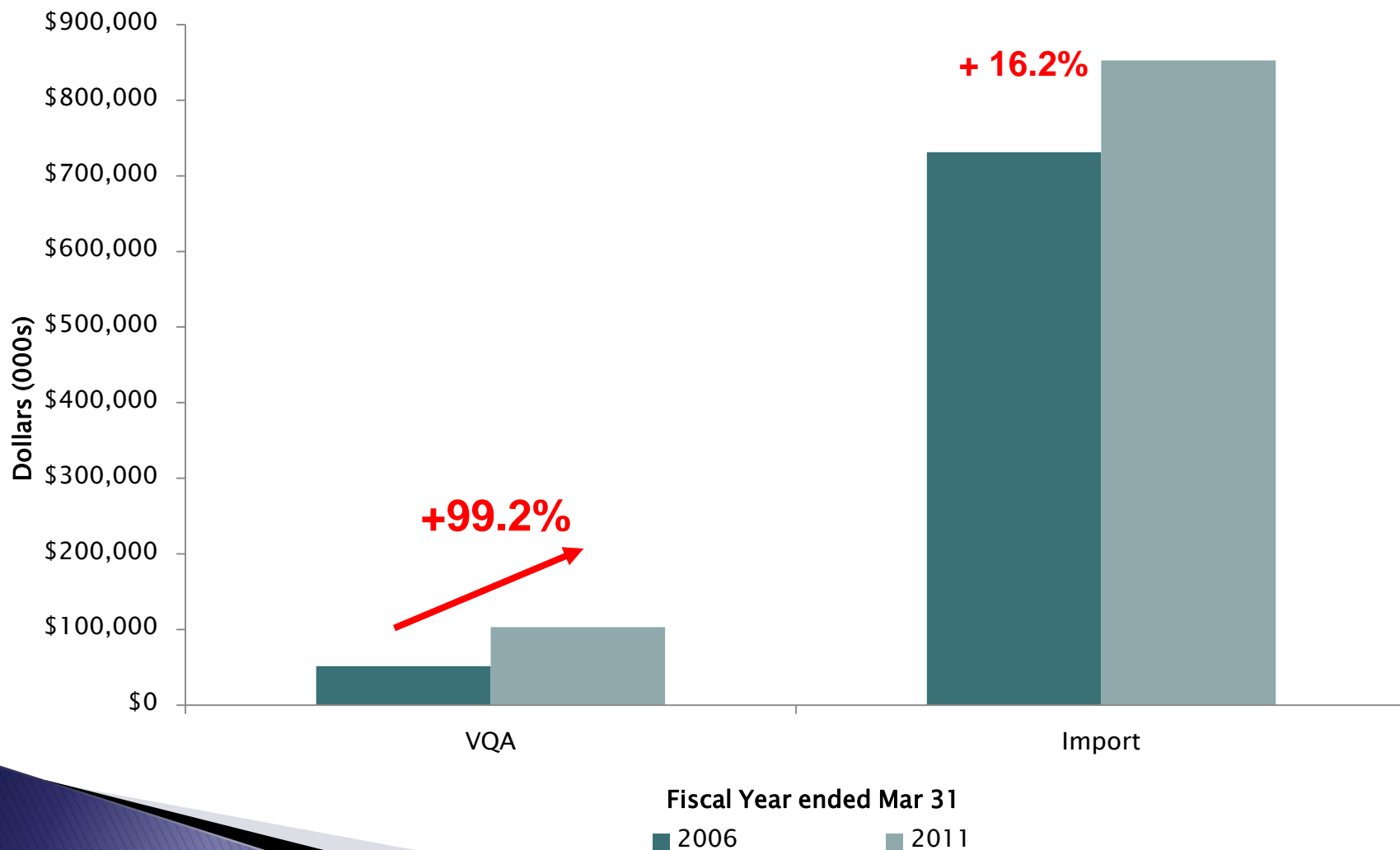
| | VQA Wineries | VQA WRS | Total |
|-------------------|--------------|---------|-------|
| Labour Income | 88.7 | 4.0 | 92.7 |
| Business Income | 66.5 | 3.3 | 69.8 |
| Government Income | 27.4 | 1.3 | 28.8 |
| Total | 182.6 | 8.7 | 191.3 |

Economic Impact = ROI to Ontario

- ▶ **\$12.29 of valued added impact per litre of VQA wine sold**
 - Over and above taxation
 - Up from \$11.50 in 2007
- ▶ Important to appreciate not only the impact but how does that impact measure up versus the direct programs of the Government of Ontario
- ▶ Can use the KPMG analysis in concert with sales to show how significantly the VQA industry has delivered results for the government's investments over this time
- ▶ Drive this analysis from incremental performance at LCBO and sales

Sales of VQA Wine vs Imports, at LCBO

(Source – LCBO period reports)



COMMERCIAL CONFIDENTIAL

Incremental performance versus Government Program investment 2007–2011 (000's)

| | | | | | | | | | | | | | | | |
|--|---|--|--|--|--|--|--|--|--|------------------------------|--|----|--------|--------|---------|
| Cumulative difference in net dollar sales for 5 years: | | | | | | | | | | | | | | \$ | 115,881 |
| | | | | | | | | | | | | | | | |
| Government REVENUES from these sales (total for the 5 years): | | | | | | | | | | Province of Ontario – direct | | | \$ | 12,867 | |
| | | | | | | | | | | LCBO | | | | 53,045 | |
| | | | | | | | | | | | | | | 65,912 | |
| Government PROGRAM INVESTMENT in Industry (total for the 5 years): | | | | | | | | | | | | | | | |
| | 2007 through 2010 – \$2 million per year in MEDT marketing funding | | | | | | | | | | | \$ | 8,000 | | |
| | Additional MEDT funding, 2009 | | | | | | | | | | | | 200 | | |
| | 2011 – \$3 million in MEDT marketing funding | | | | | | | | | | | | 3,000 | | |
| | 2007 through 2009 – \$10 million in VQA Support Program funding | | | | | | | | | | | | 10,000 | | |
| | 2010 through 2011 – \$6 million in annual VQA Support Program funding | | | | | | | | | | | | 12,000 | 33,200 | |
| | | | | | | | | | | | | | | | |
| REVENUES IN EXCESS OF INVESTMENT: | | | | | | | | | | | | | \$ | 32,712 | |
| | | | | | | | | | | | | | | | |
| RETURN ON INVESTMENT OVER THE 5 YEAR PERIOD: | | | | | | | | | | | | | | 100% | |
| | | | | | | | | | | | | | | | |

And appreciating the multiplier.....

| Description | Dollars (2007–2011) (000's) |
|--|-----------------------------|
| Net government revenues | \$ 32,712 |
| Multiplier on incremental litres @ \$12.29/litre | \$ 108,000 |
| TOTAL NET CONTRIBUTION | \$ 140,712 |

Communicating this message

- ▶ Press release of report imminent
- ▶ Ongoing communication of key numbers to media, government and stakeholders
- ▶ Tools for winery use
 - Report to be posted on WCO Member Site
 - Printable posters for use in winery, for use with trade etc
 - Available shortly – watch the eblast

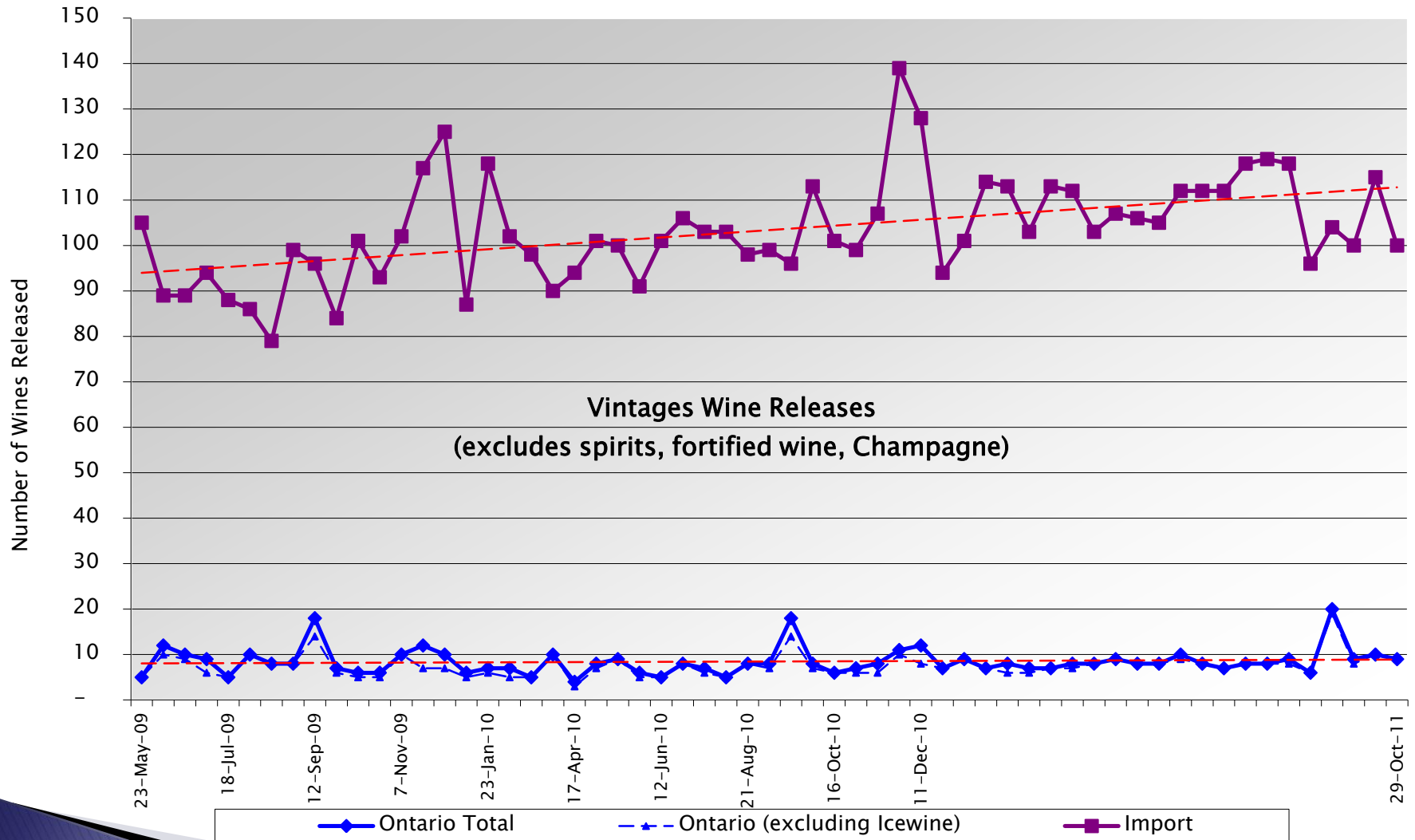
Challenges in maintaining momentum

- ▶ Concerns that in our biggest shared channel our ability to maintain or reinvigorate our momentum will be an issue
- ▶ Systemic challenges in maintaining listings
 - Crisis of success
 - New product being forced into the system which challenges the shelf space, even with the additional 20%
 - Not reasonable to expect the LCBO to generate more incremental shelf space in that volume again (though it would be welcome!)
- ▶ Hard to get the economies of scale for some growing small – medium size wineries
 - Can't rely on consistent relationship with LCBO as the customer
 - Risky to invest in inventory without other prospects

Challenges in maintaining momentum

- ▶ The LCBO can't offer significant enough space where our category needs to grow
 - Simply no business model in the LCBO that allows for brand building at premium price points
 - VINTAGES is designed for 120 new products every 2 weeks
 - Performance/sell through \neq reorders and brand presence
 - Premium (+\$15) is where this business needs to continue to grow and VINTAGES is the channel best suited to those price points
 - VQA releases continue to stagnate even in these years of incredible category performance

Vintages Releases



Vintages Releases

| Dates | Total Ontario Releases | Avg # Per Release | Avg % Per Release | Total Non-Ontario Releases | Avg # Per Release | Avg % Per Release |
|------------------------------|------------------------|-------------------|-------------------|----------------------------|-------------------|-------------------|
| May 23, 2009 -Dec 31 2009 | 136 | 9.07 | 9 % | 1447 | 96.47 | 91 % |
| Calendar 2010 | 173 | 7.86 | 7 % | 2274 | 103.36 | 93 % |
| Jan 1, 2011 - Present | 190 | 8.64 | 7 % | 2377 | 108.05 | 93 % |
| Analysis Total | 499 | | 8 % | 6098 | | 92 % |

Growing the Market

- ▶ Now more than ever there is a need to grow market to provide opportunities
- ▶ We know that government has been reticent to consider additional retail channels beyond the LCBO
 - We know that we can alleviate some of government's previous expressed concerns
- ▶ We feel that we have developed and refined a model that makes sense for all
 - Wineries, Government, Growers, LCBO

New Private Wine Stores

- ▶ To answer our questions and the questions raised by the government, we augmented our initial work with Grant Thornton and did the following:
 - Invested significant time and effort into building and maximizing industry performance at the LCBO
 - Public opinion research – presented to FIN and other key government and opposition stakeholders which illustrated consumer comfort with the proposed model as well as a desire for more points of access
 - Asked Grant Thornton to extend their work on the wine store model to project revenues
 - Commissioned work with Fraser Milner Casgrain – both their public policy and international trade practice to work with us to analyze legislative and regulatory options with a view to being able to propose a model to the government

Grant Thornton Report

- ▶ Building on its earlier work, Grant Thornton was asked by the Wine Council to build on its store modeling to assess the impact of the proposed model to each potential impacted stakeholder, but primarily the government in terms of revenue
- ▶ Success factors that were mandatory:
 - Net increase in revenues to the Province
 - No net loss in revenue to LCBO
 - Financial viability for Ontario wineries
 - Financial viability for the retailer
 - A pricing structure that would not undercut the current pricing structure for similar wines carried at the LCBO
- ▶ Analysis layered on retail model considered in 2007
 - Stores at high, med, low rent models
 - Break even after 3 years

Grant Thornton key issue – Market continues to be underserved

| Jurisdiction | Population | Retail Outlets | Population per Store | Consumption Per Capita |
|----------------------------|------------|----------------|----------------------|------------------------|
| Ontario | 13,100,000 | 1,262 | 10,380 | 13.7 litres |
| Alberta | 3,700,000 | 1,690 | 2,189 | 15.9 litres |
| British Columbia | 4,500,000 | 1,303 | 3,454 | 19.7 litres |
| Canada | 33,700,000 | | | 15.9 litres |
| Canada (excluding Ontario) | 20,600,000 | | | 17.3 litres |

- ▶ After updating data from the previous study (2009 data vs 2003 data) it was clear that the increase in the number of retail outlets in Ontario has kept pace with population growth
 - ▶ Population per store remains virtually unchanged and well above the other provinces
 - ▶ Consumption per capita in Ontario has increased since 2003, but has not increased at same rate as Canadian average
- ▶ Grant Thornton concluded that it would be reasonable to assume that increased retail access could be supported by an increased consumption per capita, more in line with other jurisdictions and approaching the national average

Grant Thornton Report – Conclusions

- ▶ Creation of stores with proposed model will meet goals of Wine Council and for VQA wineries
- ▶ Sales generated by this new channel will increase taxes collected by Provincial and Federal governments
- ▶ With an increase in sales and consumption, VQA wineries will have to increase production and demand, and imports will also increase
 - With this increase the two levels of government will collect significant additional taxes (HST, excise, wine basic tax, volume tax, environmental tax)
- ▶ This new channel will allow for increased distribution and sale of VQA wine

Grant Thornton Report

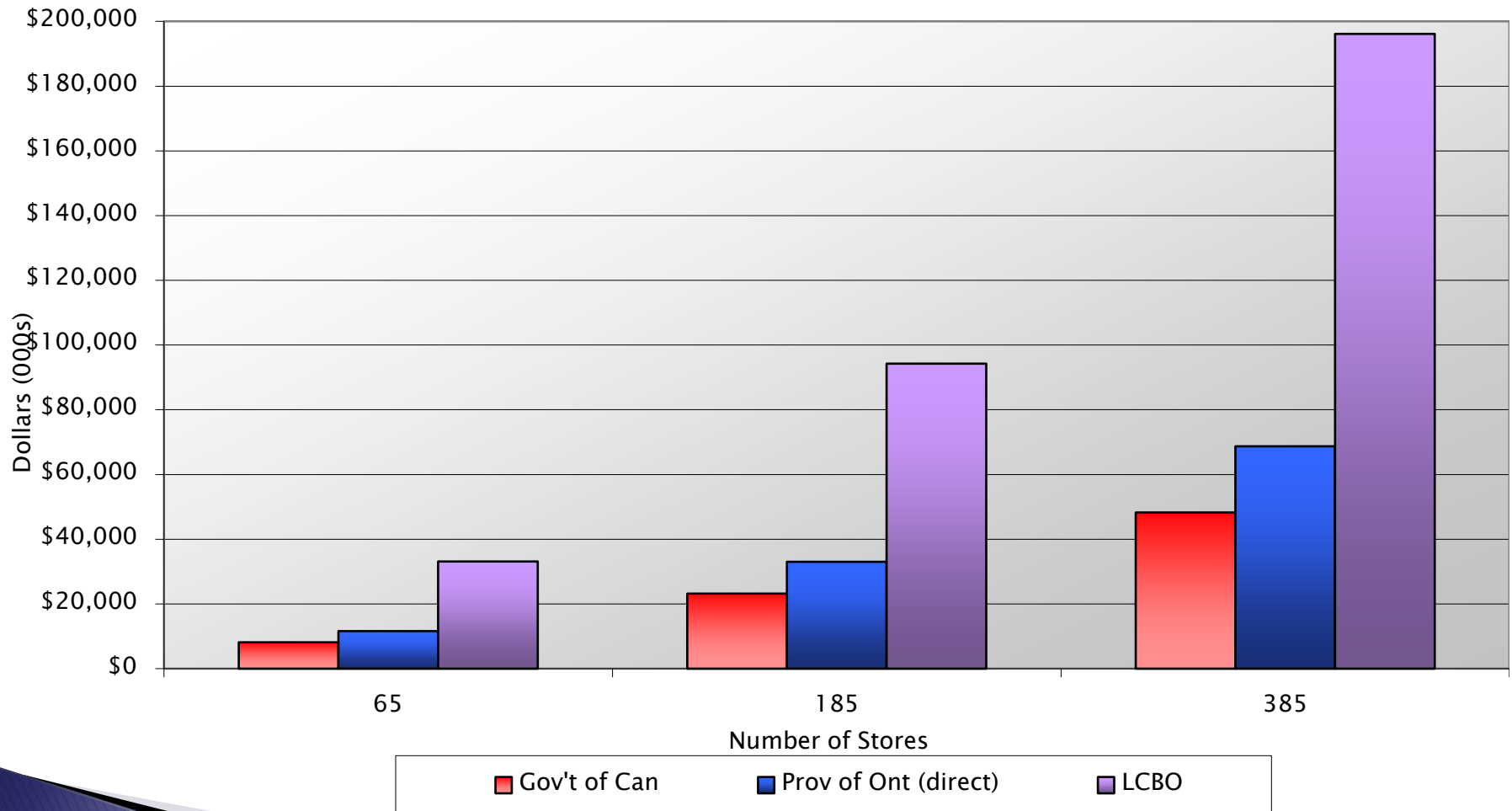
Summary of Annual Incremental Revenues to Ontario (for 3 scenarios of VQA market share – 5%, 10%, 20%)

All \$\$ amounts in 000s

| Number of Stores | 5% | | | 10% | | | 20% | | |
|---------------------|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| | Direct | LCBO | Total | Direct | LCBO | Total | Direct | LCBO | Total |
| 65 | \$10,900 | \$38,500 | \$49,400 | \$11,100 | \$36,700 | \$47,800 | \$11,600 | \$33,100 | \$44,700 |
| 185 | 31,100 | 109,600 | 140,700 | 31,700 | 104,500 | 136,200 | 33,000 | 94,300 | 127,300 |
| 385 | 64,600 | 228,200 | 292,800 | 66,000 | 217,500 | 283,500 | 68,700 | 196,100 | 264,800 |

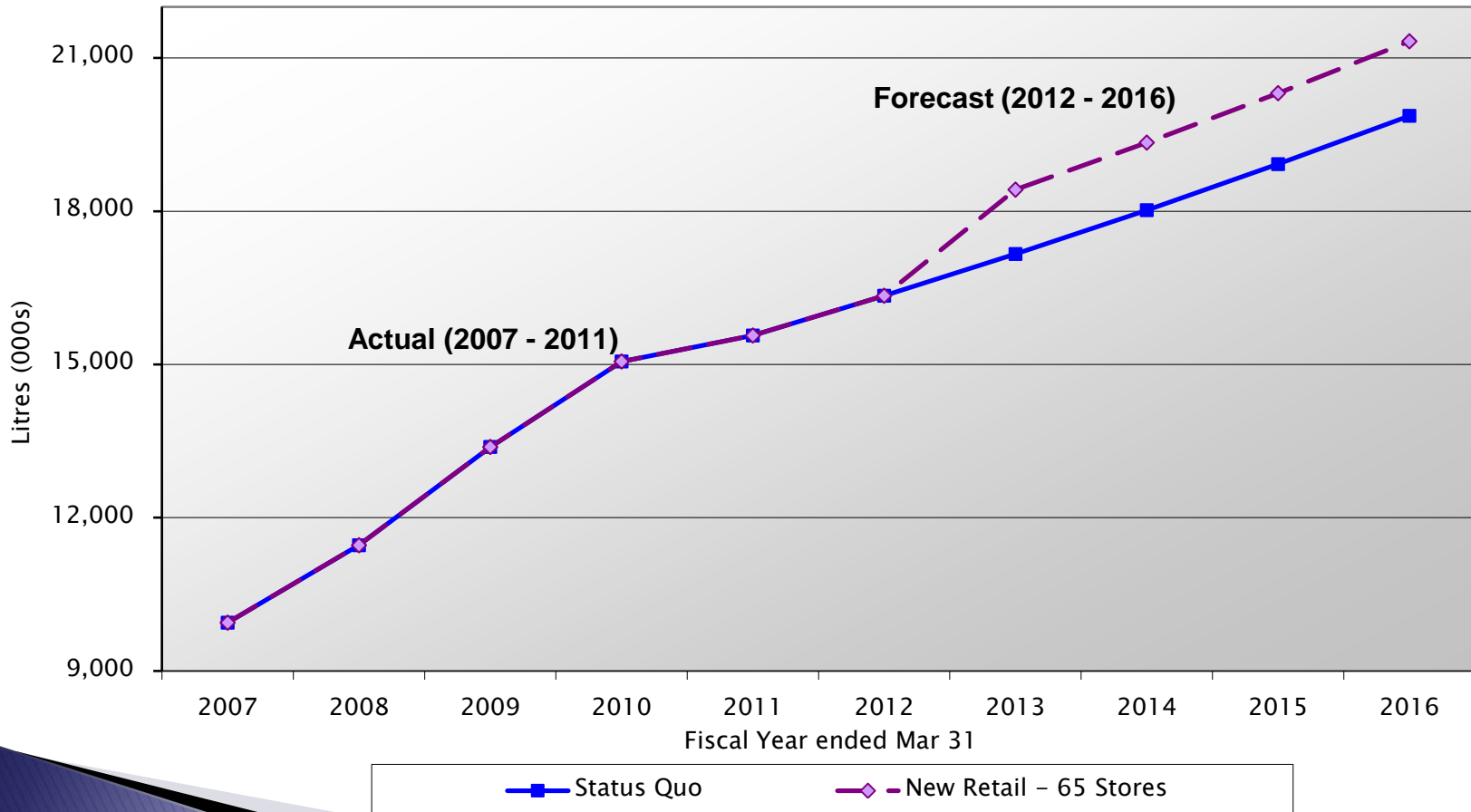
Results immediately positive

Incremental ANNUAL Government Revenues with Additional Retail Stores



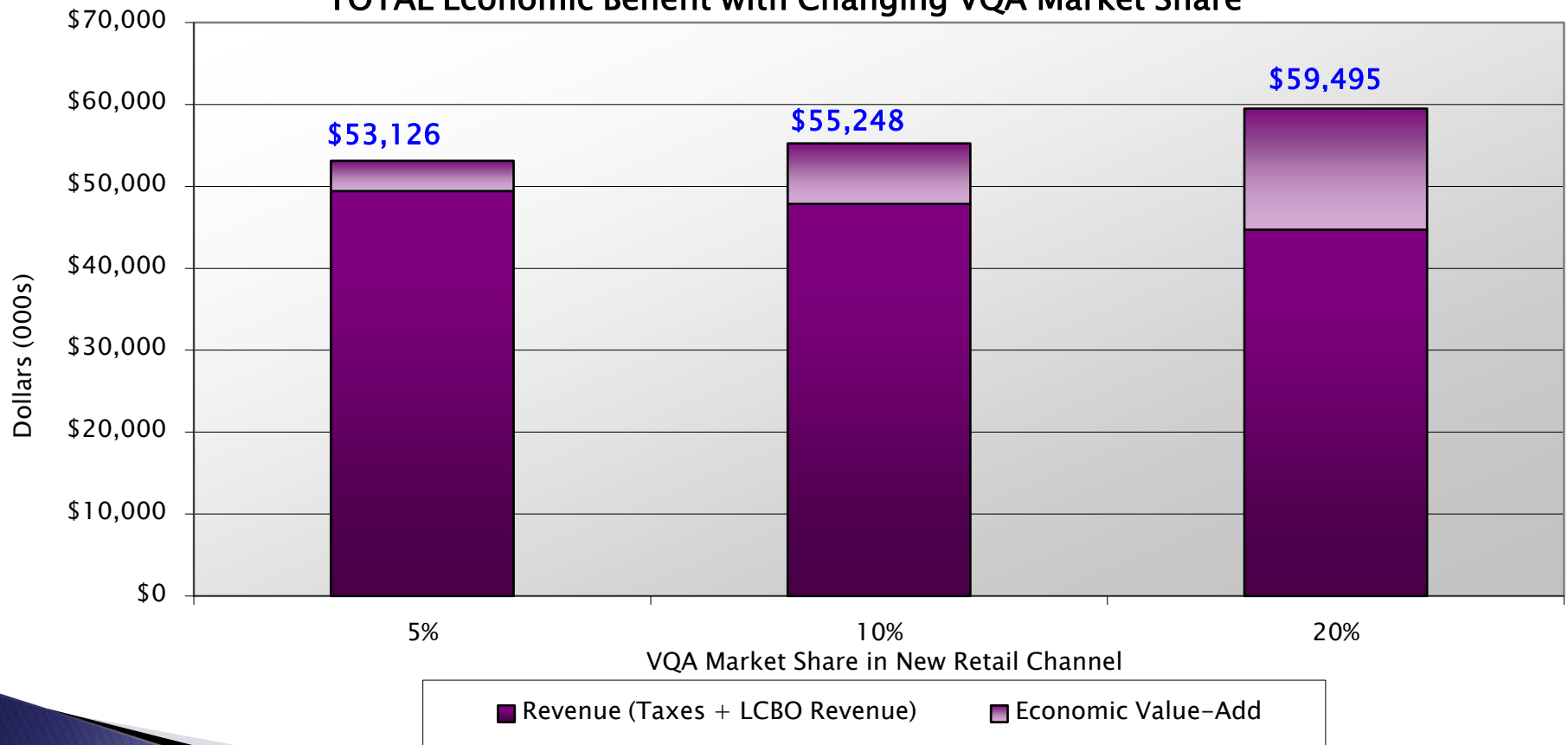
Incremental impact vs Status Quo

Annual Sales of VQA Wine – Volume
(Assuming 65 new stores / 20% VQA market share)



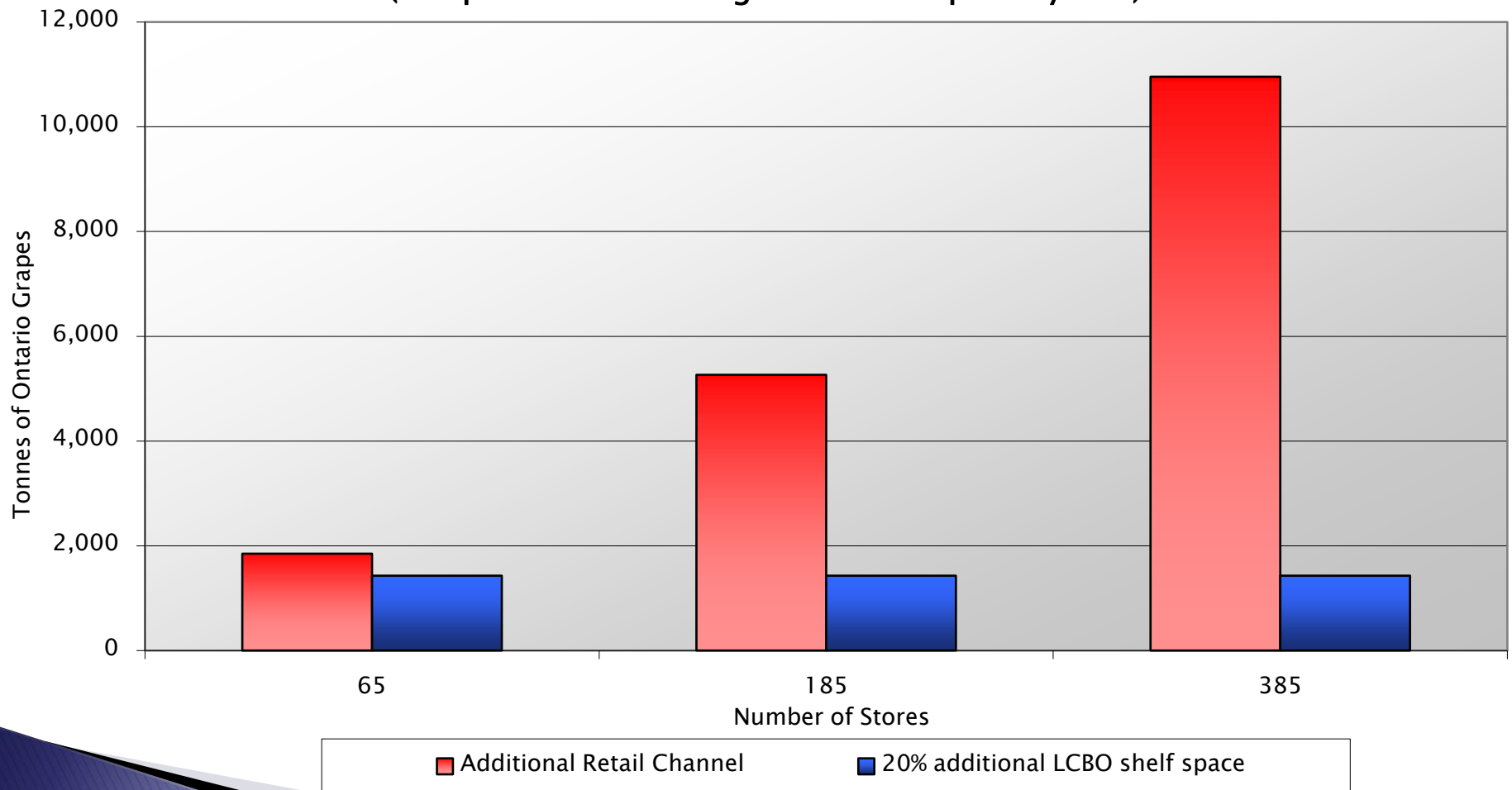
No downside to growing VQA share in new channel

Additional Retail Channel – 65 Stores
TOTAL Economic Benefit with Changing VQA Market Share

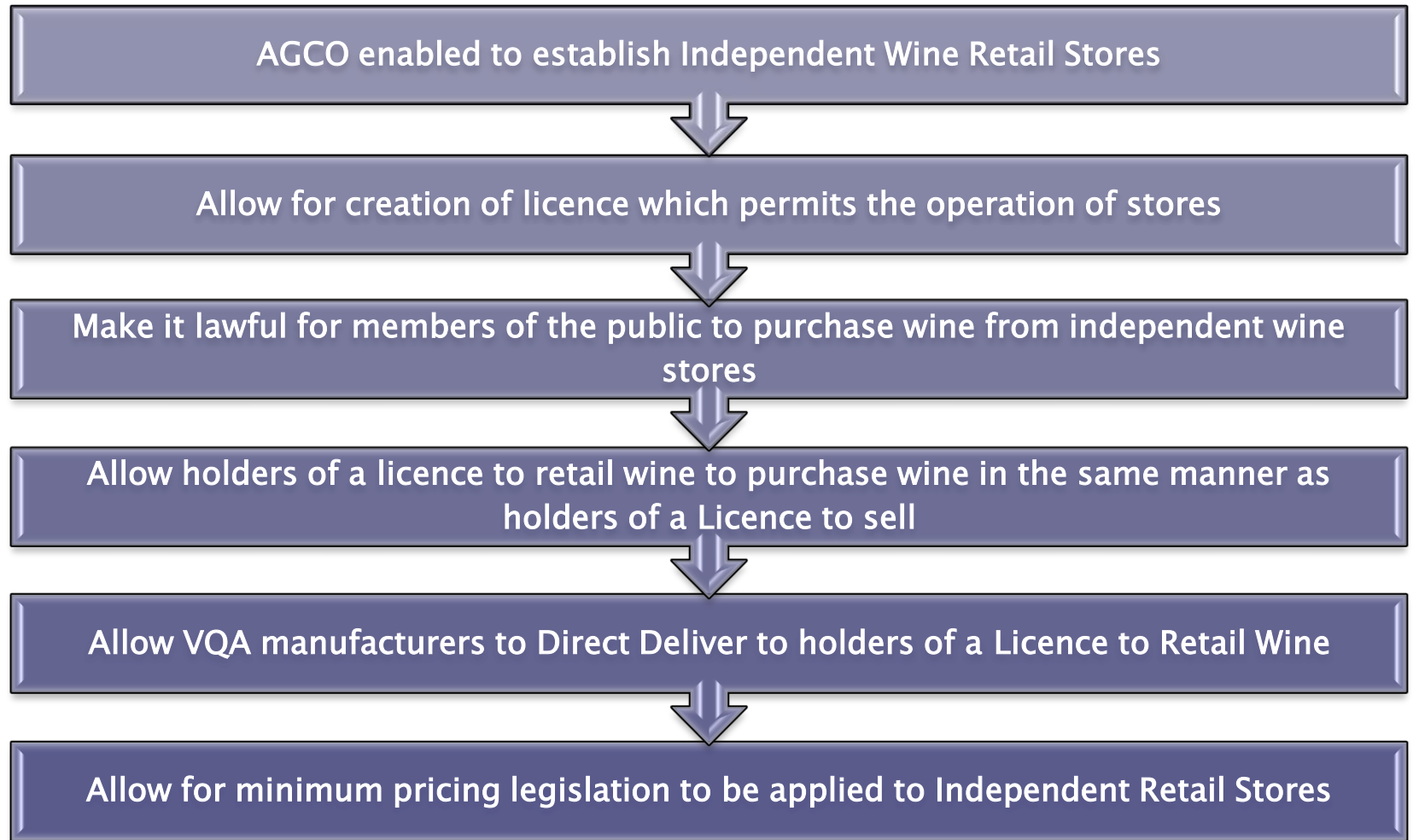


Better outcome for growers

Incremental ANNUAL Ontario Grapes used in Additional Retail Stores
(compared to increasing LCBO shelf space by 20%)



The path to a model is simple



Status of our Work – Retail Access

▶ Government

- Revising and reframing proposal to address concerns
 - Meeting to be set with MIN of FIN in mid February when work complete
 - Meeting with Minister of FIN and Premier's Office can follow once this meeting complete
- Key concerns
 - Markup structure – need to preserve uniform pricing – we feel we can address through illustration that:
 - There really is not uniform pricing at retail when you start from the same price at wholesale
 - That the structure is reasonable and defensible given markups that exist already (LCBO, WRS, DD, Duty Free)
 - Framing the issue around growing consumption
 - Want to take this head on with them – frankly this is the basis of the whole LCBO business plan – why should we be expected to only propose models that grow within a fixed market?
 - Feel that we can use model to illustrate that even if there was 100% cannibalization of the business from the LCBO (no growth in market) that this model still produces more revenues for the province
 - Differentiated markup/Trade issues
 - Like it was in DD to licensee, while this practice is still technically trade illegal, it is in line with common practice among all of our key competitor jurisdictions (ie US – 3 tier). Will still take political will given the technical trade violation.

Status of our Work – Retail Access

▶ Government

- Key focus of next presentation is on choices
- Primary point of agreement that we need is on the scope of the problem – what are the cases that we are looking to sell
 - Need to illustrate challenges with looking to other avenues (ie LCBO) to solve our problems
 - If the opportunity to sell in a private channel is XXX cases, what are the ways that the LCBO can sell that equivalent number of cases at the expected prices
 - Areas we are looking at – relief on merchandising, number of releases it would take in Vintages at current market performance to achieve same objectives, number of skus/facings they would have to add to accommodate
 - Don't know the answer yet but assume that when contrasted with private option “forcing” them through LCBO will end up being the more unwieldy and expensive option
- In the middle of all of this could come options not contemplated by us that might emerge through Drummond

Program Reviews

- ▶ Discussed at last Town Hall – government has not kicked off discussions yet but plan to in the next few weeks
 - Gov't will be reviewing marketing dollars (\$3 million per year), and VQA Support Program (\$6 million per year)
 - Both are in 2nd year of 5 year program allocation
 - Key issues
 - Are programs delivering as expected?
 - Best use of dollars?
 - On both fronts we feel very confident that the reviews will support a continuation of both programs on the same basis
 - Members should note that WGAO wineries will be arguing that they should receive a disproportionate share of VQA support program and have asked that resources be redirected from small wineries to large wineries (“Fair Share”).
 - Once the format of the review is confirmed we will be asking you as members to engage in whatever way makes the most sense – your voices will be critical!!!

Grape Price Discussions

- ▶ Still in active discussions on price for next year
 - Since last meeting WCO position has prevailed and become position of processors
 - Proposing zero price increases, continue plateau
 - GGO wants to make some tweaks to setting base price but nothing impactful
 - Hopeful that the GGO will agree to pricing soon in order to move issue forward
 - If they are keen to do “regular” negotiations we won’t be moving quickly

Icewine Definition

Background:

- ▶ On January 16, 2012, the Canadian Food inspection Agency (CFIA) initiated a 30-day consultation on a proposed Icewine definition that stipulates “grapes naturally frozen on the vine.”
- ▶ Why is this important – Canada is a world leader in Icewine and the wine industry here has worked hard to ensure that the international community formally recognizes the traditional method of making Icewine, which stipulates, among other things, that Icewine be made only from grapes naturally frozen on the vine.
 - We have worked diligently on this to ensure Canada’s strength in producing traditional Icewine is not undermined by counterfeit products and cheap knockoffs.
 - Canada has successfully negotiated several international agreements that protect Canada’s position as a global leader in Icewine.
 - While Icewine producing provinces such as Nova Scotia, Ontario and British Columbia already have definitions in place, we obviously want to demonstrate that we impose the traditional Icewine definition on ourselves at the national level as well.

Icewine Definition

Challenge

- ▶ The Association des Vignerons du Québec (AVQ) contacted the Prime Ministers' Office to complain that the proposed definition was not in line with their practice of clipping grapes and hanging them in netting above the vine until frozen.
- ▶ The definition proposed by the CFIA is the bare minimum. There are several other production standards that should probably be included, such as the temperature at which the grapes can be picked, the requirement that the grapes be crushed in this frozen state, etc.
 - There are provincial standards in Nova Scotia, Ontario and British Columbia that go beyond what the CFIA is proposing. It is important that the national standard does not unintentionally circumvent the tougher standards the provinces have imposed on themselves.

Icewine Definition

Why do we have to engage?

- ▶ Canada risks being thrown out of the World Wine Trade Group (WWTG) if it does not meet its commitment to have a national standard in place by December 31, 2012 deadline.
 - This would impact Canada's ability to sell not just Icewine but any wine into WWTG member countries.
 - It could potentially also impact our access to Asian and European markets as well.

Next Steps

- ▶ We will be circulating some draft template letters for CFIA to be submitted during their comment period – members are encouraged to act when this material comes out.
 - Number of voices is critical

Questions?