



WINE COUNCIL  
OF ONTARIO



# BUILDING ON SUCCESS

## - NEXT STEPS FOR GROWING VQA PERFORMANCE FOR ONTARIO

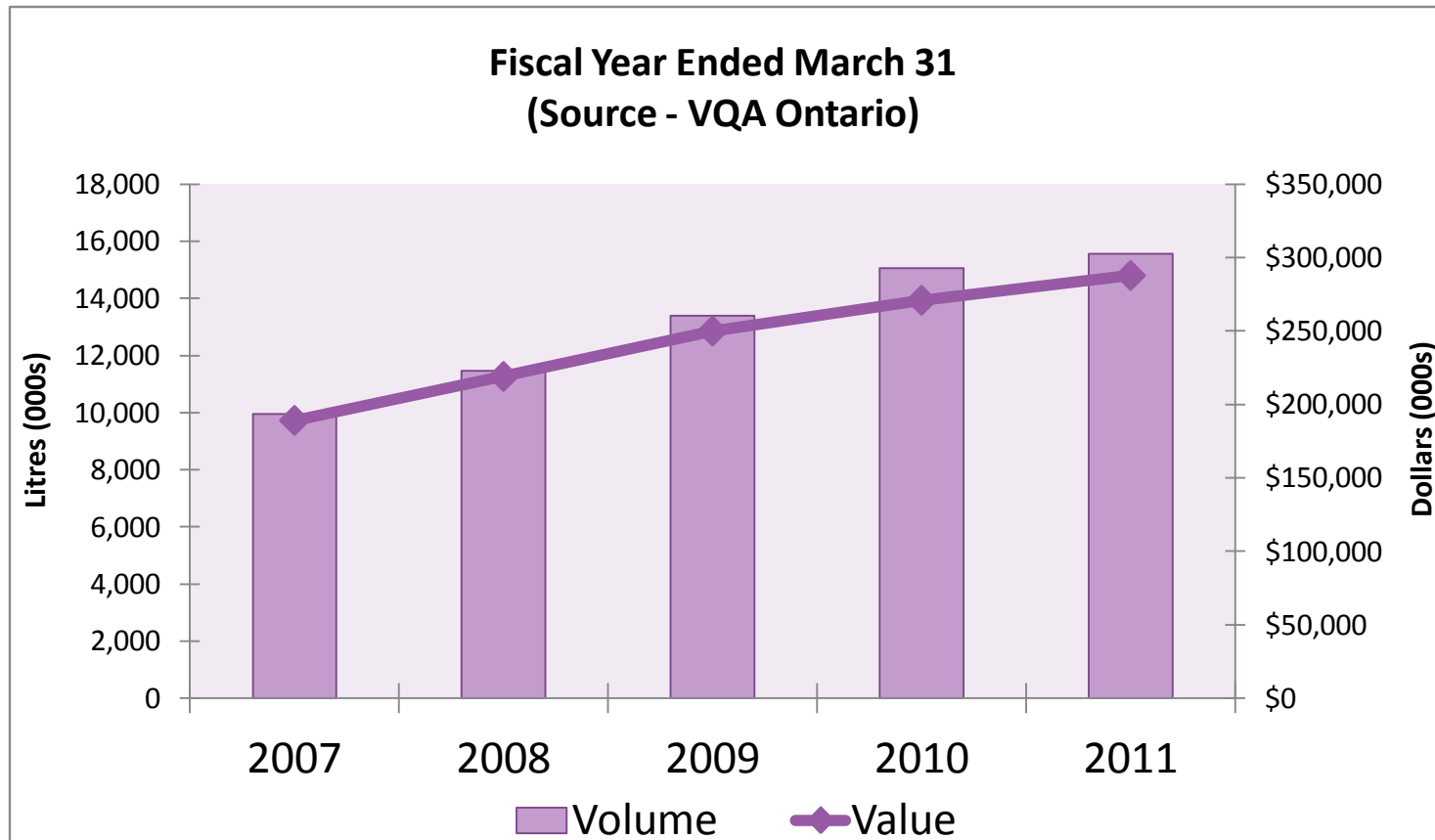
Presentation to the Hon. Dwight Duncan

Minister of Finance

April 23, 2012

COMMERCIAL CONFIDENTIAL

# ANNUAL SALES OF VQA WINE - VOLUME & VALUE GROWTH

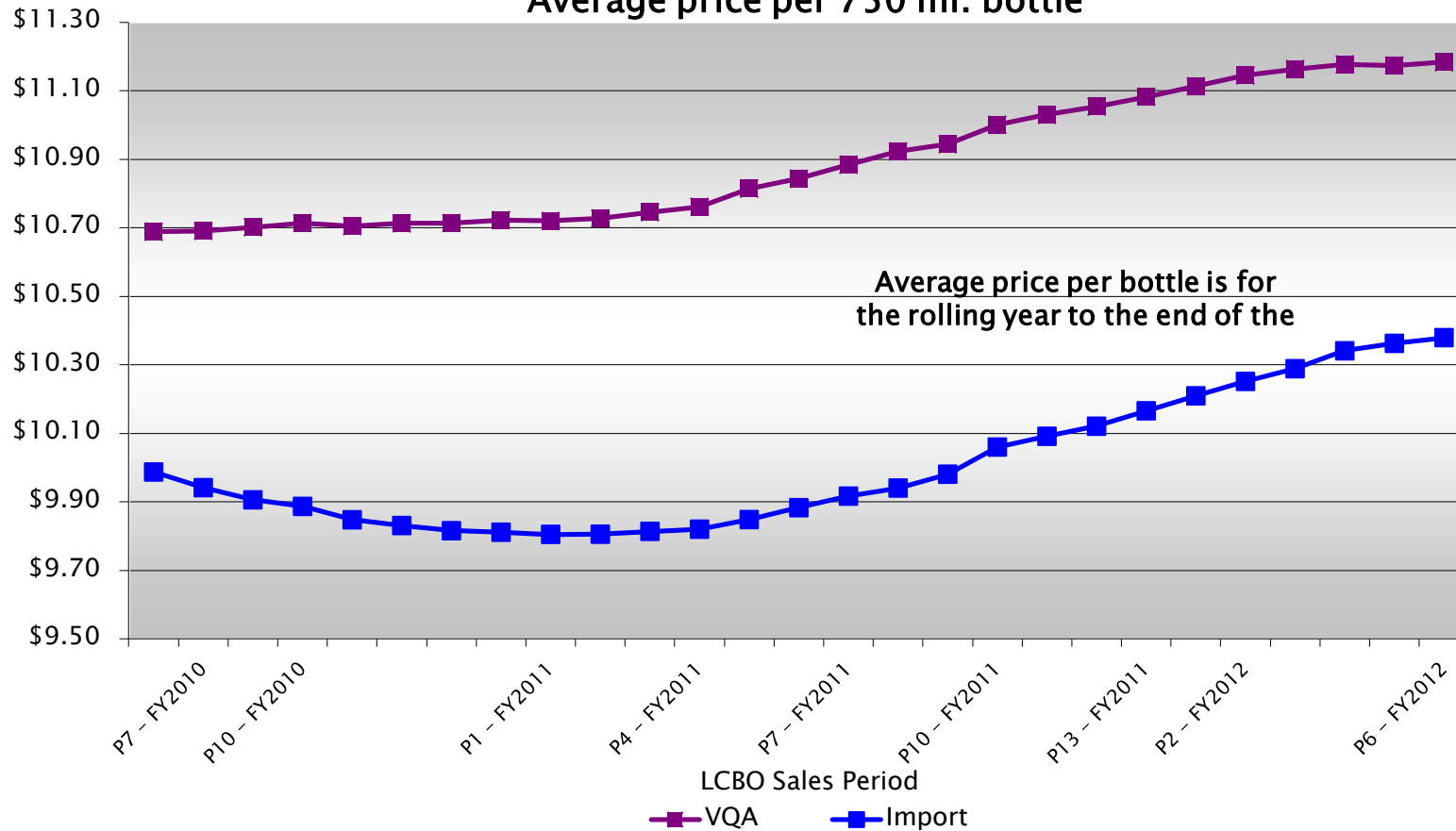


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# PREMIUMIZATION EVEN DURING RECESSION

LCBO – Total LCBO Wines and Vintages  
Average price per 750 ml. bottle



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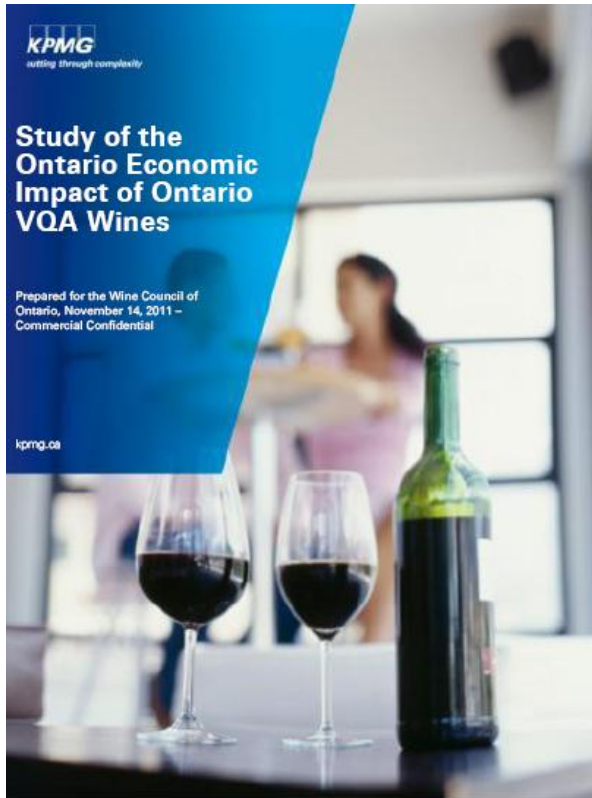
# POLICIES FOR YEARS HAVE SUPPORTED THIS RATE OF GROWTH FOR THE INDUSTRY

- ▶ Greenbelt
- ▶ Wine Content Act to 40% (until 2015)
- ▶ Federal and Provincial tender fruit replacement/grape replant programs
- ▶ OMAFRA/FedDev Ontario initiatives
  - Manufacturing supports to encourage growth in capacity
  - OVIP dollars designed to encourage growth of quality in viticulture to support VQA
- ▶ VQA Support Program
- ▶ Tobacco transition dollars
  - Wine Grapes are now becoming key transitional crop in tobacco belt
  - Regions like Norfolk County have now built growth and development of wine grapes and wineries as core economic driver (like Prince Edward County had done – the model)
- ▶ Proactive and successful partnership with LCBO to grow VQA performance
  - Increase in shelf space to accommodate capacity
  - # of wineries in LCBO up from 37 in fiscal ended 2007 to 63 in fiscal ended 2011 (and continues to grow)





# AND DRIVEN GOOD RESULTS FOR THE PROVINCE....



- ▶ KPMG analysis and observations have validated a 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
- ▶ **\$12.29 of valued added impact per litre of VQA wine sold**
  - Over and above taxation
  - Up from \$11.50 in 2007
- ▶ Clearly there is value to getting this wine to market and realizing the benefits of this wine to the economy, the next question is how and where



# YOUR CHALLENGE TO US...

- Tell us what the issues are with maintaining these great results
- Appreciate that the government is challenged financially when you propose solutions
- Tell us what the Ministry and the government can do to help



# OUR CORE ISSUE: LIMITATIONS OF RETAIL CHANNELS

- Analysis tells us that we have 500,000 cases of commercially viable wine that will need a market over the next 3 years
  - Over and above those that can be accommodated by forecast growth in all retail channels (LCBO, Direct Delivery to trade, Export, Interprovincial, Duty Free, Sales at Winery)
  - Why does this matter?
    - 500,000 cases can generate up to \$35 million in direct revenues for the province and generate over \$55 million in additional economic impact as well as causing demand for another 6,400 tonnes of grapes
- In the biggest channel – the LCBO - our ability to maintain or reinvigorate our momentum will be an issue
  - Costs of doing business escalating significantly
  - 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, if not impossible, 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



# ONE APPROACH - PRIVATE RETAIL

- ◉ We have proposed to government that they need to look beyond the LCBO to diversify access points for the consumer and drive revenue for the province
  - In line with the retail models in other provinces, especially those with wine producing regions (NS, BC, Quebec)
- ◉ Framed our approach in a way that aligned with the government's priorities
  - Responsiveness to the marketplace and consumer demand
  - Lessening the burden of capital costs on the public purse
  - Propose solutions that appreciate the potential for economic development and driving value into the economy
- ◉ Supported the analysis with research and support
  - Public opinion research
  - Retail store analysis – Grant Thornton LLP
  - Legislative, Regulator and Trade Review – Fraser Milner Casgrain
- ◉ Opportunity for government to grow marketplace without risk, capital investment
  - Potential of hundreds of millions in new revenue
- ◉ **We understand that the government is not interested in growing the market in this way at this time and our keen to understand the shortcomings of the model from your perspective**





# WITH NO NEW CHANNEL, THE TASK FALLS TO THE LCBO AND THE OUTLOOK IS CHALLENGING

## ► The Good News:

- ▶ VQA wines continue to perform well in this channel
  - This is our most important channel in terms of volume
- ▶ Growth in higher price bands remains strong and will found the strategy for continuing to grow VQA in this category going forward
  - Shari Mogk-Edwards – “you are a premium priced business in our portfolio”
  - Our 500,000 cases that need a home are primarily premium priced wines that need to be sold with other premium priced wines so their production and pricing is aligned with strategy

## ► The Bad News:

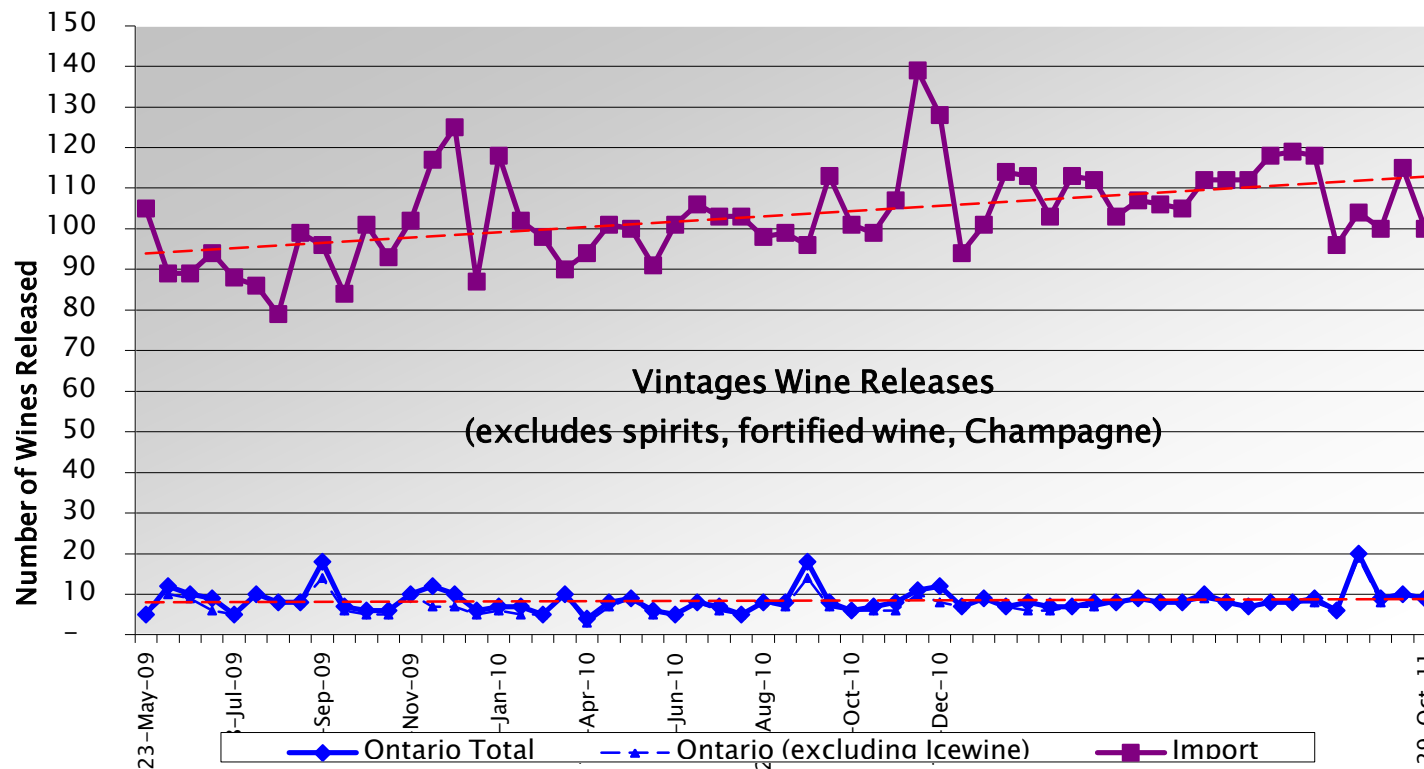
- VQA wines are becoming less competitive as the costs of merchandising increase at the LCBO
- This is our most challenging channel in terms of margin
- It seems almost impossible for the LCBO to accommodate an additional 500,000+ cases (beyond forecasted sales growth) by the end of 3 years



# ISSUE #1 - OUR ONLY PREMIUM CHANNEL - VINTAGES

## - IS NOT BUILT TO FILL THE GAP

- ▶ What does the current business look like for VQA ?
  - ▶ 200 releases per year divided amongst 120 commercial wineries
  - ▶ No growth in number of releases even with “aggressive” strategy



# ISSUE #1 - OUR ONLY PREMIUM CHANNEL - VINTAGES - IS NOT BUILT TO FILL THE GAP

- ▶ What does 500,000 cases look like in terms of the Vintages business?
  - Average Vintages release declining (focus on sell through targets for channel) – one time releases, no opportunity to build business consistently
  - Clear message to industry to expect less volume for orders not more from the buyers
  - At an average of 125 cases per order, unlikely that Vintages could release all of this volume of wine
    - **Would mean 4000 releases – currently VQA has 200 per year**
  - Opportunity to distribute is limited
    - 5 stores (1500-2000 skus each), 62 Boutiques (800-1500 skus), 147 corners (50-800 skus)
    - No planogram, no measure of linear feet of product, no accountability of Product Consultants to buyers/sales
    - Almost impossible to plan and execute a significant growth strategy in this channel
  - **Our most successful wineries are having their least successful years in Vintages – that is concerning for the future of our premium business**



## ISSUE #2 - VOLUME DRIVEN CHANNEL - LCBO WINES - CAN'T ACCOMMODATE VOLUME OR PRICE POINT

- ▶ LCBO Wines Channel more able to accommodate volume, but not premium pricing
  - Only 4.8% of sales in this channel are priced over \$15
- ▶ On average, distribution is around 200 stores per sku (very few have distribution throughout the system)
- ▶ Sales performance takes time
  - Wines to Watch program (expectation that over 1000 cases in 3<sup>rd</sup> year)
  - Best performing skus sell 5,000-7,000 cases in red and 6,000-10,000 cases in whites
- ▶ Shelves are full
  - Challenging to keep listings
  - Constant craving for “new” from the buyers – churn and burn approach does not favour brand building and has helped generate some of this new pressure – need for new brands as well as supporting existing performers

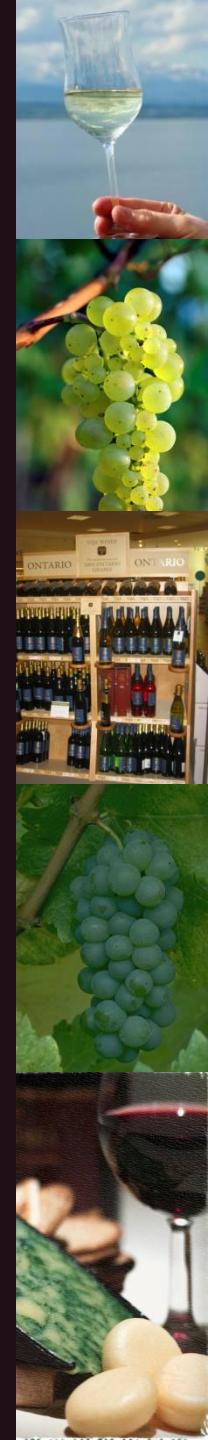




# ISSUE #3 - THE GROWING COSTS OF DOING BUSINESS AT LCBO ARE CRUSHING ANY MARGINS

- Pressure on the LCBO to increase returns to government has incited them to aggressively raise fees to all suppliers
- For VQA producers these increases are now effectively eroding the support from the VQA support program
- Many programs designed to support VQA (and very successful) now have significant fees
- Gross profit (before manufacturing costs) is down 10%

Winery Revenue for Sales through LCBO FOR 3,000 CASES (2 SKUs at quota of about 1,500 cases per year)		
	Pre container deposit	April 2012
Winery Revenue from sale to LCBO	\$ 204,664	\$ 211,177
<b>Display Merchandising Costs:</b>		
End Aisle	13,333	13,333
Fridge Space	-	13,625
1 Pod display for 1 period per year	-	6,775
Shelf Extender	13,000	13,000
Superstars	-	3,000
<b>Support Merchandising Costs:</b>		
\$1.00 LTO	1,900	3,100
Bonus Air Miles (BAM)	2,325	3,693
1 FSI per year	7,000	9,200
1 shelf talker for 1 period per year	500	700
<b>Other Program Costs:</b>		
Tasting Fees	5,250	6,400
Shopping Cart	-	?
<b>Total Merchandising Costs:</b>	<b>\$ 43,308</b>	<b>\$ 72,826</b>
<b>Offset by 30% VQA support - assumed full support:</b>	<b>61,399</b>	<b>63,353</b>
<b>Excess / (Deficiency)</b>	<b>18,091</b>	<b>(9,473)</b>
Gross Profit to winery	<b>\$ 222,755</b>	<b>\$ 201,704</b>
OTHER - charges for Sale of Data information:		<b>Up to \$35,000</b>





# BALANCING NEEDS WITH WHAT IS POSSIBLE

- ◉ Our analysis is clear on a some key things:
  - Simply opening more LCBO stores will not address our issues – same problems, just more stores to deal with
  - LCBO reviews and collaboration, which have been significant, are only generating marginal changes, if any at all
  - Unless there is a substantial shift in the way the LCBO does business, there is no ability for the existing system to accommodate the wine that needs a market
    - Especially a significant volume which is premium priced
  - We will be challenged to continue to be price competitive in the way that the LCBO would like
- ◉ We are mindful of the fiscal realities for the province and so want to ensure that any proposals are 100% respectful of these realities
  - Ensure that government efforts are directed towards channels where all wineries compete
  - Focus on changes that allow wineries to become more competitive - benefits are related to effort and changes reward entrepreneurship, investment and effort



# SHORT TERM - POLICY AND PROGRAM CHANGES OFFER A BALANCED APPROACH

- ⦿ **Our shared challenge - What can we best do given the circumstances to try and get as much wine as we can to the market and sold?**
- ⦿ **3 areas that can provide some immediate opportunities to at least mitigate in a small way some of these challenges:**
  1. Remove regulatory and other artificial barriers
    - For the most part restrictions on producers created by LCBO policy
    - Simple changes to allow for better planning
  2. Ensure that LCBO programs and merchandising are focused on delivering best results for VQA sales versus ICB sales and shift focus and relief to supporting VQA products
  3. Changes led by other Ministries that the Ministry of Finance can support and encourage



# REGULATORY BARRIERS

- ◉ Ask the LCBO to amend their current policies to:
  - Allow wineries the ability to charge delivery fees when they deliver to licensees if they choose (as LCBO, importers can do now)
  - Allow wineries to store and ship wine together to allow for off-site support of sales to trade
  - Allow all wineries to deliver to LCBO warehouses to address inventory shortfalls
  - Shift all regulatory functions so that LCBO is out of the decision making process (ie. warehouse approvals)
- ◉ Ask the LCBO to amend their current reporting to ensure we track sales at wineries on an on-site and off-site basis
  - On site (Estate winery) sales as a proxy for tourism performance but cannot be tracked



# REFOCUS LCBO ON SUPPORTING VQA WITH PROGRAMMING

- Pressure from government for revenue has caused significant growth in fees including new charges for programs designed to support VQA wines
- Recommend rolling back charges for VQA on programs that are designed to support results for VQA and that were previously without cost
  - Superstars, Fridge Space, Tasting Program fee increases as examples
  - We would support LCBO reducing the level of supports that are focused on channels where all wineries are not able to participate as a way to grow revenue to reduce the pressure on these critical programs
    - Benefits to ICB wines , benefits focused at off site retail stores
  - **Incremental dollars gained gives LCBO some flexibility in how to deliver savings to government versus universal pressure on all suppliers**
- Use current program review for Ontario wines programming to ensure that quotas and performance targets appreciate the commercial realities for VQA wines versus the business models of well-subsidized imports



# SUPPORT FOR INITIATIVES FROM OTHER MINISTRIES

- Other ministries have some policy changes that can be very impactful and no cost and any encouragement from Finance would help
- OMAFRA
  - Changes to grape contracting practices
- Attorney General
  - Changes to allow for holiday openings at on site stores, hours of operation to be more flexible
  - Changes were agreed to before the election and not acted on, MAG planning to open LLA for a singular change and these could easily be added as part of framework





# IN THE LONGER TERM

- We are very aware of the need to look at current programs and ensure that they are driving the strongest performance and best alignment with the goals, objectives and constraints of the government
- We are doing our own review and would like to then work with staff at the Ministry to evaluate options as they emerge
  - We would like to start now to engage with the Ministry if that is appropriate



# HOW TO BEST MOVE FORWARD?

- ◉ We have given you our perspective on the issues that our challenging our momentum
- ◉ We feel that we have proposed some small but impactful solutions that will at least help address some of the problems at the margins
- ◉ We think our solutions are respectful of the province's financial position
- ◉ Our goal is to work with you, the LCBO and other Ministries to deliver the strongest results we can for Ontario
- ◉ What are the next steps to moving some of these issues forward?

