

VQA and its Role in Growing the Ontario Economy

Wine Council of Ontario
November 16, 2011
COMMERCIAL CONFIDENTIAL

Today

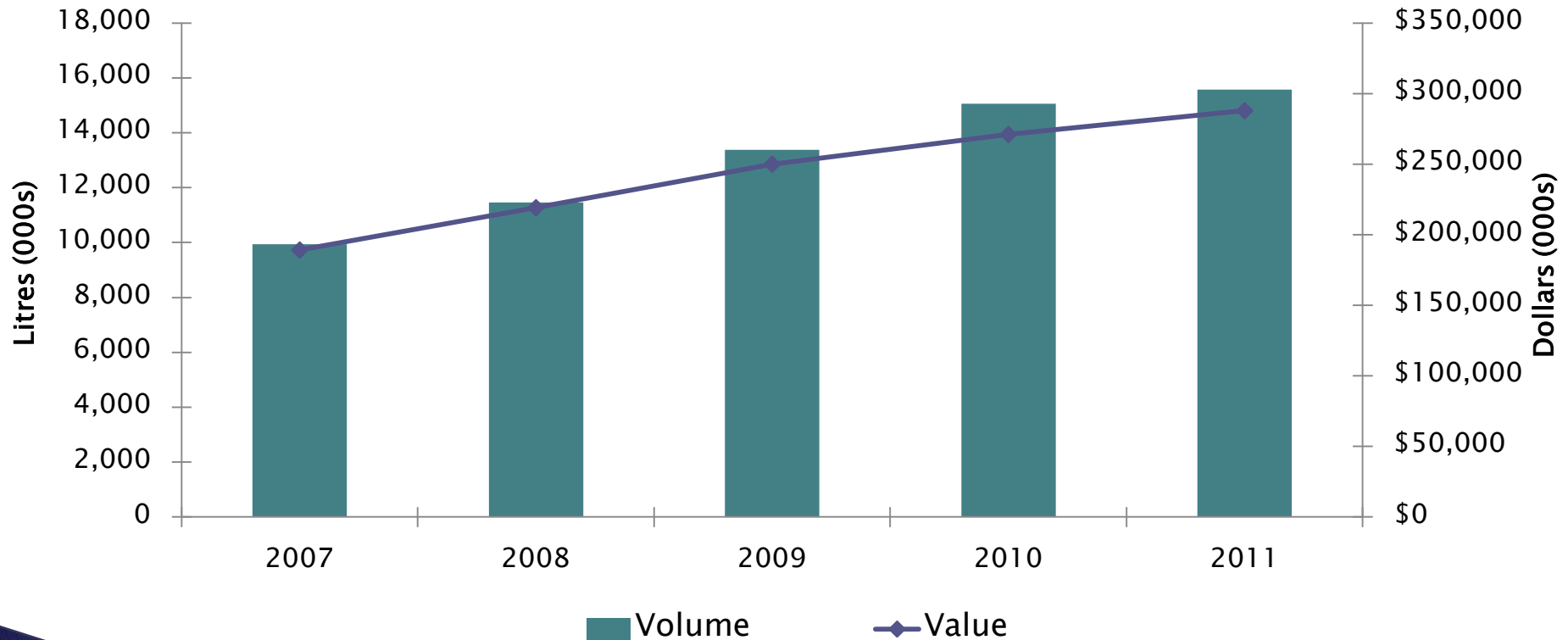
- ▶ Focus on VQA = Results for the Province
 - Performance, Economic Impact and ROI for Ontario
- ▶ How to Keep Momentum Going
 - Where are the challenges and opportunities for VQA
- ▶ Growing Revenue for Government and the Opportunity Cost of the Status Quo
- ▶ Questions

Industry Approach

- ▶ For over 12 years, the government has partnered with Ontario's VQA producers to help grow this business
- ▶ Industry for its part has supported this strategy in several deliberate ways
 - Making the necessary investments in product innovation
 - Increasing demands for quality
 - A strong collaboration with the LCBO to ensure the best possible performance in that channel
 - # of wineries in LCBO up from 37 in fiscal ended 2007 to 63 in fiscal ended 2011 (and continues to grow)

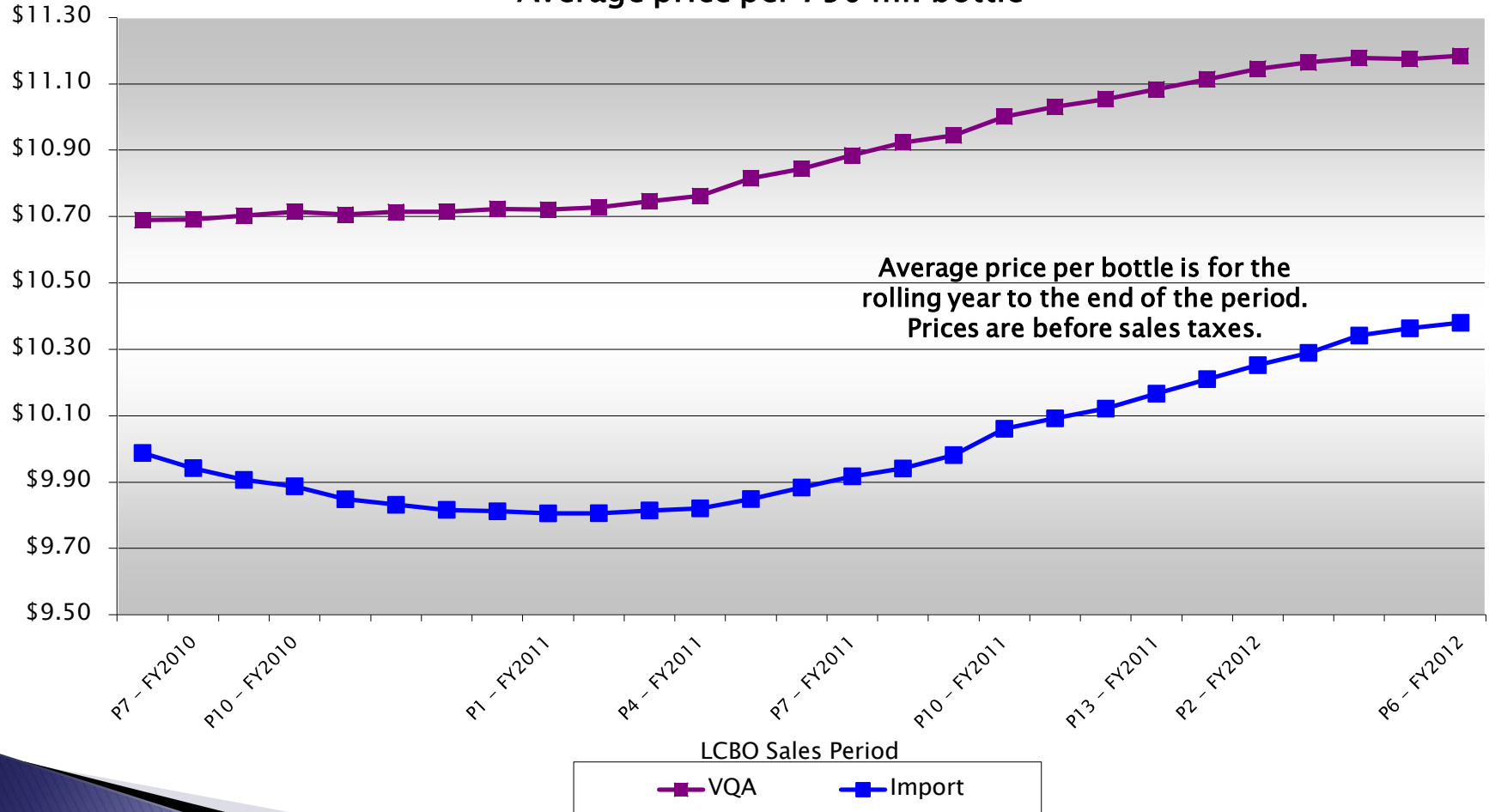
Annual Sales of VQA Wine – Volume & Value

Fiscal Year Ended March 31
(Source – VQA Ontario)



Industry Approach – Premiumization

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



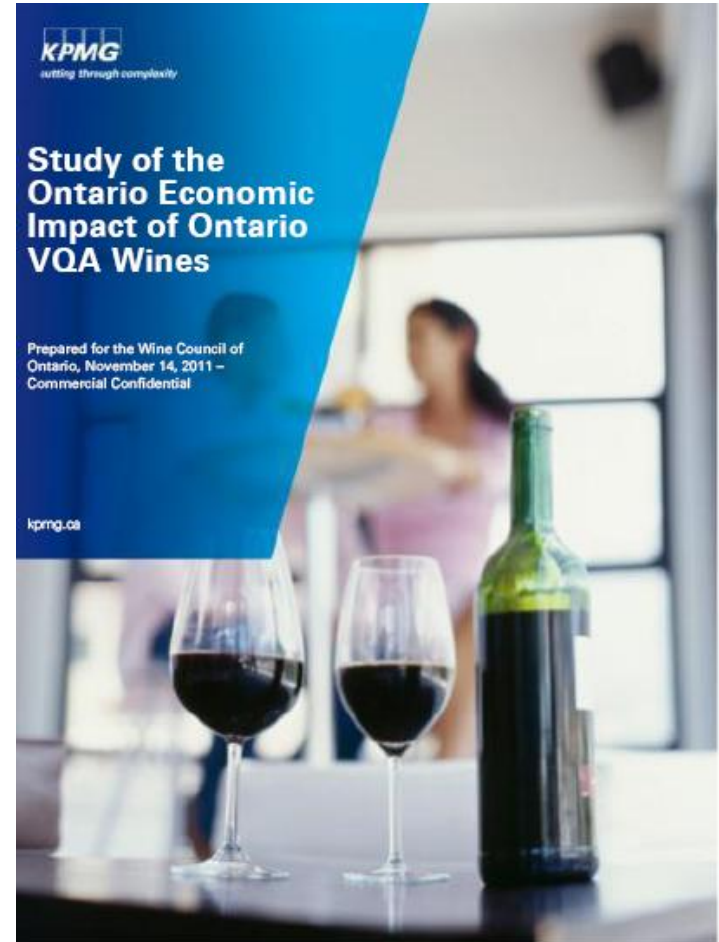
Interesting Trends of Note

- ▶ Ontario VQA white wine category is #3 and bigger than France.
- ▶ With 12% growth Ontario will by pass Australian whites.
- ▶ Ontario Reds #7 and growing at +11.7%.
- ▶ Ontario VQA is poised to overtake Argentina

	This Year	Last Year	%CHG
ICB	1519883	1504916	1%
ITALY WHITE	829097	803006	3%
AUSTRALIA	449774	441840	1%
ONTARIO VQA WHITE	432927	384457	13%
FRANCE WHITE	394552	427810	-8%
USA WHITE	393341	358552	10%
CHILE WHITE	272342	239527	14%
ARGENTINA WHITE	194666	182510	7%

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

VQA Wine Sales in Ontario – Fiscal 2010/2011 & 2006/2007

	Value (\$millions)			Volume (millions/litres)		
Year	2010	2007	% increase	2010	2007	% increase
Ontario VQA Wine Sold – LCBO	102.1	61.9	65 %	6.5	4.1	59 %
Ontario VQA Wine Sold at WRS	88.5	54.2	63 %	4.5	2.7	67 %
Ontario VQA Wine Sold – Direct Delivery to Licensees	40.7	32.7	24 %	3.0	2.8	7 %
VQA Exports & Interprovincial	37.2	30.7	21 %	1.3	0.8	63 %
TOTAL VQA SALES	268.5	179.5	50 %	15.3	10.4	47 %

Economic Impact – Results

- ▶ KPMG analysis and observations have validated as strong performance for VQA wines for Ontario
 - **1 300 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)

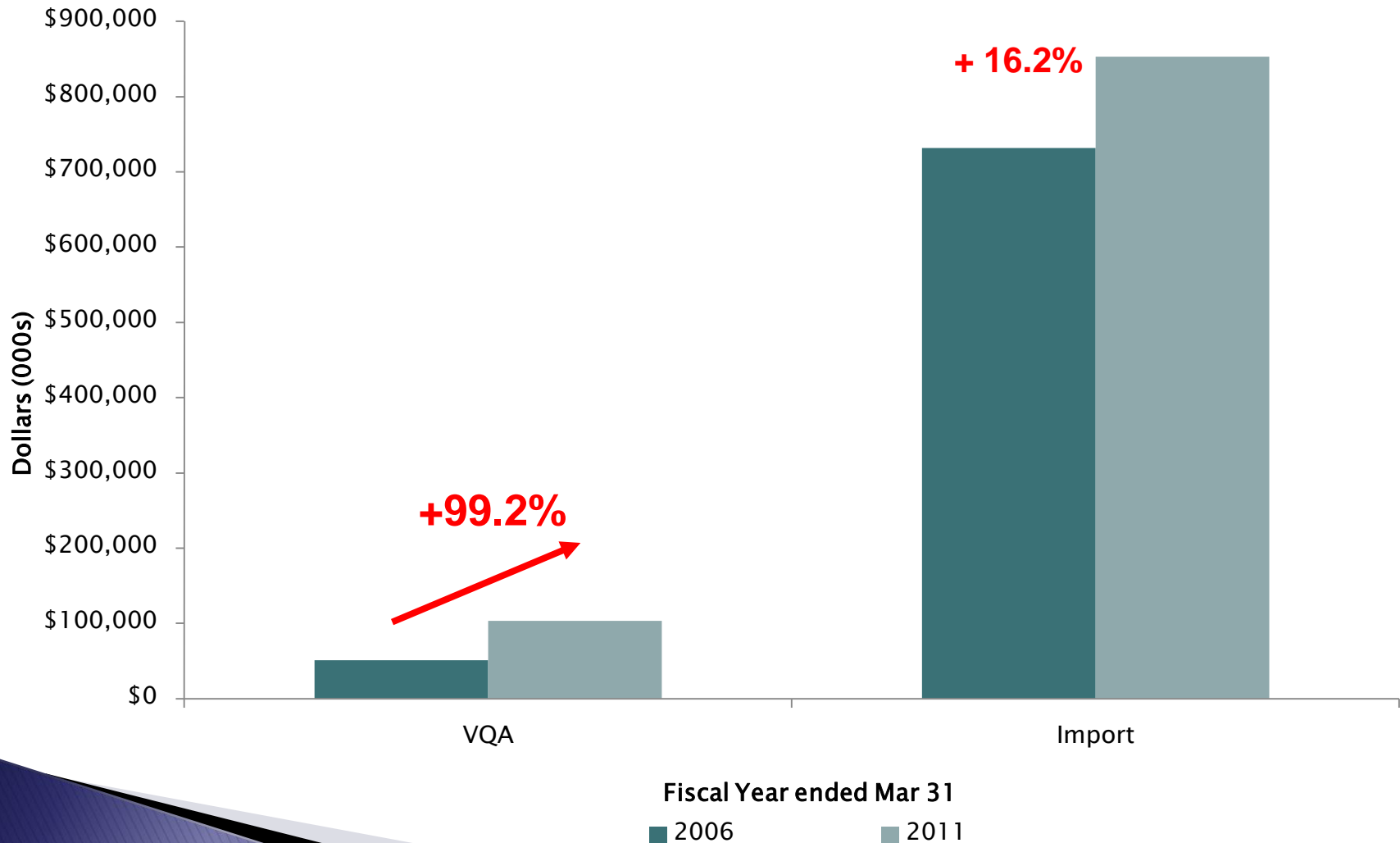
	VQA Wineries	VQA WRS	Total
Labour Income	88.7	4.0	92.7
Business Income	66.5	3.3	69.8
Government Income	27.4	1.3	28.8
Total	182.6	8.7	191.3

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)



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.....

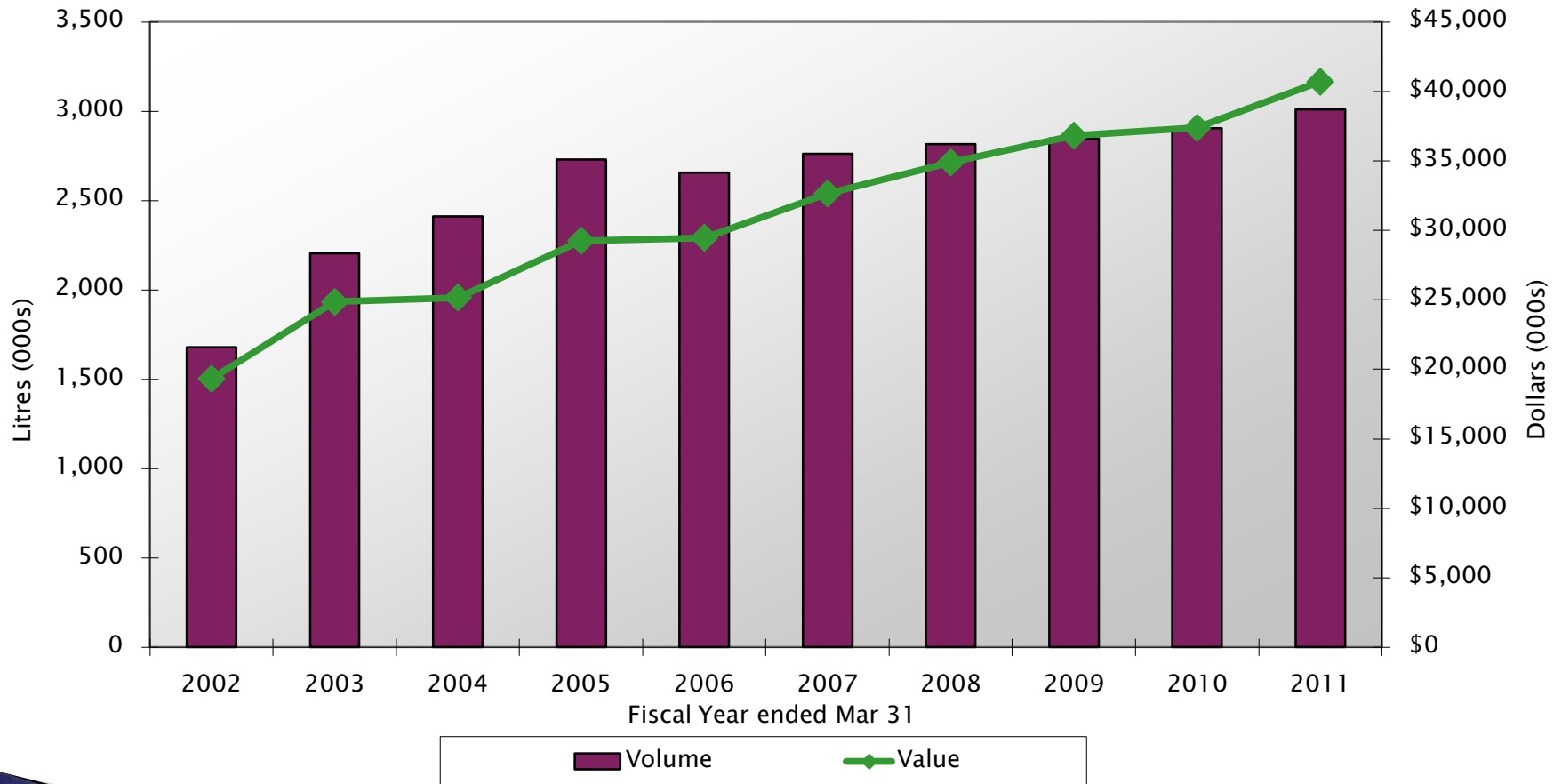
Description	Dollars (2007–2011) (000's)
Net government revenues	\$ 32,712
Multiplier on incremental litres @ \$12.29/litre	\$ 108,000
TOTAL NET CONTRIBUTION	\$ 140,712

Opportunity = Growth

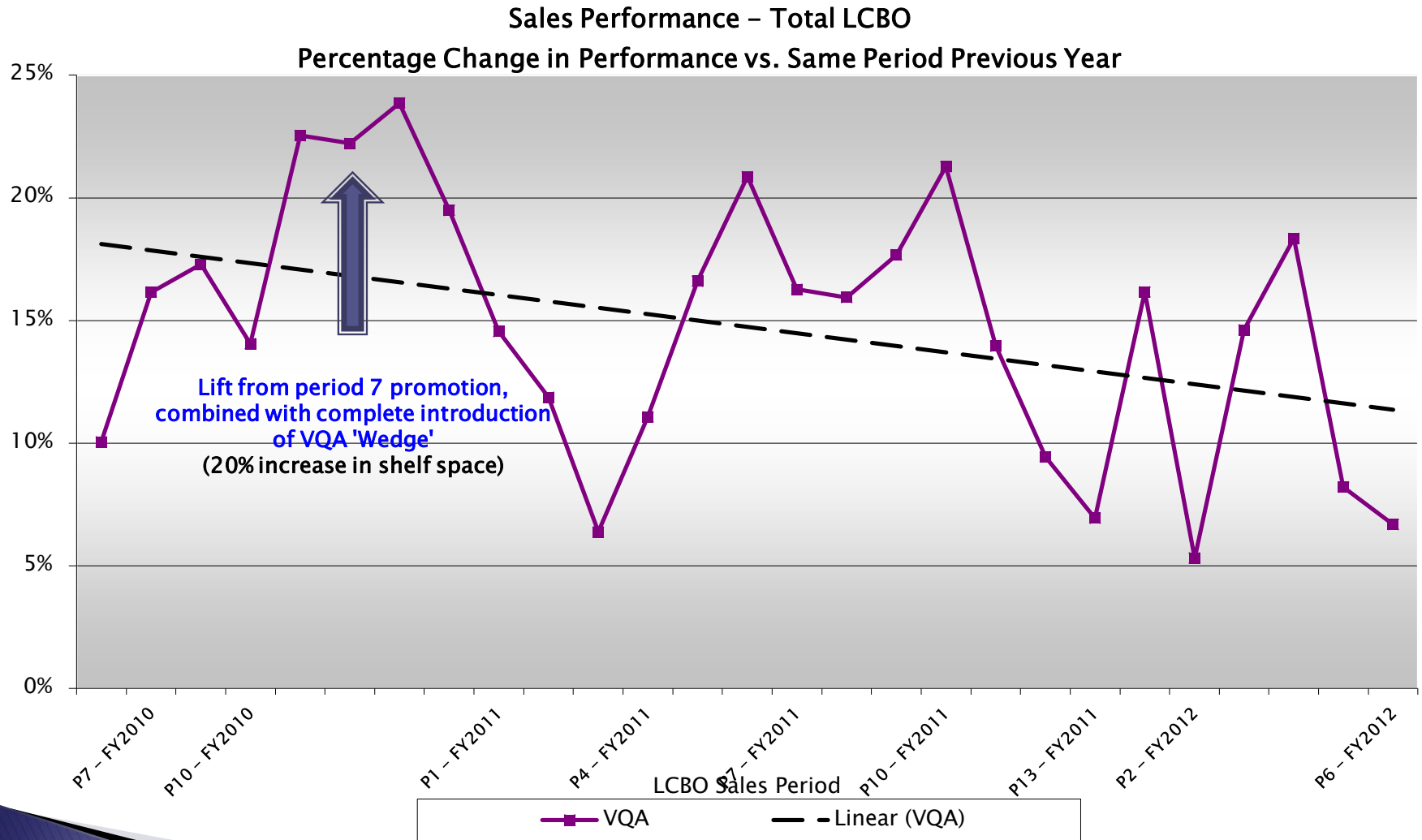
- ▶ We know that what has contributed significantly to our ability to grow is finding new capacity for our products with an alignment with consumer trends
- ▶ With the consumer we know that they have responded to both the improvement in offering from the industry and the synergies around local
 - This trend is poised to continue
- ▶ We know as well that when we get the opportunity to grow our market, we have been well positioned to take advantage of it
 - Two significant changes that have illustrated that:
 - Go Local + Shelf space increase at LCBO
 - Direct delivery margins to licencees

Opportunity = Growth

Annual Sales of VQA Wine Delivered Directly to Licensees – Volume and Value
(Source – LCBO)



Go Local + Shelf Space Increase at LCBO = Momentum



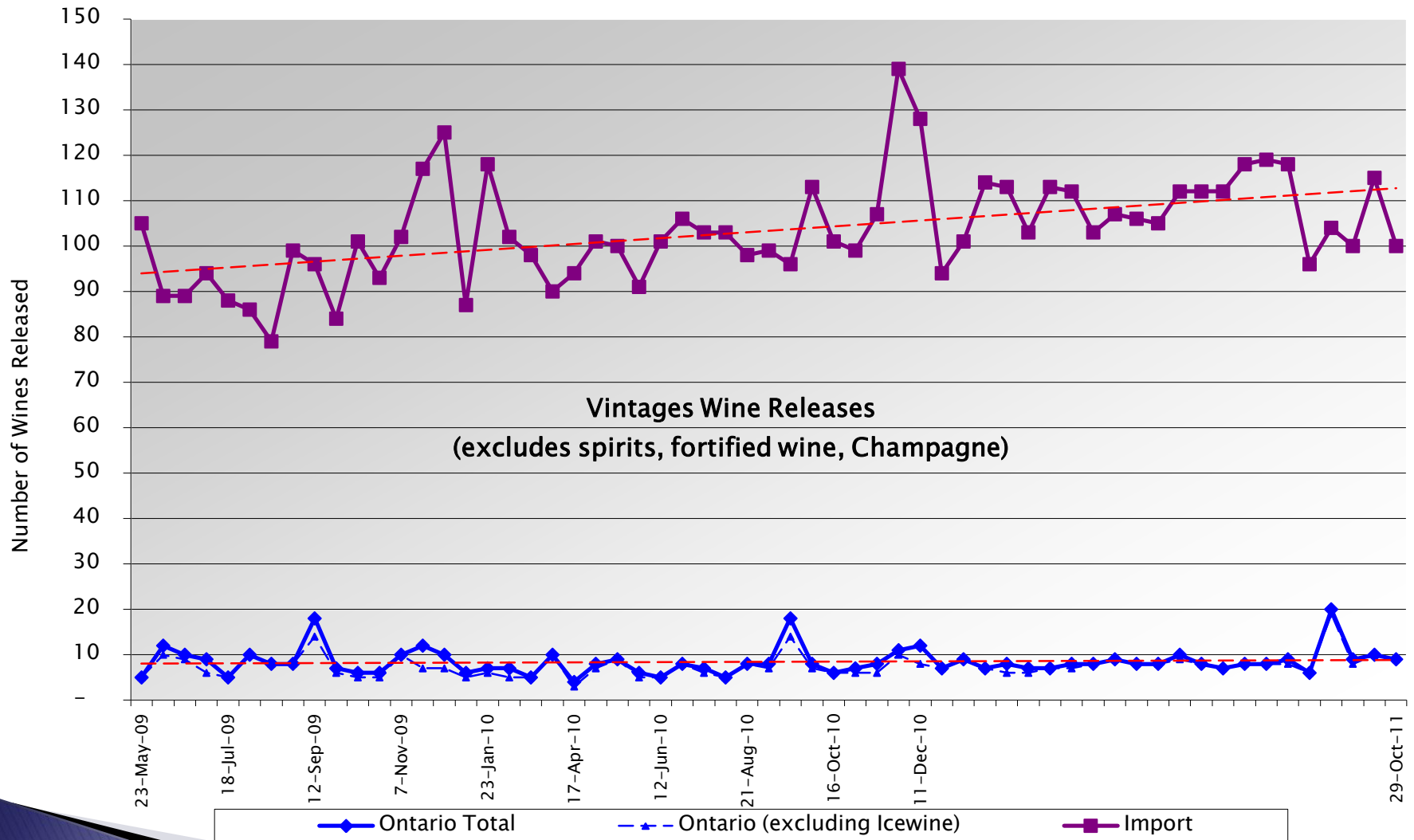
Challenges in maintaining momentum

- ▶ Concerns that in our biggest 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

- ▶ For some time the Wine Council has been developing a proposal for government around the establishment of private wine stores
- ▶ 1st step was some analysis of the retail viability of stores
 - Grant Thornton Report – 2007
- ▶ This report analyzed a series of options including private wine-only stores
 - The analysis was focused on developing a model in which the retailer could be successful

New Private Wine Stores

- ▶ After some initial discussions with the government at that time, it was clear to us that we still had to answer a few key questions in our mind to ensure that we were on the right path
 - What did this mean for all partners in terms of revenues and benefits?
 - What was the path forward from a legislative perspective that made the most sense?
 - What did the public think?
 - Were we maximizing the power of our partnership with the LCBO?

New Private Wine Stores

- ▶ One of the most critical steps that we took was to ensure that we were able to answer the existing issues that are in the lexicon of government on this issue
- ▶ We will be able to show you that this model can address stated concerns around:
 - Trade Compliance
 - Trade legal model
 - Reaction of imported wine business
 - Net negative impact on the LCBO
 - Concerns over sharing the consumer versus growing the market
 - Revenue risks to LCBO
 - Public acceptance of the option
 - Social responsibility concerns

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 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
- ▶ This work could be combined with our separate work with KPMG to estimate the impacts of our proposal on the Ontario economy

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

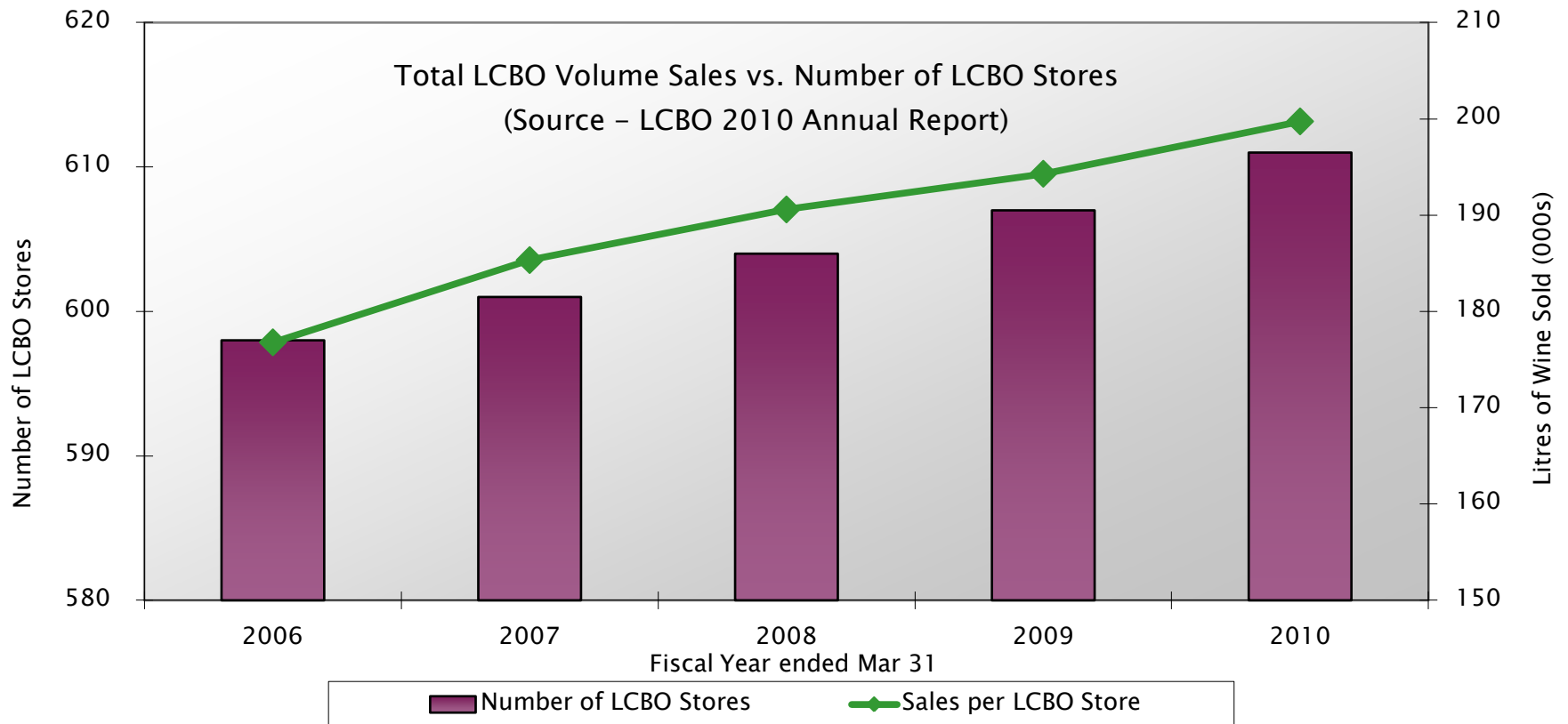
Grant Thornton Report – Conclusions

- ▶ Creation of stores with proposed model will meet goals of Wine Council
- ▶ 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

Other key issues for consideration

- ▶ Besides an analysis at face value of revenue opportunities/opportunity costs, we also wanted to ensure that this approach had no unintended consequences
- ▶ First we considered growth of outlets versus LCBO and then we looked at the impact on VQA in a comparable market (British Columbia) as its number of outlets have progressively increased.
- ▶ Interestingly, the LCBO's own performance gave us some important learnings on what happens when outlets expand – did consumption grow or did it cannibalize its own sales to support other outlets

LCBO Performance validates opportunity around growing capacity



BC Growth in capacity = Opportunities for VQA

Year	Population	Number of Wineries	Number of Outlets	# of outlets per 10,000 ppl	Volume Wine Sales (L) (VQA Only)
2010	4.53	182	1380	3.05	8,359,124
2009	4.46	170	1356	3.04	7,846,642
2008	4.38	154	1305	2.98	6,733,048
2007	4.31	134	1273	2.95	6,594,213
2006	4.24	131	1215	2.87	6,783,234
2005	4.20	119	1140	2.71	6,472,816
2004	4.16	102	1030	2.48	5,571,100
2003	4.12	87	907	2.20	4,728,612
2002	4.10	74	787	1.91	4,233,458
2001	4.08	66	774	1.90	3,717,452
2000	4.04	60	N/A	N/A	2,999,807

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

Grant Thornton Report

Summary of 5 YEAR TOTAL Incremental Revenues to Ontario

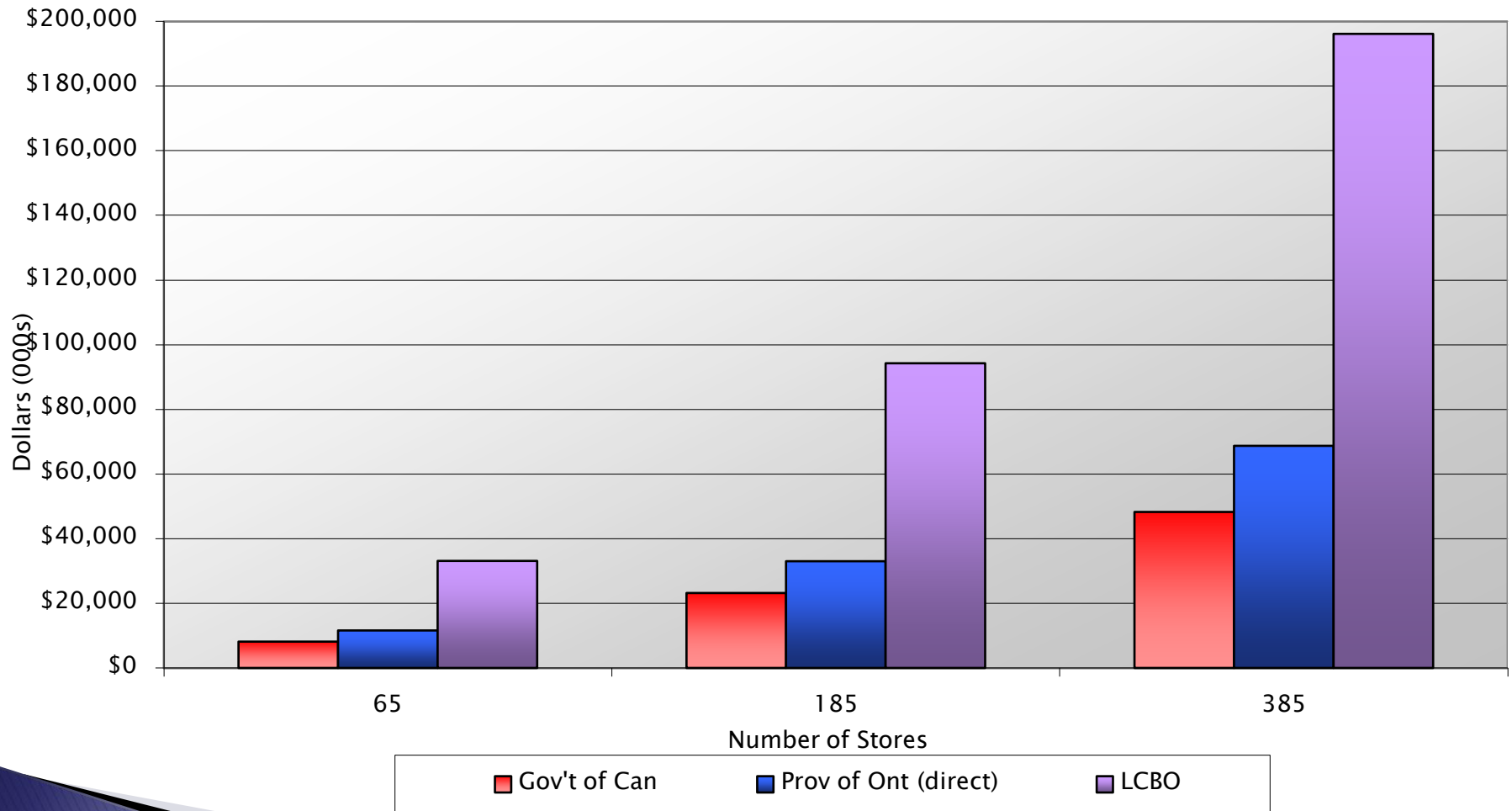
(for 3 scenarios of VQA market share – 5%, 10%, 20%)

All \$\$ amounts in 000s

Number of Stores	5%			10%			20%		
	Direct	LCBO	Total	Direct	LCBO	Total	Direct	LCBO	Total
65	\$ 54,500	\$ 192,500	\$ 247,000	\$ 55,500	\$ 183,500	\$ 239,000	\$ 58,000	\$ 165,500	\$ 223,500
185	155,500	548,000	703,500	158,500	522,500	681,000	165,000	471,500	636,500
385	323,000	1,141,000	1,464,000	330,000	1,087,500	1,417,500	343,500	980,500	1,324,000

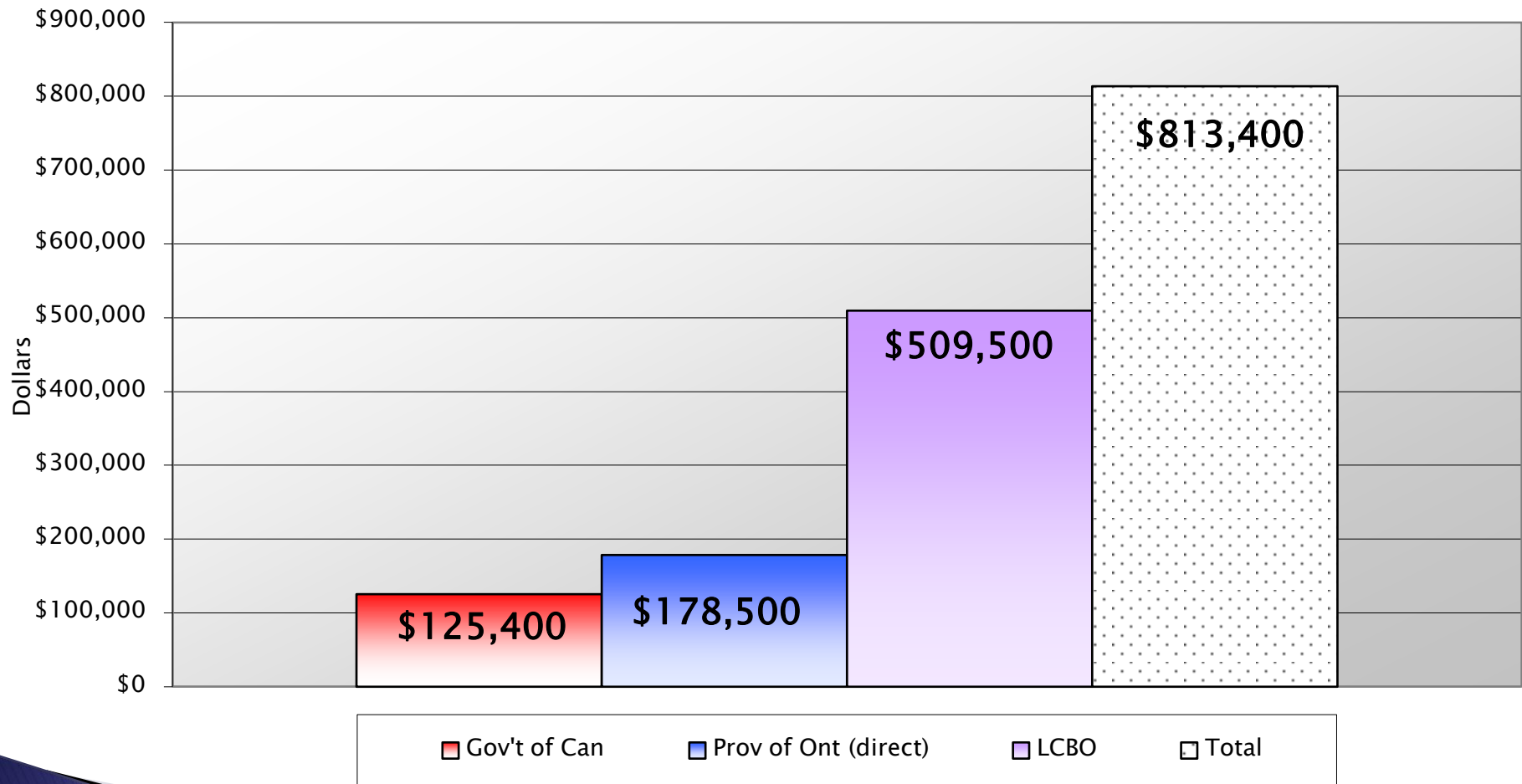
Results immediately positive

Incremental ANNUAL Government Revenues with Additional Retail Stores



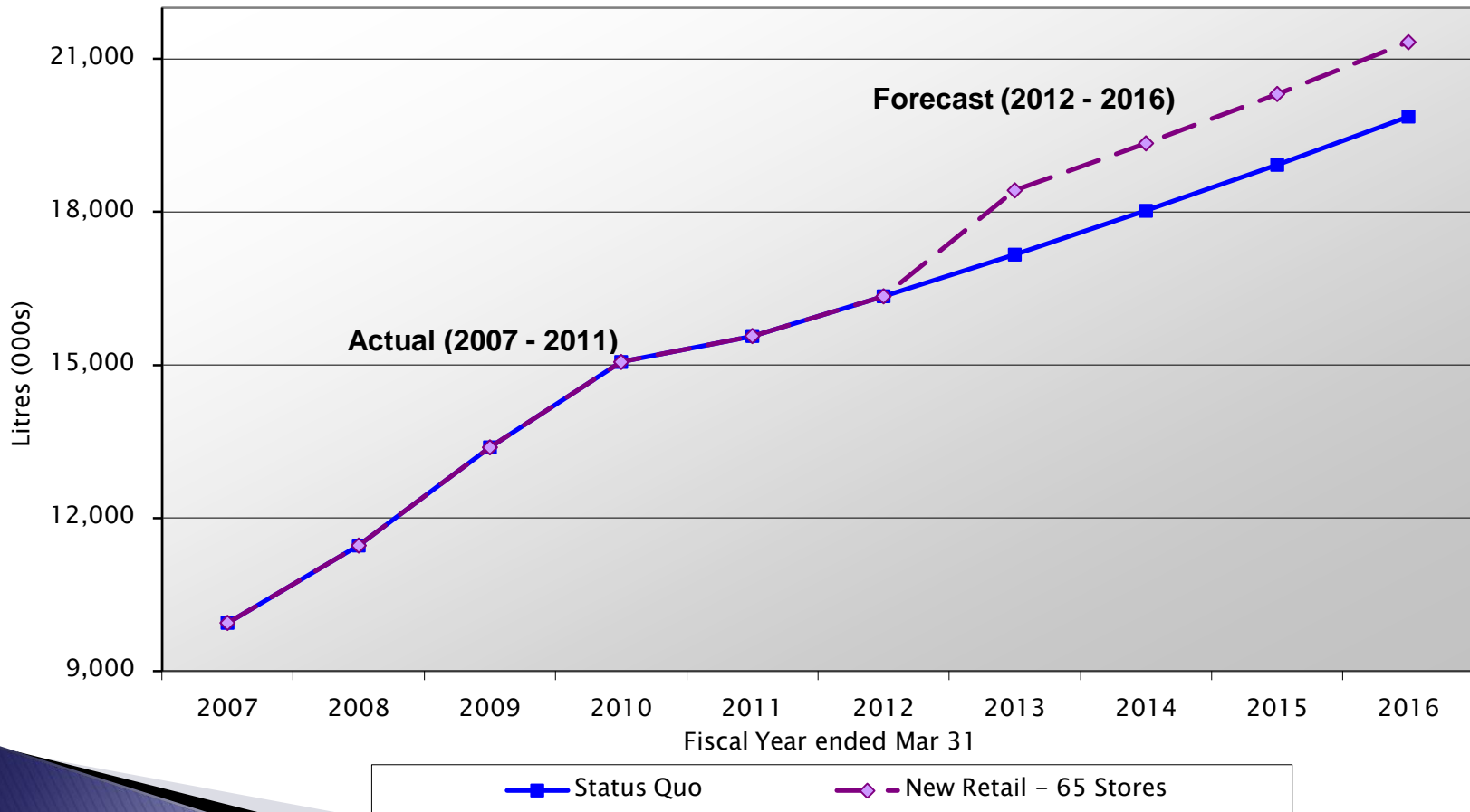
Results immediately positive

Incremental ANNUAL Government Revenues Per EACH Retail Store



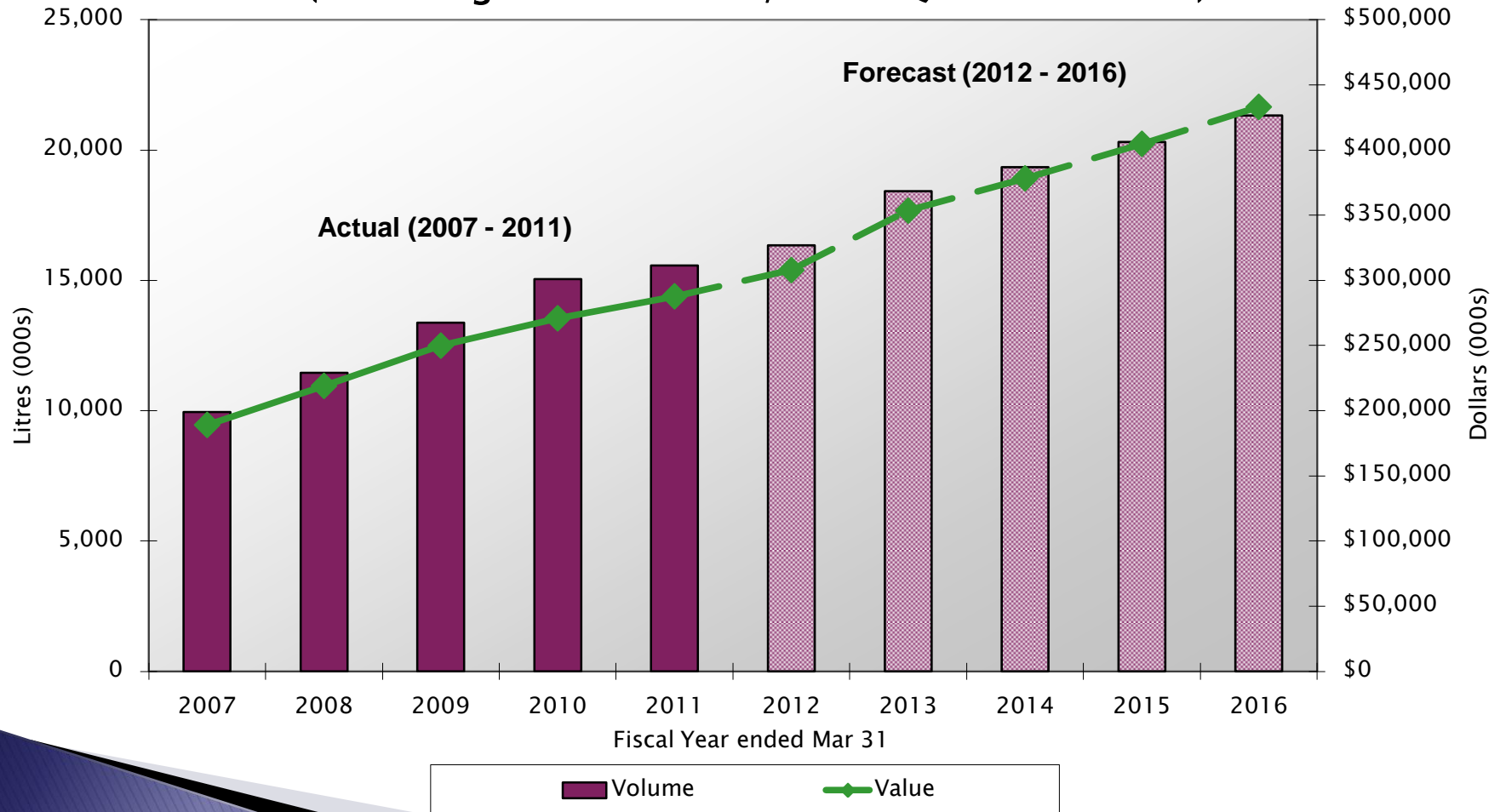
Incremental impact vs Status Quo

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



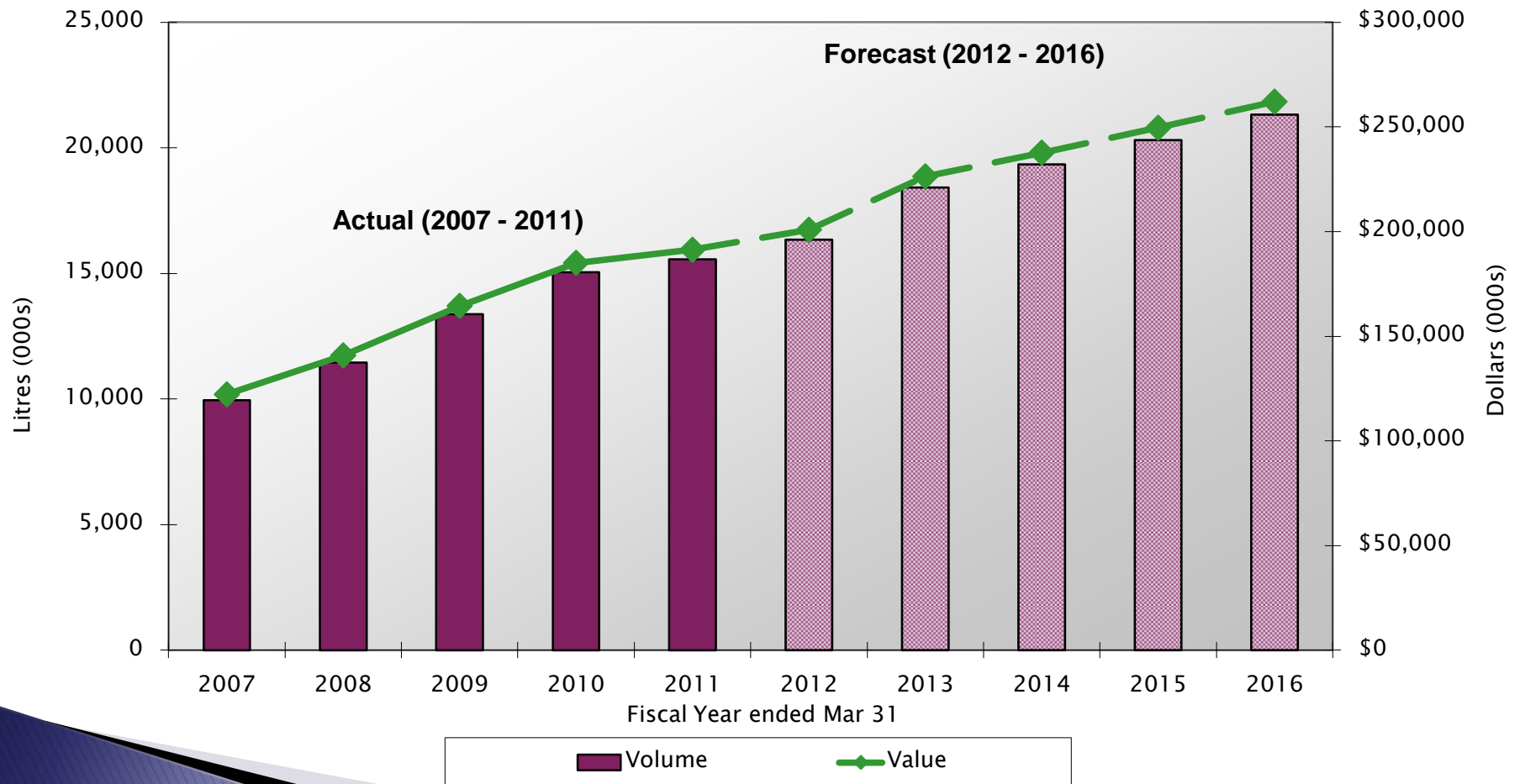
Results positive for VQA

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



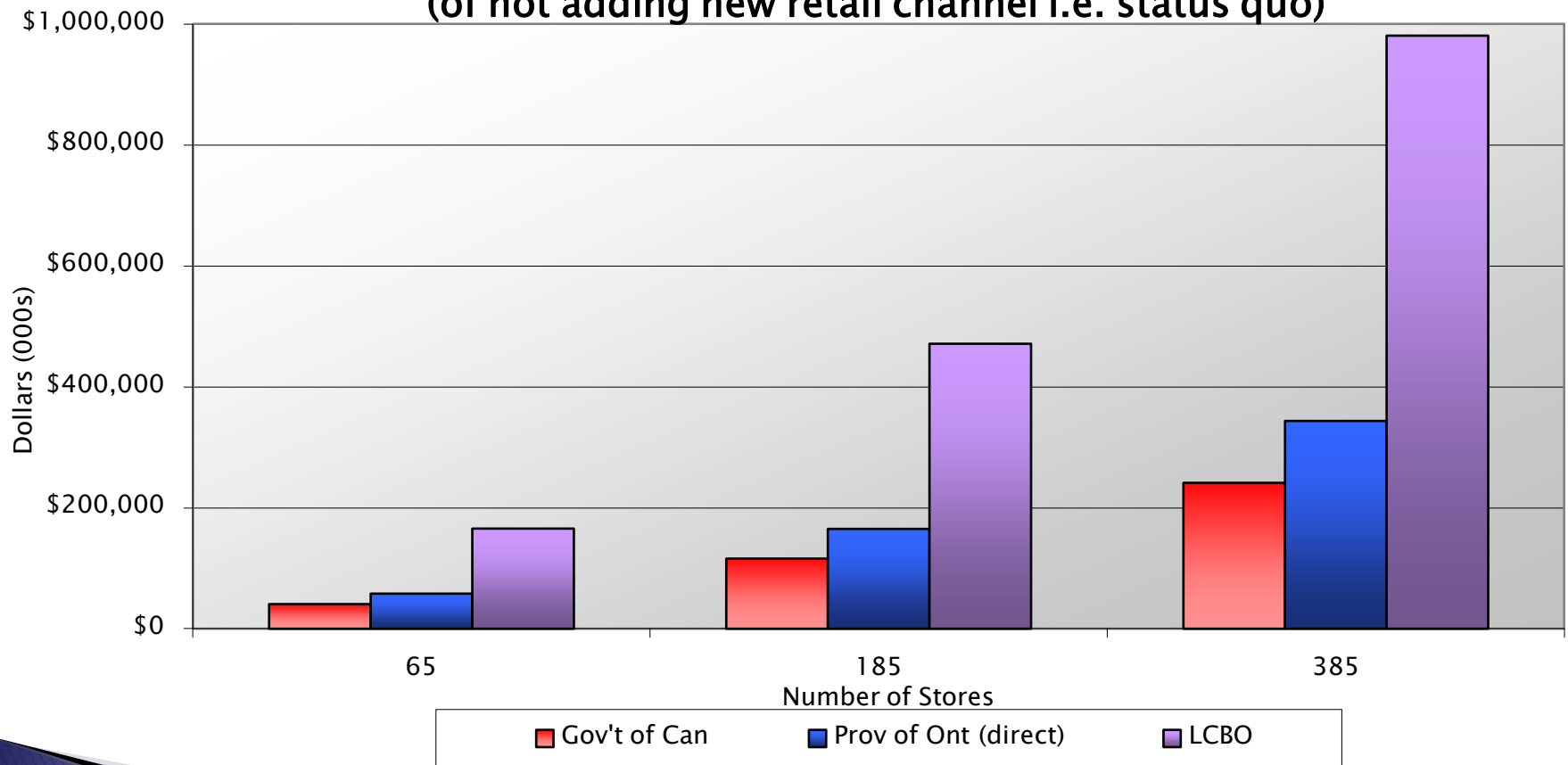
Economic Value Add allows industry to accelerate performance for economy

Annual Sales Volume of VQA Wine and Economic Value Add
(Assuming 65 new stores / 20% VQA market share)



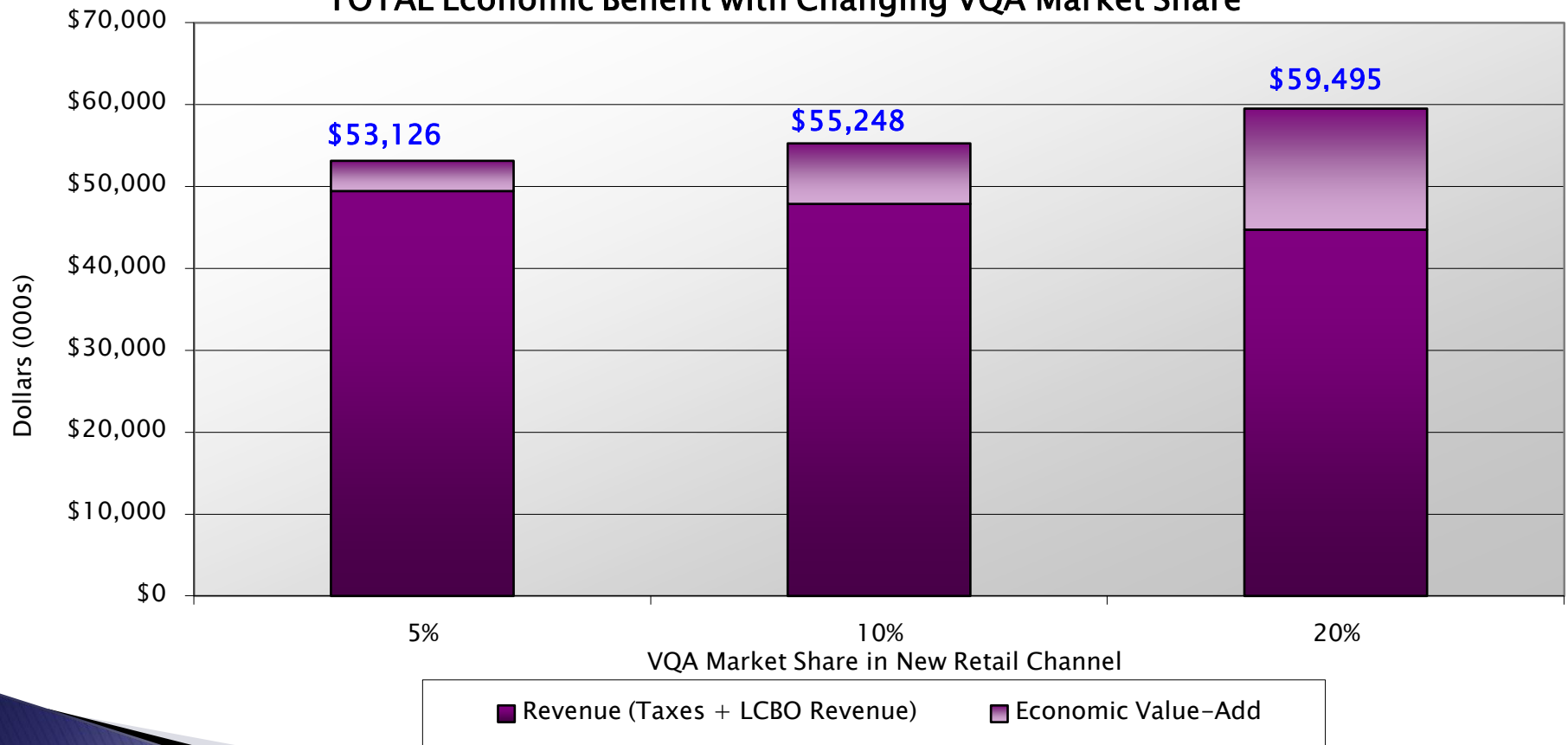
Opportunity Cost – Direct Revenues

5 YEAR OPPORTUNITY COST
(of not adding new retail channel i.e. status quo)



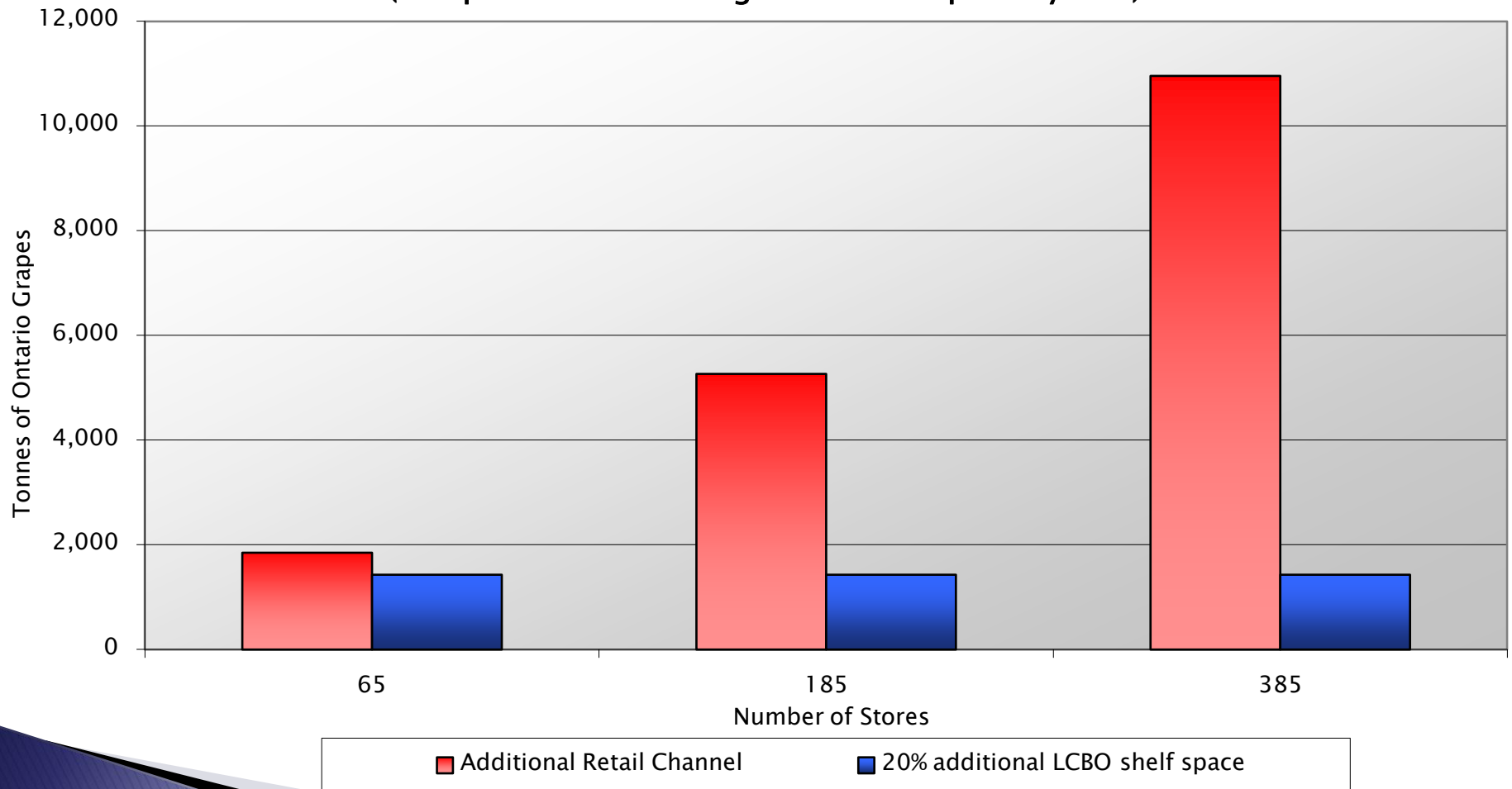
No downside to growing VQA share in new channel

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

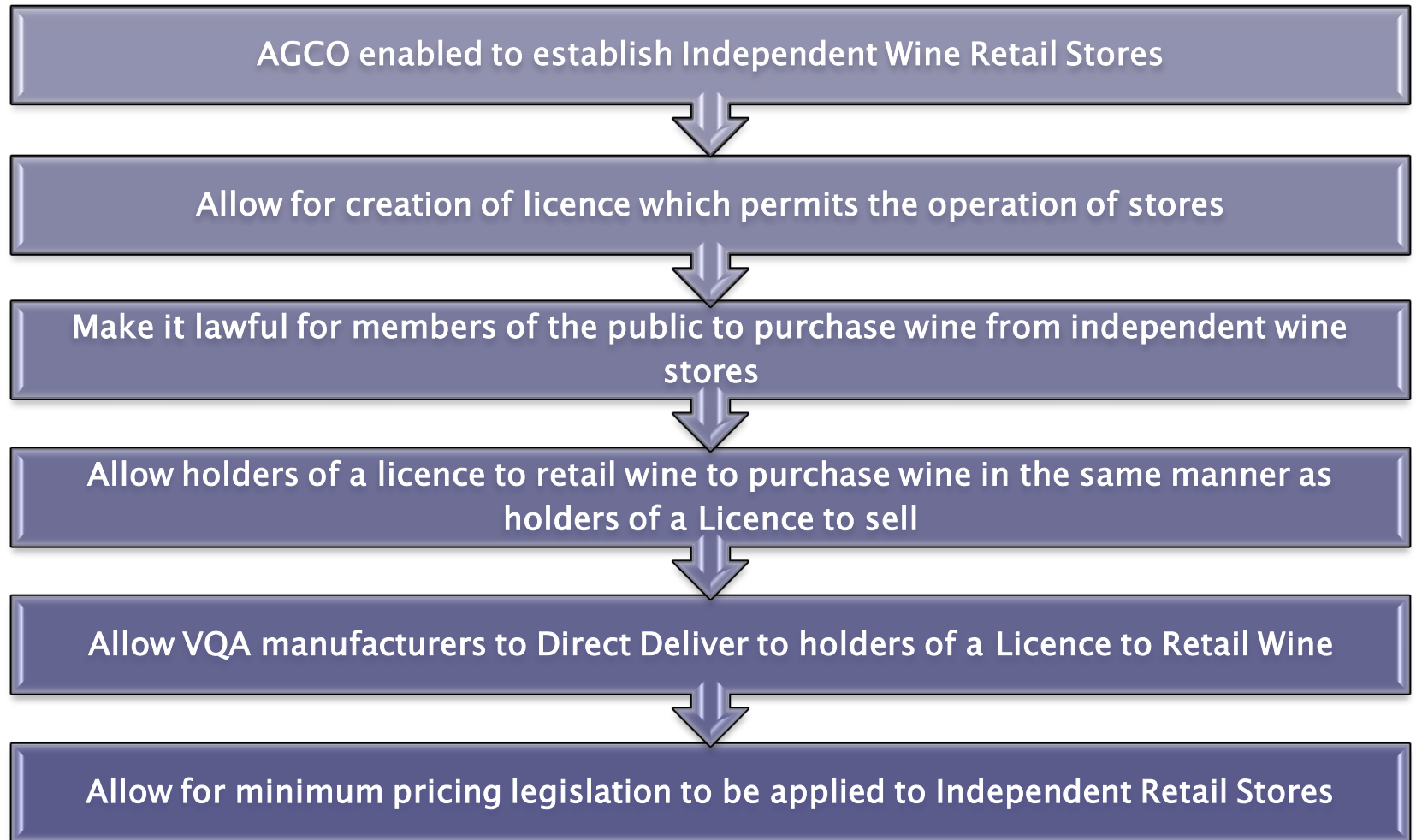


Better outcome for growers

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



The path to a model is simple



The path to a model is simple

AGCO enabled to establish Independent Wine Retail Stores

- Amendment of 3(1)(d) of the Liquor Control Act to allow the establishment of Independent Retail Wine Stores
- Amend Table 1 of Ontario Regulation 141/01 to assign to the Registrar of the AGCO the powers that would otherwise be assigned to the LCBO
- Section 3(1)(g) should also be modified so that the Registrar can establish municipalities for stores
- Amend Section 8 of Liquor Control Act to be amended to authorize LGIC to make regulations governing the operations of these stores by adding parallel to clauses c–f in section that would be applicable to these stores
- Amend General Regulations of Liquor Control Act such that the Registrar is able to set hours of operation for these stores
- Removes the LCBO, a direct competitor of the nascent retail establishments, from the process and provides some protection against predatory behaviour.

The path to a model is simple

Allow for creation of licence which permits the operation of stores

- Amend Section 6 of Liquor Licence Act to allow a person to apply to the Registrar for a Licence to Retail Wine. Make requirements identical to those in Section 6(2)
- Apply the prohibitions in Sections 6(4), 6(4.1), and 6(4.2) to apply to Licences to Retail Wine. This would prevent manufacturers from entering and controlling the market
- LGIC would be able to make regulations relating to the issuance of licences in concert with those in Liquor Control Act
- Amend Regulation 8 of the Licenses to Sell Liquor Regulations to indicate that it captures both a Licence to Sell and a Licence to Retail. This would include adding an additional class of licence at 8.1 that would authorize the retailing of wine and articles incidental to the consumption of wine by Independent Wine Retail Stores to members of the public.
- In order to maintain certain public policy objectives it is assumed that there would be similar conditions on a Licence to Retail Wine similar to those in Section 22 of the Regulations

The path to a model is simple

Make it lawful for members of the public to purchase wine from independent wine stores

- Amend Section 27 of Liquor Licence Act to provide that no person shall purchase liquor from a government store or from a person authorized by a licence or permit to sell or retail wines
- Amend Section 33.1(1) to ensure that persons can purchase for personal use wine from Independent Retail Wine Stores

The path to a model is simple

Allow holders of a licence to retail wine to purchase wine in the same manner as holders of a Licence to sell

- Amend Section 31 of the Liquor Licence Act to ensure to align provisions from Licence to retail with Licence to buy
- Add Section 31.2.(1) which would provide that a holder of a licence to retail wine may keep for sale and sell only wine the holder has purchased from a government store – maintains the LCBO's role as importer of record for non-Ontario wine. Section 31.2(2) should be added to provide that when purchasing wine under the Retail Licence that the licence holder should provide the government store with the licence number
- These amendments maintain the status quo of the role of the LCBO.
- An amendment to add Section 32.1(1) would require a holder of a Licence to retail wine to keep in stock and offer for sale a variety of wines from variety of manufacturers. This provision would preclude a Retail Licensee from stocking wines from a single manufacturer.

The path to a model is simple

Allow VQA manufacturers to Direct Deliver to holders of a Licence to Retail Wine

- Amend the current licencing framework in Section 5 of the Liquor Licence Act such that there is no restriction under Section 5(4) and its related regulations. This would ensure that the holder of a manufacturer's licence or a licence to represent a manufacturer is not prohibited from selling or delivering wine from a manufacturer to a Retail Licencee.
- Such a sale, replicating the current Direct Delivery process, would be deemed a sale from a government store under the Liquor Licence Act.
- Direct Deliveries are LCBO sales. The Direct Delivery Authorization Form, a standard form contract drafted by the LCBO, requires amendment to reflect that a wine manufacturer may direct deliver to holders of a licence to retail wine

The path to a model is simple

Allow for minimum pricing legislation to be applied to Independent Retail Stores

- Amend Section 15 of the Minimum Pricing of Liquor and Other Pricing Matters Regulations from the Liquor Control Act such that Section 15.1 is added to provide that the operator of an Independent Retail Wine Store shall not acquire wine for retailer at a cost that is less than the reference rate established in accordance with the regulations.

Additional Considerations

- ▶ Limiting holders of a Licence to Retail Wine with respect to:
 - Percentage of outlets they could own province wide
 - We would recommend one per owner – no ability to develop chains or consolidate
 - Review after first 5 years of implementation
- ▶ How to allocate licences?
 - Criteria for applicants
 - Impact on Ontario

The Opportunity is here

- ▶ We hope that you will take away from this some really important insights and opportunities
 - VQA wineries have the proven record to deliver for the Ontario economy and to deliver significant ROI on its partnership with the government
 - We have the ability to grow – we just need the opportunity
 - There is a way to grow the market which is virtually cost free for the government with an enormous upside for a province starved for revenues
 - The impact of this proposed framework can be impactful even at a relatively small scale

Next Steps

▶ Government:

- Challenge the government to work with us to review this model
 - Data and analysis available
 - Validate these assumptions

▶ Wine Council:

- Continue to engage stakeholders and other ministries so that they understand and support the opportunity
 - OMAFRA, MCS, LCBO, Industry Stakeholders

Questions?