

Strategic Priorities Update

Report to Town Hall
April 24, 2012

Today

- ▶ Update on Government Activities
 - Advocacy Activities
 - How to help
- ▶ Marketing Plan Process and Approvals
- ▶ Grape Negotiations
- ▶ Questions

Advocacy Activities

- ▶ Focus of lobbying activities on themes of **growth, prosperity and leveling the playing field**
- ▶ Reinforcing and supporting the government's policy platform focusing on VQA as a priority (October 2009 announcement)
- ▶ Building on completed work on economic impact (KPMG) and all of our research and studies on the potential for private retail
- ▶ Based on analysis that shows that over the next 3 years we need to find a home for approximately 500,000 cases of premium priced VQA wines
 - Wine that was made with the legitimate expectation of a market
 - Wine that the government should want to be sold
 - 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

Advocacy Activities

- ▶ Immediate priority – protecting funding dollars
 - No time to ask for more!
- ▶ Drummond Report motivated government to make some immediate steps to show progress in reigning in unproductive spending
- ▶ Knew that going into the budget process that we had to aggressively defend our funding
 - Many industry support programs targeted for cuts
 - Concern that government would look at our programs given the efforts of WGAO to undermine our funding
- ▶ Successful for this year in fully protecting VQA Support Program and Marketing Dollars

Advocacy Activities

- ▶ Ongoing work in promoting the need for additional retail channel and our private wine store proposal
- ▶ Have used the 500,000 case number to support our efforts
- ▶ Have to frame it in a way that the government can appreciate that there are no simple alternatives and/or solutions that they can pursue with the LCBO to get this problem addressed

With no new channel, the task falls to the LCBO and the outlook is challenging

▶ The Good News:

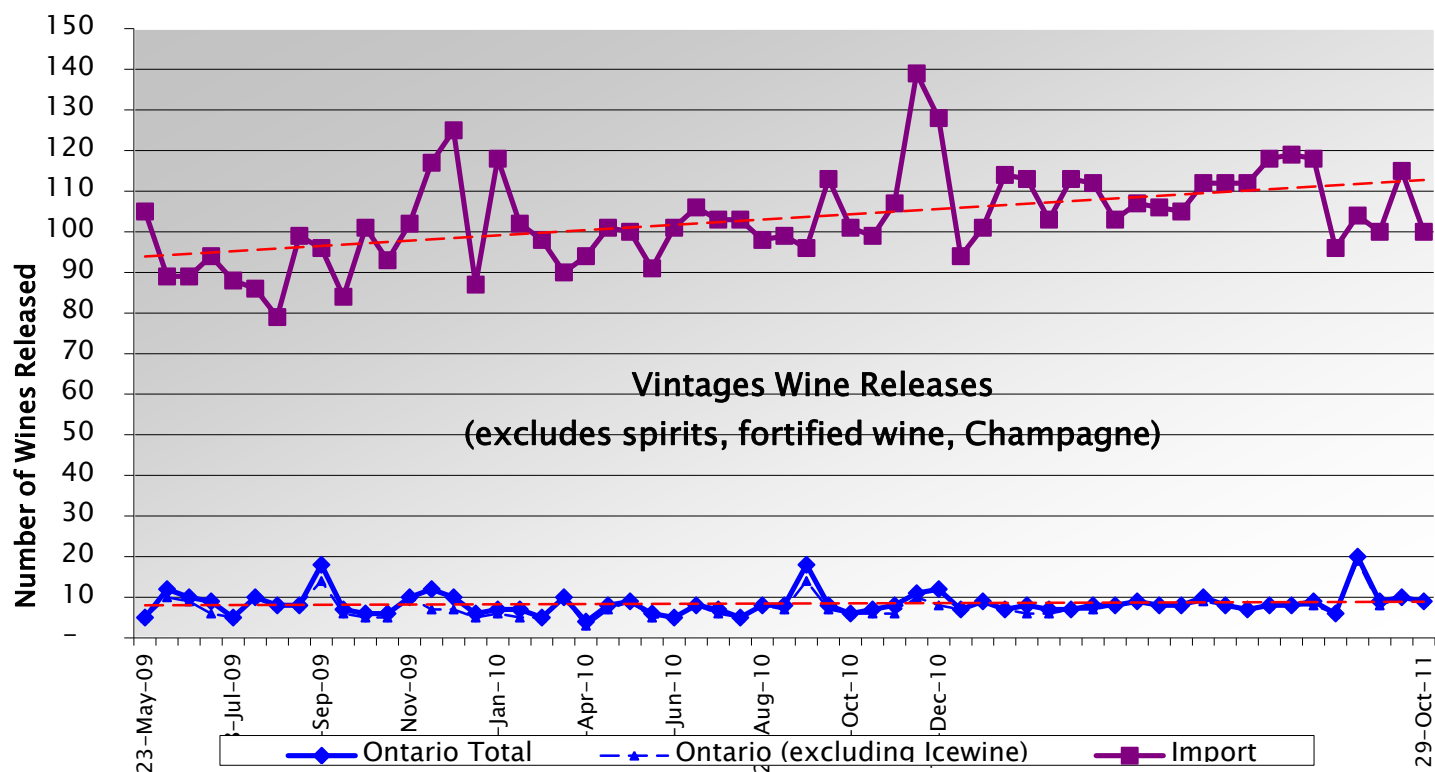
- ▶ VQA wines continue to perform well in this channel
 - This is our most important channel in terms of volume
- ▶ Growth in higher price bands remains strong and will found the strategy for continuing to grow VQA in this category going forward
 - Shari Mogk-Edwards - “you are a premium priced business 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
- New wineries challenged to find any shelf space at LCBO
- Half of the wine sold in Ontario is sold in a private retail channel that the vast majority of the wineries don't have access to, increasing the pressure on LCBO

Illustration #1 – 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 – we can't grow because 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 – We can't grow because our 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 3rd 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

Advocacy Activities

- ▶ Margins at the LCBO also have gotten a focus at these same discussions with the government
- ▶ Have to make it clear to them what the impacts are of their pressure on the LCBO for more revenue
 - They need to see some clear illustrations of what this has meant for our VQA producers who are trying to do business in this channel
- ▶ Our pitch is to go and find that money from somewhere else

Illustration on costs

Winery Revenue for Sales through LCBO FOR 3,000 CASES (2 SKUs at quota of about 1,500 cases per year)		
	April 2010 \$ 204,664	April 2012 \$ 211,177
Winery Revenue from sale to LCBO		
Display Merchandising Costs:		
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
Support Merchandising Costs:		
\$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
Other Program Costs:		
Tasting Fees	5,250	6,400
Shopping Cart	-	?
Total Merchandising Costs:	\$ 43,308	\$ 72,826
Offset by 30% VQA support - assumed full support:	61,399	63,353
	18,091	(9,473)
Incremental Cost		27,564
OTHER - charges for Sale of Data information:		Up to \$35,000

Advocacy Activities

- ▶ 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 will continue to fall behind our competitors who have far more favourable home market opportunities and programs

Advocacy Activities

- ▶ Layer on to all of this three key elements
 1. What is possible for government to deal with right now?
 2. What do we know will be coming as the government continues to address their fiscal challenges?
 3. What are the other stakeholders saying? Is there any common ground?

Advocacy Activities

- ▶ What is possible to deal with right now from the government's perspective?
 - Anything that doesn't cost money
 - Regulatory changes (AGCO, LCBO regs and policies)
 - Process issues (filings, licensing issues)
 - Red tape (excessive burden on small business)
 - Minister Duncan – Meeting in June to develop working list and action plan for completion in September
 - “I want the horror stories” – **YOU NEED TO HELP**
 - LCBO – will look at issues that we have raised on costs of doing business, barriers to growth in the channel
 - No clear path yet, but unclear if willing to back down on charging us vs going after others for money

Advocacy Activities

- ▶ What do we know will be coming as the government continues to address their fiscal challenges?
 - Review of all industry support programming – significant discussion of this in the Budget documents – Jobs and Prosperity Council
 - We see as important opportunity from a number of perspectives
 - We know we can show value and return from our financial partnership with the government so we are coming at this from a position of strength
 - Majority of the programs under review won't have this advantage
 - We also know that this can provide a valuable opportunity for us to look at ways to deliver support to our industry
 - We know we have to get ready for that discussion
 - Minister Duncan feels we have compelling case and will likely invite Council to take an early look at our sector
 - Need to have Internal discussion of options
 - Engaging our stakeholders to build consensus

Advocacy Activities

- ▶ What are the other stakeholders saying? Is there any common ground? Discussions very challenging.
 - WGAO, GGO will not support retail access proposals
 - WGAO – likes the status quo
 - GGO – don't favour anything that has imported wine – would rather have a 100% Ontario option (even though it is trade illegal)
 - Have been having some informal discussion with WGAO leadership on whether we can find some issues to work together on
 - Have been challenged in that there is little to no ambition in the areas they want to discuss – blending licenses, no expansion of retail opportunities from their perspective
 - Discussions also challenged with WGAO's active efforts to undermine marketing dollars and VQA Support program
 - GGO continues to focus their efforts on maintaining significant wine content (extending the 40%)
 - Challenge for us is that is really not driving any quality into viticulture and GGO making no efforts to focus in that way

Advocacy Activities

- ▶ Direct Contracting for Grapes
 - We are actively working in partnership with Peller and Vincor on this issue
 - Have had very positive discussions with Farm Products Marketing Commission and the Ministry
 - Feel that the stars may be aligning around this issue
 - Acknowledgement in government that this needs to happen to keep our industry competitive
 - Industry on a more stable platform and companies willing to make commitments to give growers stability
 - If this happens, there will be an important role for wineries in supporting this decision
 - FPMC will have to post regulatory changes for comment
 - Voices of all wineries in support of the changes will be critical

Advocacy Activities

- ▶ Supporting efforts on Bill C311 in Ottawa
 - Presentation at Parliamentary Hearings
 - Wine Council
 - Paul Bosc/Chateau des Charmes
 - Will continue to engage as the Bill moves to the Senate
 - Working with CVA to focus on next steps
 - Liquor Board policies
- ▶ Icewine labeling/CFIA
 - Good, not great, support on the icewine labeling issue
 - Issue not resolved but we continue to actively engage
- ▶ Engagement at CALJ on expanding sales across Canada
 - 3rd time presenting
 - Has driven further discussions with SAQ and Nova Scotia
 - Meetings set for May
 - Wineries interested in these markets should let Linda know

Advocacy Activities

▶ How to Help

- We will be looking for the “horror stories” for the Minister on regulations and red tape
 - We have a good sense of the technical elements, we now need the anecdotes and will need your help
 - PLEASE RESPOND to the call out for information
- Our research committee would like some help as we start to frame up our ideas around industry support going forward
 - Looking for volunteers to participate and engage so that we have a broad industry perspective on these very critical issues

Marketing Plan

- ▶ Submitted to government for approval
 - Full support of all Ministries
 - Formal approval expected in next couple of weeks
 - Government has been authorizing expenses in the interim to assure timely delivery of the plan
- ▶ WGAO withdrawn from process
 - Disappointing given the efforts and success of our industry marketing committee process
 - Active and productive engagement
 - Unless they can have control, they don't really want to be at the table in a meaningful way
 - Feel that they can use the discussions at the Jobs and Prosperity table to force this approach
 - Door is still open for them to come back

Grape Price Discussions

▶ Grape Negotiations – April 25

- Have agreed to a two year framework on pricing (continue plateau, agreement on way to set base brix)
- Proposing zero price increases
- GGO has signaled that they feel that 3–4% might make sense
- GGO also wants a multi year deal and could be “flexible” on pricing
 - Processors do not support – we are going in looking for one year only
- Could be heading to arbitration, but goal is to settle prices tomorrow
 - Even if we don't there is still a window between now and July before arbitration is a reality

Questions?