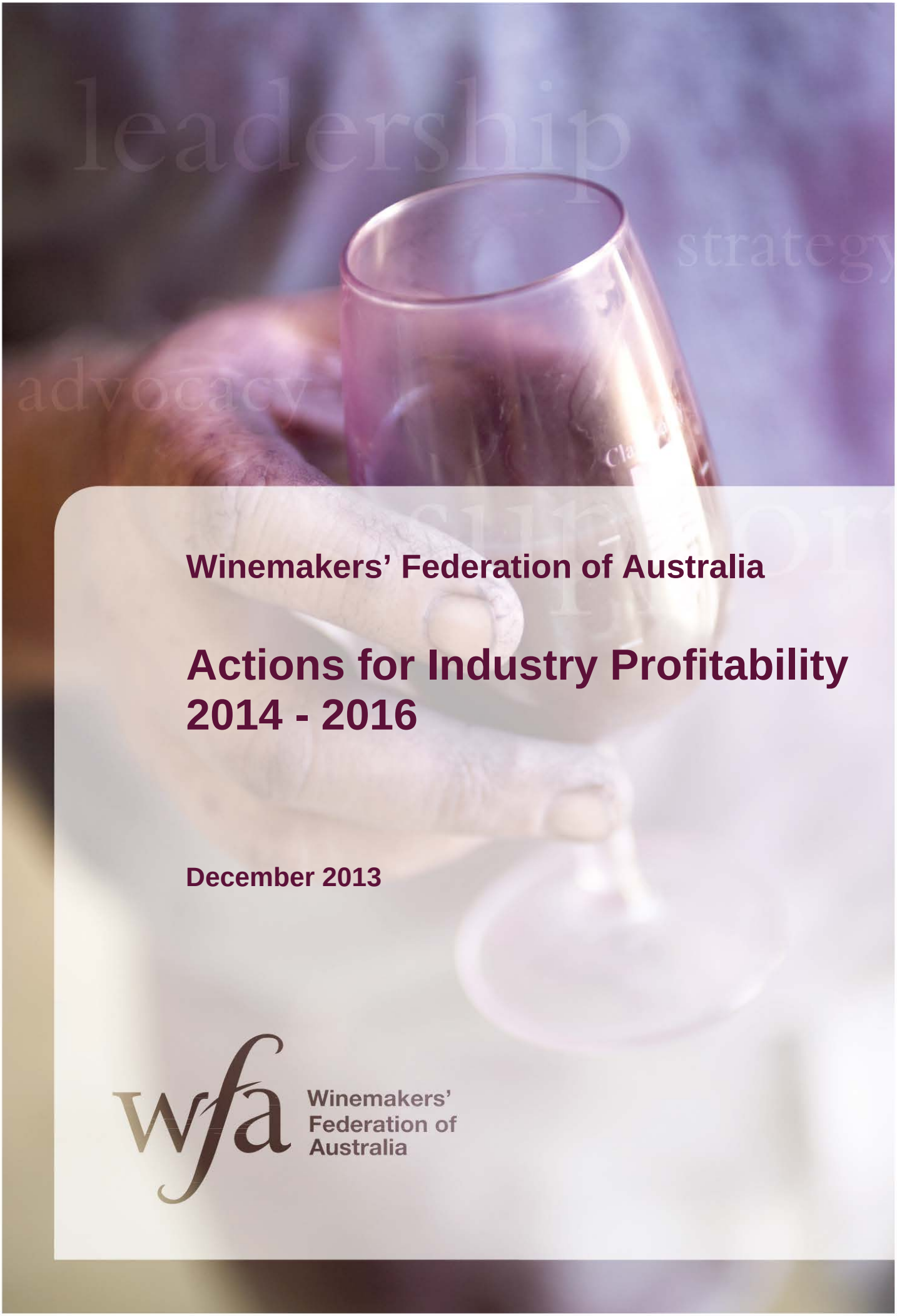


Winemakers' Federation of Australia

Actions for Industry Profitability 2014 - 2016

December 2013

Winemakers' Federation of Australia

Contents

Letter from the WFA President and CEO 3

Executive Summary 6

WFA Actions

1. Continue to Engage in the Wine & Health Debate 12
2. Grow the Demand Opportunity 16
3. Hasten the Supply Correction 23
4. Maximise Open & Fair Domestic Competition 27
5. Retain with changes to the WET Rebate 31
6. Monitor the Future of Wine Tax Policy 37
7. Secure Funding for the Action Agenda 38
8. Other Areas for on-going work 40

Attachments

1 Expert Review, *"Expert Report on the Profitability and Dynamics of the Australian Wine Industry"* 44

2 Changes following Consultation with Industry 95

3 The WFA Board members and their contact email details 102

4 Acknowledgements 104

5 Acronyms and National Wine Sector Organisations 105

Introduction

13 December 2013

Dear WFA Member and Industry,

We are now pleased to submit the 43 Actions grouped under 8 initiatives and this report to you.

By way of summary highlights:

- The Actions are a blueprint to improve the industry settings to grow domestic and export markets and lift profitability of Australian wine businesses. Examples of the Actions are:

  - additional funding for Wine Australia and their international marketing activities (such as 'Savour Australia') to help grow demand for our wine;
  - improved access to key markets such as China to lift export performance; and,
  - closer industry ties with the national wine retailers to help grow the category domestically.

- This growth and lift in profitability is important for regional jobs and to attract new capital required for re-investment in infrastructure and in necessary innovation for the sector to maintain and improve global competitiveness

- What is different about these from past initiatives is that they are comprehensive and have been developed through independent evidence-based research and real experience from a representative Board, in close consultation with small, medium and large winemakers and the wider industry.

- This difference, together with a united industry approach and a focussed WFA management team, will underpin successful implementation over the next 2 to 3 years.

Our wine industry has earned the reputation of being one of Australia's most significant globally competitive industries. This achievement reflects decades of investment, hard work and collaboration by winemakers and growers and many others across Australia. This international reputation and collaborative approach will be an advantage when competing in new markets well into the future.

In recent years however, we have been confronted by a number of challenges which have impacted industry profitability and reduced asset values. Unless they are restored, the industry will not attract the capital required for re-investment back into infrastructure, regional jobs and innovation.

WFA, as the peak industry body for wine producers, believes that we can and should take a series of steps to address this as detailed in this paper which we have called "Actions For Industry Profitability 2014 - 2016".

These Actions have been developed by the WFA Board, which represents large, medium and small producers from across Australia, and through extensive consultation with industry. They are our response to the findings of the independent Expert Review of industry dynamics (attached for your consideration) and our formal consultation with Industry conducted in September and October 2013 following the release of our suggested Actions.

This consultation included eleven regional road shows to wine making areas and over 70 written submissions from individuals and national, state and regional industry bodies and stakeholders including the major retailers. This approach to industry involvement was an important step in the process. We had genuine input and the importance of our work is reflected in the comments we received to this initiative which are more fully set out on our website. By way of example:

- "The AWRI is strongly supportive of the initiative taken by WFA..."
- "We continue to support the work taken by WFA as outlined in the paper..." (Wine Australia)
- "WGGA congratulates WFA on taking an evidential approach to understanding the drivers of the wine sector growth"
- "Let us congratulate you and your team for the extensive review undertaken..." (Amorim)
- "The WFA is to be congratulated for producing the document to enable the industry to have meaningful engagement regarding the issues and actions identified: (South Australian Wine Industry Association)
- "WV supports the efforts to provide direction to wine businesses and to help policy makers when dealing with the wine industry" (Wine Victoria)
- "The Expert Report is a substantial piece of work by Industry and its participants. It remains a relevant foundation piece to work from..." (Wines of Western Australia).
- "We therefore applaud the efforts of WFA..." (Yarra Valley Growers Association)

The consultations were well received by participants and in a number of cases had been preceded by local or regional discussions. The consultations involved frank and at times robust input. We sought to ensure that all comments were captured and were recorded on our website so they could be shared with those who may not have been able to attend. So that those attending could speak freely, we committed to not attributing names in reporting their comments.

Our Board has reviewed and discussed this input and as a result has made changes to a number of the suggested Actions such as on the WET rebate and added some new ones particularly in the area of wine and health and on increasing demand and these are explained in attachment 2. The Actions are now the richer for that input.

We are confident, now that we are at the end of the process, that we have a blueprint for implementation to improve industry settings. These improvements will assist our members and those involved in the industry to set their own strategies and directions to lift profitability and grow their businesses.

As highlighted above, what is new in this approach and WFA's leadership is:

- Evidence based research as a foundation for the WFA Actions;
- Research added to and reviewed by real experience from the WFA Board, from other industry participants and from the consultations;
- A comprehensive set of initiatives to deal with complex and interlinked issues and recognition that there is no silver bullet or one size fits all solution, and
- A dose of reality that it will take time and a continued united voice (large, medium and small) to get these industry settings right.

Winemakers' Federation of Australia

We now look forward to working with you to implement the Actions and we will provide periodic reports on our progress.

We commend the Actions and this report to you.

Yours sincerely,

Tony D'Aloisio AM
President

Paul Evans
Chief Executive

Executive Summary

The 43 Actions outlined in this document are a blueprint to lift the profitability of Australian wine businesses for growth in both domestic and export markets.

They are grouped under eight initiatives and cover what must be done at the industry and regulatory level to achieve the right industry settings to keep the wine sector as one of Australia's most significant globally competitive industries.

They are as follows:

1. Continue to engage the Wine and Health debate

WFA will proactively engage the Wine and Health debate to promote responsible consumption and ensure a balanced regulatory framework for our Industry. The outcome by taking these Actions will be to minimise harm to the community, promote the benefits of moderation and to shape the policy debate.

Responsible Citizens

1.1 All wine companies should continue to support or join WFA to participate in its initiatives aimed at promoting a responsible industry and drinking culture.

Fact-Based Analysis

1.2 WFA will continue critical analysis into the link between price and at-risk consumption and incorporate the findings into its advocacy on alcohol tax issues.

Promote Moderation

1.3 WFA will undertake analysis into the health and social benefits of moderate wine consumption and develop an appropriate communications campaign to encourage moderation.

1.4 WFA will explore opportunities to promote moderation through the industry's broader marketing campaigns.

Build an Evidenced-Based Approach

1.5 WFA will identify and meet the emerging research needs of the Industry, as it prepares for the review of the NHMRC national consumer guidelines for safe alcohol consumption and the National Alcohol and Drug Strategy.

1.6 WFA will work with GWRDC to secure and develop a permanent research capacity for health issues in the wine industry

Supporting Our Consumers

1.7 WFA will work with other alcohol industry associations and DrinkWise Australia on developing a national consumer-facing standard drinks campaign.

1.8 WFA will continue to advocate on behalf of the Industry for a balanced and evidence-based approach to the regulation of wine production, promotion and sales.

2. Grow the Demand Opportunity

With WAC and the Australian government, WFA will help wine businesses grow demand for our wine, both domestically and internationally. The outcome from taking these Actions will be an increase in the relative market share of Australian wine in all major markets while we perform as well as or better in each segment.

Understand Market Challenges

2.1 WFA will work with WAC on analysing the individual challenges in our key markets with a particular focus on route-to-market and ensure existing insights and research are leveraged in policy and programme development.

Strengthen WAC

2.2 Wine Australia should be adequately funded to rebuild its core operational capability.

2.3 Wine Australia should be adequately funded to increase investment levels in core marketing programmes including:

1) A stronger presence in trade shows
2) Partnerships with Tourism Australia
3) Educating key markets
4) Visitors programme
5) Savour Australia
6) Domestic marketplace initiatives emphasising our wine regions

2.4 Wine Australia should be adequately funded to develop and execute new initiatives including:

1) A social media-based platform to promote Australian wine
2) Regional promotions

Extend Export Market Development Grants

2.5 The Australian Government to double the level of funding to Export Market Development Grants and reform the eligibility criteria

Improve Market Access

2.6 The Australian Government to rigorously pursue the FTA with China and other regional trading partners and provide adequate resourcing to improve market access including:

- APEC initiatives in the Standards and Conformance Sub Committee and Wine Regulatory Forum aimed at standardising import requirements.
- The reduction in trade barriers caused by differing maximum residue limits for agri-chemicals across key markets.
- DAFF and FSANZ's pursuit of bipartisan and regional agreements.
- DFAT and DAFF's capabilities to properly incorporate technical and regulatory issues into the development and maintenance of FTAs and regional trade agreements.

Execute a "Buy Australian First" campaign with the major liquor retailers

2.7 WFA will support the national retailers in the development of a "Buy Australian First" consumer facing campaign. This will promote regionality, blends and leading varieties with the aim of capturing share from imports and re-engaging Australian consumers.

3. Hasten the Supply Correction

WFA with WGGA will hasten the correction to the supply base to improve margins throughout the value chain. The outcome will help reduce the oversupply of commercial grade grapes and the pricing distortion it creates throughout the industry.

Vineyard Profitability

3.1 WFA and WGGA will produce a regular review of vineyard profitability supported by a National Vineyard Database and an update of demand projections in key markets.

Vineyard Flexibility and Profit Improvement

3.2 The Joint Policy Forum (WFA and WGGA) will review the need to commission research on:
   a) lowering the cost of vineyard turnover and removal to facilitate greater responsiveness of vineyards to structural imbalances, economic cycles and changes in consumer preferences;
   b) vineyard flexibility to ascertain where there is excess supply and the technical priorities to support improvements in vineyard quality;
   c) alternate uses/markets for grape oversupply.

Code of Conduct

3.3 WFA and WGGA will continue to support the Code of Conduct between winemakers and growers.

Vine buyback

3.4 WFA does not support a vine buyback.

A Better Understanding of the Drivers behind 'Sticky Supply'

3.5 The Joint Policy Forum (WFA and WGGA) will undertake research to better understand the reasons for the slow correction to the supply base in light of on-going poor profitability as a potential pathway to developing options to incentivise consolidation and rationalisation.

4. Maximise Open and Fair Domestic Competition

WFA will work with the national wine retailers and competition regulator on fairness, transparency and equity in the domestic wine market. The outcome will be a more sustainable domestic marketplace for industry where companies can grow share through quality, innovation and investment.

Collaborate on shared issues and build relationships

4.1 Collaborate with the retail sector on shared issues through a standing Industry Working Group.

Code of Conduct

4.2 WFA will work with the national chains to adopt an Industry Code of Conduct based on agreed Principles and Practices.

Assist retailers and members with concerns over unfair treatment

4.3 WFA will establish a process with retailers and producers to confidentially highlight concerns regarding retailer conduct that they believe could be an abuse of market power.

Deal with Horizontal and Vertical Integration

4.4 WFA will continue to work with the ACCC and the Government on the structure of wine markets, potential vertical and horizontal acquisitions by the chains, and the likely impact these acquisitions may have on competition and market structure.

Public Benefit Review

4.5 WFA will continue to consider options to reform Competition Law and the ACCC in a manner consistent with the objectives of the recommended Principles and Practices and with greater scrutiny and control over vertical and horizontal integration.

Further analysis on the wine market and competitiveness

4.6 WFA to work with the Productivity Commission to extend the analysis of the domestic wine market and competition issues.

Appropriate labelling for Retail-owned Brands and Cleanskins

4.7 WFA to work with the national retailers to ensure appropriate labelling of all wine products.

5. Retain with changes to the WET rebate

WFA with the Australian Government will retain and make changes to the Wine Equalisation Tax rebate to support regional communities. The outcome will be the retention of the WET rebate to ensure that it is working within its original policy intent, and to seek policy changes to improve the workings of the WET rebate on the wine industry, consistent with its original intent.

Retain and Apply the Rebate in Accordance with the Original Intent

5.1 WFA will work with the ATO to identify any changes that can be made to the interpretation and application of the existing provisions so that implementation is in line with the original intent.

5.2 WFA will, for example, work with the ATO to identify and assess claim accessibility for uncommercial arrangements (for example when the ATO forms the view that the growers/winemakers have split their activities or have colluded in the establishment of business activities with the substantial purpose of claiming multiple rebates), and for schemes with the sole or dominant purpose of accessing the rebate contrary to the anti-avoidance provisions.

Policy Changes in the Near Term

Phase Out Eligibility for Bulk and Unbranded Wine

5.3 Remove eligibility for the WET rebate from bulk, unpackaged, unbranded and wine for the private label of retailers and from wine that is not a finished product fit for retail sale. That is, limit the rebate to those who:

a) manufacture and sell wine in a form that is packaged ready for retail sale and where the finished product is identifiably theirs;
or
b) grow grapes and sell wine in a form that is packaged ready for retail sale and where the finished product is identifiably theirs.

Bulk wine is defined as wine in containers over 25 litres.

The measure will be introduced with the rebate on bulk and unbranded wine phased out at 25% per year starting at 75% of the rate as of 1 July 2014.

5.4 Remove eligibility to foreign entities.

5.5 Introduce transitional rebate measures to allow the second rebate on a merger of two businesses which are entitled to the rebate to remain with the new entity but be phased out at 25% per year over 4 years. These transitional arrangements will be made available to the industry for up to 5 years from the date of implementation.

WET Rebate Policy Review

5.6 WFA will analyse the impact of the reform measures outlined above and continue the analysis of the WET rebate which forms part of the Expert Review and carry out the following further work in consultation with, and making all results available to, Industry:

a) On-going assessment of whether the rebate is causing unintended industry consequences, distorting supply and impacting profitability and if so how it should be dealt with.
b) A formal review of rebate policy arrangements 3 years from implementation of the reform measures to assess all options, which could include keeping the rebate or a substitute, further restricting rebate eligibility, reducing the cap (the maximum claimable amount) or a timetable for phasing out the rebate.

Standing Tax Task Force

5.7 WFA will form a permanent industry taskforce in partnership with WGGA, the ATO and Federal Treasury on wine tax reform and implementation issues.

5.8 The ATO to reform rebate reporting requirements to capture an improved data set on the profile of claimants and rebatable wine.

6. Monitor the future of wine tax policy

WFA will monitor the future of wine tax arrangements in response to changing market conditions. The outcome will be the on-going examination of optimal taxation arrangements for industry to support growth and our licence to operate with the community.

6.1 WFA will continue to analyse proposals for reform to wine tax arrangements.

6.2 WFA will develop an updated socio-economic footprint of the industry to help model the commercial and community impacts of any proposed policy changes related to tax reform.

7. Secure the funding for the Action agenda

WFA will secure the funding to support the recommended reform agenda in partnership with Industry and Government.

7.1 WFA will secure funding to implement the Actions.

8. Areas for On-going Work

WFA will continue and expand its good work in a number of important programme and policy areas.

8.1 Improving our understanding of cost pressures and working with the broader business community to reduce the costs of doing business.

8.2 Promoting Innovation and prioritising R&D spend.

8.3 Leveraging the Australian wine industry's environmental credentials.

8.4 Leading Organisational Reform.

8.5 Improving market access.

Action 1: Continue to Engage in the Wine & Health Debate

Proactively engage the Wine and Health debate to promote responsible consumption and ensure a balanced regulatory framework for our Industry.

Outcome: To minimise harm to the community, promote the benefits of moderation and to shape the policy debate.

The Australian wine industry is deeply committed to acting responsibly and working with others to ensure its products are consumed in moderation. In particular, consultation with industry has highlighted a strong willingness on their part to participate in direct action programmes that empower consumers to make more informed drinking choices, and to support research initiatives that underpin the on-going policy debate on alcohol regulation, with a strong evidence base. There is an overwhelming sense of importance put on the sector's licence to operate with the Australian community and in wine making regions.

There is also a significant support for the wine industry to do more to enhance its reputation as a responsible industry and to counter claims made by some sections of the public health lobby that the sector should be more tightly regulated. This push includes proposals to increase wine taxes and to limit the industry's ability to sell, market and innovate its products. As such, the wine and health debate presents the Industry with a range of immediate commercial risks. There is a high expectation for WFA and other industry organisations to 'step up' and do more in engaging these issues and progressing a balanced, fact-based response with governments, NGOs and the broader community.

It is important to note that, while some data on alcohol consumption and rates of misuse indicate positive or neutral trends, community values around the acceptability of alcohol-related harm and expectations for corporate behaviour continue to evolve and "raise the bar". For the wine industry, this has manifested in increasing levels of scrutiny on the corporate social responsibility commitments of individual companies and increased expectations from governments that the industry will pro-actively self-regulate and pursue voluntary activities aimed at reducing levels of harm. WFA believes the Industry can and should pro-actively and positively respond to these expectations.

There is also widespread concern in the wine industry regarding the imbalance between the importance of the wine and health debate for the sustainability of the sector and the level of funding available to develop programmes and to meet research priorities. Currently, financial support for activities is provided by WFA and the National Wine Foundation and this has enabled a number of important initiatives to be undertaken (see below). A number of WFA member companies also provide significant funds and resources for company-specific initiatives or to support organisations such as DrinkWise Australia. However, the combined funding levels of the industry and the body of work it currently supports are worryingly deficient relative to the resources available to the public health and anti-alcohol lobby.

Securing the funding to enable WFA to make a difference in the debates and subsequent policy development will be challenging and, going forward, the statutory authorities will need to provide direct support to undertake this important work. The case for doing so is strong given the importance of these issues to the future of the industry and the wellbeing of wine consumers. In particular, the consultation has highlighted strong support for GWRDC to make funding available for research on wine and health issues and an appetite within industry to better understand GWRDC's funding parameters in this space. Other potential sources of funding and programme partnerships also need to be fully explored and include federal and state agencies, the University sector and willing NGOs.

WFA will also continue to ensure any analysis and research is conducted by credible and independent organisations and that outputs where appropriate are peer reviewed. We remain strongly committed to an evidence-based approach to our advocacy efforts and public commentary on the issues.

This means that WFA (on advice from the GWRDC) may take an 'arms-length' approach to the undertaking of the research and analysis referenced in the Actions below and request independent research organisations to undertake the work.

Engaging the wine and health debate will continue to be a primary focus for WFA. We will continue to provide Industry with advice and support to help them promote moderation and we will continue to advance a fact-based policy debate on future regulation. Not only is this the right thing to do, but it is also a priority to ensure the sector operates within a stable and balanced regulatory environment that supports profitability and growth.

This approach has support from other national, state and regional wine associations. The national retailers are also committed to these efforts and have indicated their willingness to collaborate on programmes and priorities. WFA will progress the Actions outlined below in consultation with these organisations and explore opportunities for direct partnerships.

Responsible Citizens

➢ Action 1.1

All wine companies should continue to support or join WFA to participate in its initiatives aimed at promoting a responsible industry and drinking culture.

The wine industry enjoys strong support in regional communities and its products continue to be consumed in moderation by the vast majority of wine drinkers. WFA has also put in place programmes such as membership and support of the Alcohol Beverages Advertising Code, the Voluntary Pregnancy Labelling Initiative and Responsible Winery Initiative to ensure producers have the necessary tools available to effectively self-regulate. It is important that all winemakers participate in these and future initiatives to both reduce misuse and the likelihood of arbitrary regulation. Being a member of WFA also provides funding to support these programmes and the development of future activities. Future programmes will include working with other sectors of the alcohol industry on a consumer-facing standard drinks education campaign and promoting a message of moderation to specific target groups (see below).

Fact Based Analysis

➢ Action 1.2

WFA will continue critical analysis into the link between price and at-risk consumption and incorporate the findings into its advocacy on alcohol tax issues.

There are specific proposals generated by the public health lobby that pose an on-going risk to the industry in the form of an ad hoc increase in wine taxes aimed at lifting prices and lowering consumption. While there is no clear evidence that such a measure would reduce potential harm from excessive drinking, the hypothesis that a drop in overall consumption leads to a proportional reduction in alcohol-related harm has gone largely unchallenged. To enable industry to build its understanding on this critical issue, research commissioned by WFA is now underway to explore the price sensitivity of "at-risk" consumers. This analysis is central to mitigating the risk of a wine tax increase aimed at achieving social policy outcomes and, specifically, interrogating the claim that higher retail prices will reduce alcohol-related harm.

Promote Moderation

➢ Action 1.3

WFA will undertake analysis into the health and social benefits of moderate wine consumption and develop an appropriate communications campaign to encourage moderation.

➢ Action 1.4

WFA will explore opportunities to promote moderation through the industry's broader marketing campaigns.

Work within WFA is underway to consolidate global research on the health and social benefits of moderate wine consumption. This work will ensure we have a solid evidence base to develop a consumer-facing education campaign that confirms moderate drinking can be a part of a healthy Australian diet and lifestyle, and can lead to a happier and longer life. It also has the potential to facilitate a more proactive approach to the current community debate around Australia's drinking culture and inform a credible "drink in moderation" message from the industry based on sound evidence that could be promoted to targeted at-risk groups and the health profession across a number of mediums and platforms.

Upon the completion of this work, WFA will explore the potential for an appropriate and independently endorsed communication campaign on the health issues surrounding wine consumption. WFA will seek funding support from the Federal Government in the development and delivery of this initiative. The approximate cost will be $0.5m in 2015.

There is also potential for WFA to work more closely with WAC on promoting the message of moderation in generic category marketing and in campaigns such as Tourism Australia's 'Restaurant Australia' initiative.[1] These opportunities and consideration of the possible mechanics and execution techniques will be explored by the WFA's Wine and Health Working Group in consultation with WAC.

Build an Evidence-Based Approach

➢ Action 1.5

WFA will identify and meet the emerging research needs of the Industry as it prepares for the review of the NHMRC national consumer guidelines for safe alcohol consumption and the National Alcohol and Drug Strategy.

➢ Action 1.6

WFA will work with GWRDC to secure and develop a permanent research capacity for health issues in the wine industry.

WFA believes that the specific analysis referenced at Action 1.2 and 1.3 above should be the start of a broader industry-wide commitment to establishing a strategic research capability that informs and reinforces our positioning on key wine and health policy issues. Addressing this matter is urgent as important inter-governmental reviews of current consumer advice and alcohol regulation are scheduled to get underway during the current term of the Federal Government.

Funding of up to $0.25m per annum will be required to support appropriately qualified and experienced staffing to meet this need.

[1] http://www.tourism.australia.com/documents/Campaigns/TA_Austourism_foodandwine_Factsheets.pdf

Potential areas for work include studies comparing international standards and approaches for safe alcohol consumption and the case to reform the existing guidelines across all population cohorts; comparing risk of alcohol-related injury and disease relative to other dietary and behavioural community issues; and, a better understanding of international best practice in responsible marketing including social media.

Priorities will be further explored by the WFA Working Group on Alcohol and Health in partnership with GWRDC. It is estimated that up to $0.5m per annum will be required to sustain and build the body of knowledge required for this work.

Supporting our Customers

➢ Action 1.7

WFA will work with other alcohol industry associations and DrinkWise Australia on developing a national consumer-facing standard drinks campaign.

The first step in supporting better drinking choices among drinkers is to arm them with a better understanding of the quantity of alcohol they are consuming across different alcohol types and varieties and across different glass and container formats. Research has repeatedly shown poor levels of understanding among consumers of what constitutes a 'standard drink' and without this awareness, it is difficult for them to measure and moderate their alcohol intake.

WFA supports a multi-category education campaign, to be delivered on and off premise directly to consumers, that raises awareness levels of what a standard drink of alcohol is. WFA will work with DrinkWise on the concept and help via cellar doors and other wine retail locations to execute the campaign.

➢ Action 1.8

WFA will continue to advocate on behalf of the Industry for a balanced and evidence-based approach to the regulation of wine production, promotion and sales.

WFA will continue to work with other wine organisations, the broader alcohol industry (including on and off-premise retailers) and all layers of government on a regulatory framework that is balanced, evidence-based and provides business certainty. This includes on-going participation in important industry forums such as the National Alcohol Beverages Industry Council, the Alcohol Beverages Advertising Code and DrinkWise Australia. We will continue to focus on our rights to responsibly make, market and sell our products, and to participate in community debates on how rates of harm and misuse can best be reduced. This work includes advocacy on a number of commercially relevant policy areas on behalf of industry and wine consumers such as labelling; advertising; sports sponsorship; licensing and availability; new product development and packaging; and, taxation.

Action 2: Grow the Demand Opportunity

Grow demand for our wine, both domestically and internationally.

Outcome: To increase the relative market share of Australian wine in all major markets while performing as well as or better in each segment.

WFA strongly believes increasing the local and export demand opportunity for Australian wine is critical for the future profit growth of the industry. While individual companies will continue to lead these efforts, ongoing and adequately funded support from Wine Australia Corporation (WAC) will also be crucial and consultation with industry has reaffirmed this view.

In regards to international markets, a drop in the value of the Australian dollar will not be enough on its own to achieve our demand ambitions. Domestically, and despite the domestic market offering producers higher average margins than exports, the industry has lacked a coordinated response to the increasing penetration of foreign wine and a plan for domestic category growth. We believe Actions can be taken by WFA to help the campaigns of individual companies and brands to address both markets. However, significant resourcing and focus will be required.

Australian wine has shown resilience in volume terms, trading since 2007 in a highly competitive environment that has been exacerbated by global oversupply and margin erosion. This has severely impacted the ability of individual companies to maintain investment levels in their brands and in-country marketing. In many cases, investment has shifted to price discounting.

Over the same time, levies paid to WAC to support all its activities have declined from $17m to $11m per annum.

Together, these developments have seen the Australian wine category trade down, with many brands reduced to competing on price and convenience alone. In the crowded international marketplace, the Australian category has lost support among some traditional distributors and importers and potentially is not well placed to capture the full opportunity presented by the 'Asian Century' and emerging markets such as China.

For example, the trading performance of Australian wine was trending down in the key US and UK markets before the sharp appreciation of the Australian dollar from 2008. In addition, there has been a downward shift in the demand curve for Australian wine in local currency terms in key markets across all price points, suggesting that our challenges will not be resolved by price alone – including a sustained depreciation of the Australian dollar.

As such, a broad range of tailored activities will be needed to rebuild support for Australian wine among consumers, distributors, commentators and other "gatekeepers" in key domestic and international markets. This will include stronger investment in market opportunities, and long-term fully funded collaborative initiatives lead by WAC aimed at rebuilding the Australian category. Strategies to educate the supply chain, surround the Australian category with excitement and "telling the story" of the quality and diversity of our wine offer will be important.

Meeting these challenges will be a priority for the in-coming Board of the merged statutory authority that will combine the work of WAC and GWRDC into a single entity and management structure. It is clear from consultation that, while the broad WAC objectives of highlighting diversity and distinctiveness has widespread industry support, there is a range of views about how this can be best achieved. A review of the strategy and programme focus of WAC by the new Board will need to consider these views and continue to strike a balance in marketing intent between promoting regions, the leading fine wine segment, generic category promotion and finding profitable markets, specifically for the oversupply of commercial grade wine currently competing for limited domestic retail shelf space.

This will ensure that future funding continues to be used effectively and that industry fully understands the strategic priorities.

Themes for future WAC marketing initiatives and programming raised during the consultation include; focusing on the 'heroes' of the industry; developing a clear and simple narrative of Australian wine and why we are better; varietal campaigns; tastings for and the specific targeting of international students; certification for the fine wine segment; better leveraging of Australia's environmental and sustainability credentials; the conversion of market insights into specific advice for individual businesses and regions; promoting leading regions and regionality; developing a specific advisory role on route-to-market challenges and to improve negotiation skills; and, an improved presence at international trade shows.

The future application of the 'user-pays' approach for programme participation is also an issue for many smaller winemakers and this matter will also need to be considered by the in-coming Board. The potential for closer operational ties and programme management with state and local government wine marketing and tourism authorities was also raised during the consultation as an opportunity. It was also suggested that understanding the full potential of this opportunity requires an audit of all current and potential market funding at the national, state and regional level. This work should consider the total quantum of industry funding that could be available if greater strategic and programme alignment was struck across the different levels and various wine marketing organisations.

It is also clear from Industry's feedback that there is significant support to increase funding for WAC's marketing activities and that this provides an opportunity for WAC to strengthen its consultative processes with industry, and to improve industry's understanding of how it develops, reports against and achieves its annual and longer-term key performance measures. This could include WAC developing a network of industry advocates across the regions to help promote its work and to provide feedback into strategy and programme development. Consultation and the measurement of return on levy payers' investment in marketing activities will be a matter that WFA will continue to progress with WAC and the new merged statutory authority when it comes into being.

In the meantime, by taking the Actions outlined below, WFA believes we can increase the market share of Australian wine in all major markets in each segment.

Understand Market Challenges

➢ Action 2.1

WFA will work with WAC on analysing the individual challenges in our key markets with a particular focus on route-to-market and ensure existing insights and research are leveraged in policy and programme development.

WFA acknowledges that considerable work has already been undertaken by WAC with the support of the GWRDC on understanding the state of the Australian category's 'brand health' in key markets and specific in-market challenges including consumer trends. This analysis can be found on the WAC website[2]. This work needs to continue to support the activities of individual companies as they undertake the difficult task of reasserting themselves (and in some cases re-entering) these key markets.

[2] Please refer to http://www.gwrdc.com.au/completed_projects

It is also important that this research and data continues to be communicated to industry to highlight and build a better understanding around the on-going challenges in capturing emerging demand opportunities. Realising the potential will continue to be hard and difficult work for both individual wine companies and the industry organisations that support them.

The future focus for analysis should be twofold. Firstly, on how best to re-engage and excite distributors and other important gatekeepers in the critical North American market. This research will be aimed at developing a better understanding of what support they might require to put resources behind our wine and to build compelling Australian portfolios. WFA believes the North American market is a priority and critical to the overall improvement in the Australian category's export performance because this market offers substantial volume and value growth potential that could be re-captured in the short term.

Secondly, future work should also focus on how businesses can overcome the specific route-to-market challenges of the China market and other emerging Asian markets. The China market also presents an enormous opportunity for the Australian category across all segments but there is still much to learn about its particular challenges in distribution. This work will need to be coordinated with advice from other relevant Government agencies and aim to deliver improved networks and practical advice and tools for wine businesses.

Strengthen WAC

➢ Action 2.2

Wine Australia should be adequately funded to rebuild its core operational capability.

Facing declining levy-based budgets and increasing fixed costs, WAC has significantly reduced operating costs, restructured its operations and made difficult decisions about where to focus limited resources. Further changes will be required if alternate revenue sources cannot be found. These may include further reductions to in-market representation and the withdrawal from some markets altogether. It is estimated that to reach the desired level of activity, WAC will require an additional $2m per annum. However, there will be a need for the in-coming Board of the merged statutory authority to confirm this figure via a strategic review of WAC operational priorities and to outline to industry where the funding priorities are.

➢ Action 2.3

Wine Australia should be adequately funded to increase investment levels in core marketing programmes including:

1) **A stronger presence in trade shows**
2) **Partnerships with Tourism Australia**
3) **Educating key markets**
4) **Visitors programme**
5) **Savour Australia**
6) **Domestic marketplace initiatives emphasising our wine regions**

WFA believes there are a number of existing and potential WAC programmes that could help engage and re-engage international and domestic consumers with the Australian category beyond price and convenience.

The key will be to change perceptions and raise awareness of the value presented by the category across all price points, bringing into the consumer conversation the breadth of styles, the characters and the places that give our wines their distinctive personalities and make them uniquely Australian.

The programmes outlined below position Australia's best wines as being second to none, and also promote the quality, diversity and value of the wider Australian branded category. This investment is particularly relevant for the large commercial segment which has been confronting significant declines in export demand and margins.

The overall aim is to restore "excitement" in the Australian category, and provide a strong basis for a more concerted industry effort to compete for sales against our competitors, return better margin to producers and anticipate and shape emerging consumer trends.

Many of these programmes also present opportunities for WAC to work closely with regional wine associations and other federal, state and regional government wine and tourism authorities. WAC has adopted the 'user pays' principle for participation in many of its programmes and this approach is supported by WFA and should continue for appropriate programmes. However, additional funding should also be made available to WAC to invest in developing market opportunities. Additional activity (supported by user pays and/or additional funding) is as follows:

1. Establishing a much stronger presence at key trade shows. Developing appropriate branding of larger scale pavilions and making a greater statement at these key shows is important, particularly in Asia, where face and image are vital considerations. Australia's presence at these shows is currently fragmented and understated in comparison to competitors, and this needs to be addressed. Target shows would include ProWein (Germany and China), the Hong Kong International Wine and Spirits Fair, London International Wine Fair, and Vinexpo.

   Additional funding required is approximately $1m p.a.

2. Under its MOU with Wine Australia, Tourism Australia will invest dollar for dollar in activities developed from a jointly created food and wine strategy. The underlying consumer facing campaign (currently in development) seeks to establish a more premium perception of Australian wine and make our food and wine offering more compelling for travellers to and within Australia.

   Additional market development investment needs to be channelled to this campaign in order to effectively target consumers in China, the US and the UK. Additional funding required is approximately $2.5m p.a.

3. Greater investment in education in key markets. The education of trade, key influencers and other gatekeepers is crucial in building a stronger perception of the quality and diversity of our wine offer. We believe WAC's education programs, delivered under the name of A+ Australian Wine, are achieving cut through. However, extending this to reach more supply chain participants and facilitate consumer facing education programs would accelerate the development of our premium offer in key markets. Partnerships could be further developed between WAC and key global wine education providers such as the Court of Master Sommeliers and Wine and Spirit Education Trust to improve Australian wine related content and delivery in their syllabi.

   Additional funding required is approximately $0.5m p.a.

4. The Visitors Program is important for changing the attitudes of international trade and media, and establishing a greater understanding of the diversity of Australian wine regions, the quality of our wines and the people who make them. Greater investment in this program would allow us to reach more key influencers and provide a deeper immersion into our wine regions and better overall experiences. In addition, funds could be invested to support regions in up-skilling, and improving visitor experiences.

   Additional funding required is approximately $0.5m p.a.

5. Savour Australia 2013 was the biggest and most comprehensive Australian wine forum ever undertaken. It challenged out-dated perceptions of Australian wine and highlighted the domestic and global business case for wines from Australia. The forum also showcased the quality and diversity of Australian wine and wine regions to the global and domestic wine trade, importers, distributors and wine/lifestyle media. There is a strong case to hold this event every two years to keep the category front of mind with the supply chain and key influencers and to engage the next generation of influencers. WAC should review options for making future events more inclusive and cost effective for regional organisations and individual branded wine businesses to attend.

   Additional start-up funding required is approximately $2m.

6. Increased investment in domestic marketplace initiatives to work more closely with the trade on consumer events and activities in capital cities and regional centres. Building the Australian wine category in the domestic market and raising the awareness of wines and regional experiences available from our own backyard must remain a priority if we are to recover share from imports.

   Additional funding required is approximately $0.5m p.a.

➢ Action 2.4

Wine Australia should be adequately funded to develop and execute new initiatives including:

1) **A social media-based platform to promote Australian wine**
2) **Regional promotions**

1. While many individual cellar door operators already have successful web-based sales formats, research on the potential of social media and web-based sales platforms can provide WAC with a better understanding of the opportunity for the sector and how best to leverage the category offering on-line. We believe a three step solution is required:

   i. GWRDC to fund a project into how the Australian wine sector can use social media to build a platform to engage and communicate with consumers and build category support. This work should take full advantage of the existing industry expertise in social media and develop tangible commercial performance measures to assess the initiative's success.
   ii. Utilising the outcomes of this project, develop on-line initiatives to promote Australian wine to the world
   iii. Use Tourism Australia and WAC's existing social media networks to foster a broad based on-line interest in Australian wine.

2. In partnership with progressive regions, undertake highly visible regional promotions in key markets and with key channel customers. This would include getting wine into the hands of consumers with in-store tastings, by the glass promotions, strong branding and in-store/on-premise collateral.

   Additional funding required is approximately $0.5m p.a.

Extend Export Market Development Grants

➢ Action 2.5

The Australian Government to double the level of funding to Export Market Development Grants and reform the eligibility criteria.

The Australian Government can play an important supporting role in strategies to increase the demand opportunity. The multiplier effect of Export Market Development Grants is well known, and the wine industry has had a major presence in the programme, averaging around 250 recipients each year. These grants have enabled many small and medium producers to develop and promote their products effectively, and should be expanded.

Doubling the EMDG across the entire manufacturing sector would need to be progressed in consultation with a number of other industry sectors. In addition, eligibility criteria should be reviewed. Present arrangements exclude many of the most innovative wine industry leaders from receiving further grants, which creates an artificial ceiling on the potential impact of the program. These restrictions also come at a time when many of these leading businesses require support to undertake the difficult task of re-entering markets where demand for our wine has suffered as a consequence of external forces such as high exchange rates. Changes should also be made to ensure existing EMDG contracts have provisions that shield recipients from future policy changes that alter the terms of the grants.

If the Government cannot support such an increase in support for the EMDG programme, WFA should pursue an industry specific grant programme aimed at fostering export innovation and growth.

Improve Market Access

➢ Action 2.6

The Australian Government to rigorously pursue the FTA with China and other regional trading partners and provide adequate resourcing to improve market access including:

- **APEC initiatives in the Standards and Conformance Sub Committee and Wine Regulatory Forum aimed at standardising import requirements**
- **The reduction in trade barriers caused by differing maximum residue limits for agri-chemicals across key markets**
- **DAFF and FSANZ's pursuit of bipartisan and regional agreements**
- **DFAT and DAFF's capabilities to properly incorporate technical and regulatory issues into the development and maintenance of FTAs and regional trade agreements**

Completing the Australia-China FTA is a key priority if the full export potential of the fine wine segment identified in the Review is to be captured and to ensure the competitiveness of our lower priced wine

The Australian Government must continue to pursue Agreements with China and other emerging Asian markets as an upmost priority. Targeted resourcing to government agencies to accelerate other market access opportunities also remains important such as the inclusion of wine in other bilateral agreements with Japan, Korea, India and Indonesia.

The funding required to support these measures is estimated to be an additional $2m per annum across a number of government agencies and would need to come from a redirection of existing Government spending.

Execute a "Buy Australian First" campaign with the major liquor retailers

➢ Action 2.7

WFA will support the national retailers in the development of a "Buy Australian First" consumer facing campaign. This will promote regionality, blends and leading varieties with the aim of capturing share from imports and re-engaging Australian consumers.

Industry has generally lacked a concerted and collaborative approach to recapturing share of the domestic market. We believe that a partnership approach with the national liquor retailers could make a difference, with sustained promotion of Australian wine rebuilding excitement around the category. This initiative will be developed with the retailers by the Industry Working Group proposed at Action 4.1 below and integrated with existing WAC initiatives for the domestic market.

Action 3: Hasten the Supply Correction

Hasten the correction to the supply base and improve margins throughout the value chain.

Outcome: Help reduce the oversupply of commercial grade grapes and the pricing distortion it creates throughout the industry.

Analysis and commentary on supply is difficult given the differences in approach across the industry to defining grade and quality. In addition, pricing distortions in the market created by the mismatch in demand and supply for our wine adds complexity in making assumptions and undertaking analysis. WFA acknowledges these difficulties.

However, our analysis estimates that up to 70% of total current wine grape production may be uneconomic with the most significant profitability issues concentrated in lower grade grapes. These poor returns are being driven by a significant oversupply and under-demand in C and D grapes/wine (as defined in the Expert Review) which has a distorting impact on the pricing of other grades[3]. This oversupply is likely to continue even under the most optimistic projections of demand growth for the domestic and international markets and will continue to see downward pressure over the long term on grape prices.

These sustained low grape prices also provide an understandable incentive for grape growers to; increase yields to maintain revenue levels; reduce costs that may negatively impact quality and environmental outcomes; and, develop direct commercial arrangements with retailers that undermine existing branded product.

There is, however, some evidence that market forces are addressing the supply-demand imbalance. From a peak of 163,000 hectares in 2006-07, the national bearing area has since declined by approximately 8.7% or 14,140 hectares, with the early adjustment in warmer regions now being followed in cooler-temperate regions. Overall, however, without further action, the market correction will continue to be slow and restrict the profit potential of E and F grade production.

The reasons for the slow correction to supply in the face of low profitability are numerous and include; winemakers processing and providing a market for uneconomic grapes; significant sunk costs; few alternate land uses; human and emotional factors; the WET rebate; and, current banking practices.

WFA believes a number of steps can be taken to hasten the correction and bring supply into better balance with demand, while also reducing pricing distortions. An important forum to progress these matters and to devise unified industry positions is the Joint Policy Forum (JPF) which brings together the leadership of both WFA and WGGA[4].

Both organisations agree that greater proactivity in the area of supply adjustment is required and the JPF will continue to work through the implementation of the Actions listed below and develop new initiatives. The key priorities include; a better understanding and directly addressing the drivers of the slow adjustment; developing strategies to encourage fair and equitable dealings between grape grower and winemaker; and, identifying future research and programme priorities to improve the competitiveness of Australian wine through technical, economic and product innovation. WFA considers the JPF as an important form of integration with WGGA that will lead to closer working relations on a number of issues and greater efficiency in the application of limited industry resources on resolving key issues.

[3] Please note that the definition of grades used in the report (all in Australian dollars)

- In terms of grape prices per tonne, A (above $2,000/tonne), B ($1,500.01 to $2,000), C ($600.01 to $1,500), D($300.01 to $600), E/F- less than $300
- In terms of domestic retail prices, A (>$30 per bottle), B ($15-30), C ($10-15), D ($7-10) and E/F (<$7)
- In terms of export FOB prices, A (>$10/litre), B ($7.50-9.99), C ($5-7.49), D ($2.50-4.99) and E/F (<$2.50)

[4] The Joint Policy Forum is an initiative of WFA and WGGA to provide a forum for the leadership of both organisations to discuss and progress a range of shared issues. The membership of the Forum includes the President of WFA, the Chair of WGGA, two Directors from both WFA and WGGA and both CEOs.

WFA also agrees with feedback from WGGA that more must be done to communicate to grape growers and vineyard owners on industry fundamentals to encourage more pro-active decision-making. This dialogue should include stronger market signals that provide growers with a sharper definition of market opportunities and demand-side trends and projections. With WGGA, WFA will review the outcomes of the Wine Restructuring Action Agenda and how they may be updated and explore communications opportunities to increase industry's understanding of the profitability challenges facing producers and grape growers.

The submission from WGGA also advocated the importance of stronger market signals being sent to growers through the adoption of objective measurement systems and protocols. WFA does not support such systems being adopted at the industry level, believing the processes in fruit purchasing should remain a matter for the individual parties involved and dependent on local circumstances. Strategies to encourage fair commercial dealings in setting prices and payment terms will be part of the work on reviewing WFA's recommended Code with growers (see Action 3.3 and discussion below). WFA agrees with WGGA that supply side adjustment will be supported by specific programmes to improve demand for commercial grade fruit (as outlined in Actions 2.1) and that innovation plays a vital role in improving our competitiveness (see Action 8.2).

Ultimately, however, WFA believes that economic forces will continue to be the primary driver to further adjustments in the market. Again, it will be up to individuals and companies to assess the situation and make proactive decisions in their best commercial interest.

Vineyard Profitability

➢ Action 3.1

WFA and WGGA will produce a regular review of vineyard profitability supported by a National Vineyard Database and an update of demand projections in key markets.

WFA urges all industry participants to consider the Expert Review's analysis on vineyard profitability in their decision-making on cost structures, improving vineyard quality, consolidation, diversification or whether to exit the industry altogether. To maintain a focus on this issue, the analysis of vineyard profitability needs to be ongoing and complemented with a national register of vineyards managed by WAC, information on demand trends in key market segments and trend analysis of the industry's foundation data set.

WFA will also commit greater resources to communicating these critical facts across industry and among key stakeholders in the investment and banking community. This will see WFA reviewing both the timing and content of its annual Vintage Report to ensure this work provides more comprehensive and market relevant information that is communicated more effectively.

It is estimated that establishing the National Vineyard Database will require up to $1m in funding for infrastructure and that the on-going management of the Foundation Data set will require $1m annually.

Vineyard Flexibility and Profit Improvement

➢ Action 3.2

The Joint Policy Forum (WFA and WGGA) will review the need to commission research on:

a) **Lowering the cost of vineyard turnover and removal to facilitate greater responsiveness of vineyards to structural imbalances, economic cycles and changes in consumer preferences.**
b) **Vineyard flexibility to ascertain where there is excess supply and the technical priorities to support improvements in vineyard quality.**
c) **Alternate uses/markets for grape oversupply.**

The Expert Review shone a light on the particular challenges of C and D grade production against projected demand. While addressing the oversupply in these segments relies heavily on developing domestic and international demand, more can also be done to support those growers who want to exit the industry through research and innovation to reduce adjustment costs.

Assessing the need for further research on vineyard improvement will provide insight as to whether more options are required for growers who believe their future lies in increasing their vineyard and grape quality. Improving quality, particularly for C grade vineyards, has the potential to help address the oversupply of commercial grade grapes and meet the projected undersupply of fine wine grapes in the key domestic, U.S. and China markets.

In recent years several international markets in oversupply have sourced alternate commercially sustainable markets for wine grapes. The redirection of grapes into concentrate and fresh juice, combining fruit with wine, pharmaceutical and other health products are examples. There is also potential innovation and lessons from other agricultural industries on income sources from the waste stream to be researched. These options need to be considered and appropriate analysis undertaken on the opportunities for domestic producers.

The funding required for these three research Actions is estimated to be $1.5m.

Code of Conduct

➢ Action 3.3

WFA and WGGA will continue to support the Code of Conduct between winemakers and growers.

Just as the Code of Conduct between retailers and winemakers is important (refer to Action 4.2), so too is a strong Code between winemakers and grape growers. The two national member organisations via the Joint Policy Forum will continue to review the Code in a manner consistent with the recommended Principle and Practices document for retailers, while acknowledging that the Code continues to raise a number of issues around indicative pricing and payment terms.

WFA is committed to working through these matters with WGGA and this process is already underway in the Forum and Code Management Committee. Any potential changes to the Code will be the subject of further consultation with industry. It should also be noted that recent progress has been made in obtaining further signatories to the Code with approximately 40% of the national crush covered by the Code as of late 2013.

With the finalisation of any amendments to the Code, the Forum will also consider ways and means to encourage further industry participation from both growers and winemakers in the Code.

Vine Buyback

➢ Action 3.4

WFA does not support a vine buyback.

WFA believes further re-adjustment to the supply base is likely to remain slow given processing overcapacity and significant sunk costs throughout the industry. A reduction in oversupply in some segments may result from the WET rebate reforms outlined at Action 5 below. However, the analysis of market projections suggests that even under the most optimistic scenarios, demand for C and D grade grapes is unlikely to address oversupply and the distorting impact this has on grape prices.

In considering the oversupply issue and the need to support the ongoing market correction, WFA has also assessed proposals for a targeted vine buyback scheme. After weighing up the case for and against, including the results from past state-based schemes and the challenges of avoiding unintended consequences, WFA has determined that such an initiative should not be supported. This approach has received strong support from the consultation with industry but it is an issue that will continue to be debated. Finding the funding for a buy back initiative is also an issue. Industry is aware of the difficulties of approaching government for financial support to remove vineyards after receiving tax incentives to plant vineyards for many years while the industry was in growth.

On balance, economic forces will continue to drive change. Beyond this there are no easy or quick solutions to hasten the correction to oversupply, WFA will continue to undertake and communicate the analysis that will encourage wine enterprises to take well informed and proactive decisions. WFA will also continue to emphasise the structural drivers behind poor profitability at lower grape grades and reiterate that a sustained recovery is some time away. Additionally, it will monitor the impact of WET rebate reforms on uneconomic production and update its advice to industry as the reform measures are implemented. Finally, it will fully explore with WGGA the reasons behind the slow correction to enable other options to be considered as outlined below.

A Better Understanding of the Drivers behind 'Sticky Supply'

➢ Action 3.5

The Joint Policy Forum (WFA and WGGA) will undertake research to better understand the reasons for the slow correction to the supply base in light of on-going poor profitability as a potential pathway to developing options to incentivise consolidation and rationalisation.

Although the Review consulted a number of sources on the reasons behind the on-going oversupply, there is no national body-of-work that analyses the issues and prioritises the drivers behind the slow supply side adjustment. While some good research has been undertaken at the state level, a more comprehensive body of work is required. Depending on the outcomes and insights, this research could illuminate commercial and non-commercial options to incentivise targeted growers and vineyard owners to change their business models or exit the industry.

The funding required for this work is estimated to be $0.5m.

Action 4: Maximise Open & Fair Domestic Competition

Work with the national wine retailers and competition regulator on fairness, transparency and equity in the domestic wine market.

Outcome: A more sustainable domestic marketplace for industry where companies can grow share through quality, innovation and investment.

WFA acknowledges and appreciates the work of retailers, particularly the national chains, in bringing Australian wine to Australian consumers. It believes, however, that there is scope for improving relationships to support a diverse industry and provide long term benefits to consumers. It is clear that this view is also shared by the major retailers themselves and they have indicated a willingness to work with the WFA.

The Expert Review provided a detailed analysis of the challenging Australian retail environment and the increases in margin losses to the national chains in recent years. It concluded from an initial analysis of the available data, that between 2007 and 2012 retailers captured a significant portion of winemakers' profit margin. The analysis also indicated that the majority of this margin was not transferred to consumers.

Submissions from the national retailers, however, have provided WFA with information demonstrating that consumers have benefitted from improvements to supply chain efficiencies and the shift to 'big box' retail formats. Over a 5-year period, the national retailers have highlighted that the average retail price of a bottle of wine has decreased by 4%. This is further explained in their submissions which are on the WFA website.[5]

More broadly, there are widespread industry concerns over the increasing market power of the major retailers, perceived unacceptable buyer behaviours and on-going horizontal and vertical integration. Some 77% of all domestic off premise retail wine sales are now controlled by the national chains. WFA believes it is important for the Federation to participate in national debates on competition, and work with the retailers on addressing anti-competitive behaviour.

This priority also has strong support from Industry, despite mixed views about how much can be practically done by industry or the Australian Government to undo the current retail market structure. Overall, there is significant backing for WFA to add its 'voice' to the current policy discussion on the future of the competition framework.

WFA welcomes the submissions on the Actions provided by the retailers, which are on the WFA website, where they restate their commitment to helping Australian wine producers grow in the future through initiatives that include making changes within their respective businesses to resolve immediate concerns. They have also responded positively to the proposed Industry Working Group and the opportunity to progress discussions over a set of agreed principles and practices to improve the interaction between retailers and wine producers.

Collaborate on shared issues and build relationships

➢ Action 4.1

Collaborate with the retail sector on shared issues through a standing Industry Working Group.

WFA acknowledges a number of shared issues with the retail wine sector, particularly the need to collaborate on promoting moderate consumption and responsible alcohol regulation. A standing Industry Working Group including the leadership of WFA and the national retailers will provide a forum to progress wine industry-related issues and an opportunity to collaborate on whole-of-supply-chain solutions.

[5] http://wfa.org.au/information/noticeboard/action-plan-consultation/

The forum will also enable concerns within the Industry over emerging practices such as retailers by-passing contracted distributors and moving towards consignment payment terms to be discussed. The national retailers support this proposal.

Code of Conduct

➢ Action 4.2

WFA will work with the national chains to adopt an Industry Code of Conduct based on agreed Principles and Practices.

WFA believes that a Code of Conduct based on agreed principles and practices with the retailers has the potential to drive more fairness and consistency across the supply chain. The principles of such a Code would provide a basis for developing longer-term partnerships between industry participants. The principles will include:

- A Fair Go: Industry participants will act and deal fairly with each other.
- Transparency: Each industry participant will be transparent in its processes and decision making, while preserving the confidentiality of commercially sensitive information.
- Contracts are paramount: Industry participants will at all times honour the terms of agreements, whether or not reduced to writing.
- Clarity in contracts and invoicing: As contracts are paramount, industry participants will make reasonable efforts to make contracts as comprehensive as possible, easy to understand and in plain English. A single invoice approach should be adopted to increase the certainty and transparency in the commercial understanding.
- Clarity of procedure: Procedures for sales and supply and all other trading terms will be clearly explained. Any changes to procedures will be clearly explained, and notified well in advance of the changes coming into effect. Compensation should be paid to parties affected by changes in procedures.
- Fairness in discounting and rebate practices: No industry participant should be required or pressured into providing a discount or rebate that was not previously agreed in writing, or that operates retrospectively.
- Fairness in marketing and promotions: All marketing and promotional practices will be fair and equitable, and respect the value of each participant's brand, a participant's right to decline to participate in a promotion, and equitable contributions to the costs of marketing and promotions.
- Equitable treatment of marketing participants: All industry participants will be treated in a fair, equitable and commercial manner.
- No unreasonable or unjustified penalties or payments: Industry participants will not be penalized or delisted unreasonably or without justification. Any penalty or delisting procedure must be clearly explained and set out in the supply agreement. Any procedure for de-listing should include a review mechanism.
- Open dialogue and dispute resolution: Industry participants will strive to keep open lines of communications with each other, and use efficient mechanisms to resolve disputes that arise between them.
- Industry participants will work towards pricing and promotional activity that is sustainable, supports future investment in brands and reinforces our licence to operate with the community.

WFA will work with the retailers on these Principles and a Code through the Industry Working Group proposed at Action 4.1. WFA will also continue to work with other supplier groups on the proposed generic voluntary Code for the grocery sector with the retailers where appropriate.

Assist retailers and members with concerns over unfair treatment

➢ Action 4.3

WFA will establish a process with retailers and producers to confidentially highlight concerns regarding retailer conduct that they believe could be an abuse of market power.

There is an immediate role for WFA to help monitor and record claims of unfair or unjust treatment and to highlight to retailers issues that arise. This could include a reporting system put in place by WFA to enable individuals to confidentially report their concerns so that any systemic behaviours can be identified, raised with the retailer and addressed within the context of the Code and, if necessary, with the ACCC.

Deal with Horizontal and Vertical Integration

➢ Action 4.4

WFA will continue to work with the ACCC and the Government on the structure of wine markets, potential vertical and horizontal acquisitions by the chains, and the likely impact these acquisitions may have on competition and market structure.

Ongoing engagement with the ACCC and government to ensure they have a full understanding of the market and the issues raised by further vertical or horizontal integration by retailers is also an important priority for the Federation. The ACCC's agreement to the acquisition of Cellarmasters by Woolworths in 2010 highlights an urgent need to assist them in developing a more robust and realistic market definition.

Public Benefit Review

➢ Action 4.5

WFA will continue to consider options to reform Competition Law and the ACCC in a manner consistent with the objectives of the recommended Principles and Practices and with greater scrutiny and control over vertical and horizontal integration.

WFA will participate in the Australian Government's 'root and branch' review of the competition framework and cooperate fully with Government and Parliamentary inquiries into potential policy reform to competition legislation, regulation and enforcement. This will require ongoing consideration by WFA of specific proposals to reform the Competition and Consumer Act and the mandate/ powers of the ACCC.

Further analysis on the wine market and competitiveness

➢ Action 4.6

WFA to work with the Productivity Commission to extend the analysis of the domestic wine market and competition issues.

The Expert Review has provided initial analysis of the domestic market and the impact of retail consolidation on margins and profitability. This work needs to continue, to help build the fact base, inform future policy discussions and assess the findings of the Review. WFA believes the Productivity Commission has the appropriate resourcing and expertise to conduct such research.

Appropriate labelling for Retail-owned Brands and Cleanskins

➢ Action 4.7

WFA to work with the national retailers to ensure appropriate labelling of all wine products.

Consultation with Industry has highlighted strong support for the labels of brands owned by retailers to be clearly marked as products owned by the retailers to ensure consumers are aware of the origin of the wine. WFA will work with the retailers in the Working Group as proposed at Action 4.1 on how retail-owned brands can be better demarcated with consumers.

Similarly, there are perceived loopholes and some uncertainty around the current provisions for the labelling of individual wine bottles that may be enabling 'cleanskins' to be inadvertently presented and sold without important consumer information including standard drinks information and recommended messages on drinking during pregnancy. This practice should not be allowed to continue and consumers should have access to this information with every retail wine purchase.

Action 5: Retain with changes to the WET Rebate

Retain with changes to the Wine Equalisation Tax rebate to support regional communities.

Outcome: To retain the WET rebate and seek to ensure that it is working within its original policy intent and to seek policy changes to improve the workings of the WET rebate on the wine industry consistent with its original intent.

The rebate was originally intended to assist smaller producers to remain in business, so that diversity in wine styles is maintained and to secure the positive economic impact of wine enterprises in regional communities. The Explanatory Memorandum to the relevant legislation that introduced the current producer rebate system in 2004 stated, "Around 90% of wine producers will be able to fully offset their WET liability by accessing the new rebate. In particular, small wine producers in rural and regional Australia will benefit significantly…" As summarised by the Australian National Audit Office, the rebate was introduced "in recognition of the substantial financial hardship being faced by small rural and regional wineries and aimed to support their viability and consequent capacity to generate employment and wealth in local communities."

In 2011/12 some $282mm of rebate was shared among at least 1,912 Australian claimants. In the same year 205 New Zealand claimants received $25m in WET rebates.

The consultation with Industry has confirmed that the rebate remains an important revenue source for small and medium winemakers in both the fine wine and commercial segments which are struggling with a decline in export sales and intense competition in the domestic market. This has also been confirmed in several member surveys undertaken by regional and state wine associations which have been provided to WFA. It is clear that without the rebate a significant number of wine businesses would be severely impacted financially. Whether originally intended or not, the rebate has been factored into business models and pricing strategies at all points in the supply chain.

The consultation has also confirmed that there are widespread concerns in Industry that the WET rebate has evolved beyond its original intent and is being compromised by the ability of brokers, intermediaries and foreign-based entities to access the entitlement. There are also reports of non-commercial multi-party schemes and ventures. Between 2007/08 and 2011/12 ATO data indicates an increase of 21% or 365 in the number of rebate claimants with refunds increasing over the same period from $211m to $308m.

It is also instructive that the Tax Commissioner rates the compliance risk associated with its administration of WET as ''high'' and has recently issued a series of Tax Alerts to Industry on rebate compliance issues.[6] In response, WFA will work with the ATO to maintain the integrity of the rebate system.

The consultation with industry also raised a number of suggested options for policy change to further tighten future eligibility beyond current provisions including developing a national producers' licence; introducing an assets and/or income test; lowering the rebate cap; and, phasing in any reform measures over a number of years to enable businesses to adjust. A number of concerns were also raised in the consultation about the potential unintended consequences of policy reform including the impact on; the next generation of winemakers; those without production assets; wine volume available for processing; grape prices; and, those regional communities reliant on bulk wine production.

At this point in time, the majority of the Industry supports the retention of the rebate and for WFA to work with the ATO to improve compliance and restrict the ability of uneconomic arrangements to access the rebate. There is also strong support for the abolition of the New Zealand rebate scheme and for transition arrangements that encourage consolidation without the threat of immediately losing one rebate where two eligible companies may want to merge.

[6] http://law.ato.gov.au/atolaw/view.htm?DocID=TPA/TA20132/NAT/ATO/00001

However, Industry support for other policy changes to the rebate is mixed and there are differences of views about what form a policy reform agenda should take. It is understandable in an environment of low profitability that many remain nervous about the potential direct and indirect impacts from any policy changes on individual businesses and the broader sector. This unease is compounded by concerns over the sustainability of current arrangements, the ability of a growing number of 'non-producers' who are able to access the rebate and the risk that the rebate may be removed altogether by Government under circumstances and conditions not of the Industry's choosing.

During consultation, WFA also sought from Industry, feedback on the link between the rebate and oversupply. While there is agreement that the rebate creates a pricing distortion in the sector, the views on the role it plays in supporting the production of otherwise surplus grapes and whether this was in the long term interest of the industry were mixed and inconclusive. There is acknowledgement that current reporting requirements to the ATO to claim the rebate do not provide the necessary data to develop clear conclusions on this issue, and that this should be addressed in discussions with the ATO, and that WFA should continue its analysis.

After considering all this feedback, WFA remains of the view set out in the consultation paper on the draft Actions that the rebate should be retained. However, three policy changes should be pursued now.

First, we do not believe that bulk, unpackaged, unbranded wine and private label wine should be eligible for the rebate as, over the long-term, they do not support regional development, and they diminish the ability to build brand equity and margins with retailers and consumers.

Second, remove rebate eligibility for New Zealand wineries and other foreign entities at a time when local producers are already confronting high exchange rates and escalating competition from imports.

Third, transitional arrangements should be introduced to remove a potential barrier to consolidation to enable businesses to merge and maintain the second rebate but for it to be phased out at 25% per year over four years. We believe this will provide more options for producers pursuing economies of scale.

WFA is also aware that a broad ranging Tax Review will be undertaken by the Government over its coming term and that its Terms of Reference will include alcohol excise and tax arrangements. This forum will undoubtedly raise issues relevant to the rebate and WET that will attract comment from both the public health lobby and beer and spirits sector, all of which have consistently lobbied for an increase in the rate of taxation on wine. With this in mind, WFA will continue to collect evidence on the impact of the rebate on the industry and possible benefits and disadvantages.

This work will include on-going analysis of the impacts from the reform measures outlined above and detailed below, as well as further consultation with Industry if further initiatives and changes are found to be necessary and a formal policy review 3 years from the adoption of the reform measures.

In summary, WFA is committed to a three-stage approach to the WET rebate aimed at retaining the rebate and eligibility so it is claimed in accordance with its original policy intent to support regional communities:

1) *Retain and Apply the Rebate in Accordance with Original Intent*: Immediate steps to work with the ATO to give effect to Actions 5.1 to 5.2 below to return the scheme to its original policy intent as soon as possible.
2) *Policy Changes in the Near Term*: To phase out eligibility for bulk/ unbranded wine, exclude foreign claimants and introduce transitional arrangements for mergers discussed at Actions 5.3, 5.4 and 5.5, and
3) *WET Rebate Policy Review*: More analysis and a review of further reform options in 3 years. These are discussed at Actions 5.6 and 5.7 below.

Retain and Apply the Rebate in Accordance with the Original Intent

➢ Action 5.1

WFA will work with the ATO to identify any changes that can be made to the interpretation and application of the existing provisions so that implementation is in line with the original intent.

➢ Action 5.2

WFA will, for example, work with the ATO to identify and assess claim accessibility for uncommercial arrangements (for example when the ATO forms the view that the growers/winemakers have split their activities or have colluded in the establishment of business activities with the substantial purpose of claiming multiple rebates), and for schemes with the sole or dominant purpose of accessing the rebate contrary to the anti-avoidance provisions.

Addressing this growing list of unintended rebate recipients and consequences has widespread support among winemakers to ensure the rebate is being accessed only by those who make a contribution to regional communities. This is what WFA believes is the original policy intent of the rebate and what it should be going forward. Maintaining the integrity of the rebate system is important to safeguard its retention for those who are entitled to claim it.

WFA believes more can be done in partnership with the ATO within the existing legislative framework to improve compliance and restrict the eligibility of uneconomic arrangements and schemes designed primarily to access the rebate. This will continue a strong working relationship between the two organisations that most recently delivered important changes to blending rules in late 2012 that will help reduce multiple claims being made over the same volume of wine.

Specifically, WFA will assist the ATO in its understanding and identification of uneconomic practices which are not in keeping with the original policy intent and what steps can be taken to stamp them out. This work will include a review of the definitions of key terms in the rebate provisions (such as ''manufacture'', ''manufacturer'', ''producer'' and ''rebatable wine''), which in recent years have been expanded and have made the rebate more accessible to a broader range of grape growers, grape processors, wholesalers and retailers. The aim will be to analyse the scope of these definitions to ensure new categories of claimants are wine businesses whose operations support regional communities.

WFA will also examine with the ATO the adequacy of the recent changes to the eligibility rules for blending and the rules intended to prevent related entities from making multiple producer rebate claims and whether any changes are required. It is in the industry's interests that we do all we can to maintain the integrity of the rebate and improve our understanding of the issues.

Policy Changes in the Near Term

As well as working with the ATO within the existing provisions, WFA will pursue three policy changes to the WET rebate in regards to the treatment of bulk and unbranded wine, for foreign claimants and to introduce specific transitional arrangements to remove a barrier to consolidation.

Phase Out Eligibility for Bulk and Unbranded Wine

➢ Action 5.3

Remove eligibility for the WET rebate from bulk, unpackaged, unbranded and wine for the private label of retailers and from wine that is not a finished product fit for retail sale. That is, limit the rebate to those who :

a) manufacture and sell wine in a form that is packaged ready for retail sale and where the finished product is identifiably theirs;
or
b) grow grapes and sell wine in a form that is packaged ready for retail sale and where the finished product is identifiably theirs.

Bulk wine is defined as wine in containers over 25 litres.

The measure will be introduced with the rebate on bulk and unbranded wine phased out at 25% per year starting at 75% of the rate as of 1 July 2014.

WFA believes brands and 'brand power' at all price points enable producers to engage consumers and command loyalty, take price, maintain sustainable margins and generate profit growth that can be reinvested back into regional communities and infrastructure. They are critical to developing category equity and a compelling consumer franchise that can support both above inflation retail pricing and increased margin share with the retailers.

WFA believes 'cleanskins', other unbranded wine and the private labels of the retailers work against these objectives and therefore do not play a long term role in encouraging regional development. For this reason unpackaged (bulk) wine, unbranded wine, wholesale and retail private label, and wine that is not fit for retail sale also should not be eligible for the WET rebate.

To enable the industry time to plan and adjust for the measure, the removal of rebate eligibility for bulk and unbranded wine should be phased out at 25% per year starting at 75% of the rebate rate as of 1 July 2014.

During the consultation WFA received strong feedback from many small winemakers producing their own regional brands that the introduction of a 'Substantial Investment' test for future rebate eligibility would impact those who leased or contracted their production assets and would put them at a significant competitive disadvantage compared to those who did. Further, it would act as a barrier to entry for the next generation of winemakers who could not easily find the capital required to own physical production assets. It was argued that such a measure could compromise the future diversity of the industry and see many small winemakers exit the sector. WGGA also opposed this measure and stated that the current ATO definition of eligibility should remain for wine producers who lease a vineyard.

WFA has listened to these views and accepted that a Substantial Investment test may have unintended consequences that see the rebate eligibility removed from many branded producers who make a significant contribution to the industry and their regional communities. WFA will not pursue a Substantial Investment test as previously proposed.

By example, this Action will enable the following to continue to claim the rebate:

- Winemaking and grape growing businesses that produce their own branded and packaged wine;
- Winemakers who lease their production assets or contract out the making of their wine and produce their own branded and packaged wine; and
- Businesses that purchase grapes or lease vineyards and produce their own branded and packaged wine.

Remove eligibility to foreign entities

➢ Action 5.4

WFA believes the extension of the rebate to eligible NZ producers in 2005 was also inconsistent with the intent of the rebate and this position is strongly supported by Industry. We believe the separate New Zealand rebate scheme be abolished and that such a step should be prioritised by the Australian Government. It is also possible for foreign entities to claim the rebate under the Australian rebate scheme provided they are registered for GST purposes and trading from stock based in Australia. This provision enabling foreign based entities to access the rebate should also be abolished by the Australian Government.

In recent years we have seen New Zealand imports increase from 21m litres in 2007 to over 51m litres in 2012 and 30% of the total value of the leading 20 SKUs sold in Australia are from New Zealand. This loss of market share to New Zealand imports has directly harmed Australian producers. WFA believes that providing access to foreign entities to the rebate at a time of high exchange rates and low profitability is not consistent with the original policy intent, indeed, is directly damaging branded Australian wine businesses that support local regional communities.

➢ Action 5.5

Introduce transitional rebate measures to allow the second rebate on a merger of two businesses which are entitled to the rebate to remain with the new entity but be phased out at 25% per year over 4 years. These transitional arrangements will be made available to the industry for up to 5 years from the date of implementation.

WFA believes that current rebate arrangements may be inhibiting industry consolidation at a time when there is considerable pressure to rationalise and capture efficiencies and economies of scale. Wineries that believe their future lies in consolidation should not be stymied by the unintended consequence of a tax measure. Transitional rebate rules should be introduced to support merger activity.

WET Rebate Policy Review

➢ Action 5.6

WFA will analyse the impact of the reform measures outlined above and continue the analysis of the WET rebate which forms part of the Expert Review and carry out the following further work in consultation with, and making all results available to, Industry:

a) **On-going assessment of whether the rebate is causing unintended industry consequences, distorting supply and impacting profitability and if so how it should be dealt with.**

b) **A formal review of rebate policy arrangements 3 years from implementation of the reform measures to assess all options, which could include keeping the rebate or a substitute, further restricting rebate eligibility, reducing the cap (the maximum claimable amount) or a timetable for phasing out the rebate.**

Given the difficulty of the Expert Review to establish a clear view on the impact of the WET rebate on industry dynamics, WFA will continue its analysis of the issues. Important areas of inquiry include the profiling of claimants, actual and projected growth in the rebate and the key drivers, the role of the rebate in various business models, and exploration of any link between the rebate and oversupply.

This work will be important preparation before further reform measures are considered and for the Australian Government's review of taxation arrangements due within its current term of office.

This analysis will require up to $0.5m in funding in 2014 and WFA will immediately explore the funding options.

A date to formally consider this analysis and evolving market conditions should be set 3 years after implementation of the proposed reforms outlined at Action 5.1 to 5.5 above. This will give industry, the investment community and individual companies adequate certainty around tax arrangements without abandoning potential future reform.

Standing Tax Task Force

➢ Action 5.7

WFA will form a permanent industry taskforce in partnership with WGGA, the ATO and Federal Treasury on wine tax reform and implementation issues.

➢ Action 5.8

The ATO to reform rebate reporting requirements to capture an improved data set on the profile of claimants and rebatable wine.

Building a better fact base on the impact of the rebate on the industry as proposed at Action 5.6 will be critical to assessing the merits of any further steps. This will also require a closer working relationship between WFA and the ATO and significant changes to BAS reporting obligations to enable the ATO to gather more insightful data.

Action 6: Monitor the Future of Wine Tax Policy

Monitor the future of wine tax arrangements in response to changing market conditions.

Outcome: Continue the examination of optimal taxation arrangements for industry to support growth and our licence to operate with the community.

➢ Action 6.1

WFA will continue to analyse proposals for reform to wine tax arrangements.

➢ Action 6.2

WFA will develop an updated socio-economic footprint of the industry to help model the commercial and community impacts of any proposed policy changes related to tax reform.

Consultation with industry has confirmed mixed views on the optimal tax platform for the Australian wine sector with opinions heavily dependent on the various models and portfolio weightings of the individual businesses. After considering the arguments for and against, along with the findings of the Expert Review and the consultation feedback, WFA does not believe that the industry should pursue a broader wine tax reform agenda at this time. Industry's immediate focus should remain on the measures outlined at Action 5 to reform the WET rebate.

During this time, WFA will maintain its current position on wine tax arrangements with governments, the public health lobby and within industry. This position does not preference the current wine tax base over a potential volume-based approach and is committed to no overall increases in wine tax revenue, no reforms to wine tax arrangements driven by a social policy objective, a differentiated tax rate for wine from other alcohol categories and, ongoing reform to the WET Rebate.

WFA analysis of wine tax issues will be updated as market conditions change. A shift in wine tax arrangements to a volume based approach could provide an opportunity for the premium wine segment to raise margins in the domestic market or to reduce retail price points to drive volume, although it is less clear how this profit opportunity would be ultimately divided between producer and retailer. Also, with few immediate avenues for the commercial segment to divert volume to international markets at profitable price points, it is likely that a shift to a volume-based tax on wine would see significant volume exiting the industry and a material industry restructure. The subsequent socio-economic impact on certain regional communities is unknown.

Action 7: Secure Funding for the Action Agenda

Secure the funding to support the recommended reform agenda in partnership with Industry and Government.

Outcome: To fund the reform agenda.

➢ Action 7.1

WFA will secure funding to implement the Actions.

Additional funding will be needed to implement the Actions proposed in this paper. While the existing resources of WFA, WAC, GWRDC and WGGA will be utilised there is not sufficient funds available among these organisations.

In regard to the further funding options for individual Actions, the consultation process has raised a number of options including:

- GWRDC funding to support the wine and health research initiatives outlined in Action 1.1 to 1.6 (as well as other national and state government funding and grant sources).
- Better coordination between national, state and regional marketing spends of wine organisations. WFA supports an audit of the total sum of marketing spend to be undertaken to ascertain the quantum of money available and the potential to coordinate the activities of the various wine marketing bodies.
- Lobbying the Australian Government to match levy funding for the activities of WAC in the same manner it matches levy contributions for R&D programmes. WFA acknowledges the difficulty of attracting additional Commonwealth funding in the current budgetary climate to match levy contributions for marketing activities.
- Securing funding from wine producing State Governments. WFA also acknowledges the tough budgetary environment for other levels of Government. This option will be explored further but is likely to take time and considerable resourcing to achieve.
- Lobbying the Australian Government to return any savings from implementing the Actions aimed at reforming WET rebate eligibility to industry to fund those Actions aimed at growing the demand opportunity and hastening the correction in supply. WFA acknowledges that achieving this end will be difficult and cannot be guaranteed.

WFA will now enter discussions with all the relevant stakeholders on the options mentioned above and report back to Members and Industry on progress. If funding is not secured through these means, then WFA in further consultation with Industry will need to consider other options.

WFA maintains its commitment to industry that the merger of GWRDC and WAC will see research funds quarantined from being used for marketing initiatives.

In summary, the initial estimates on funding the Actions over the next three years are as follows:

ACTION	Year 1 (m)	Year 2	Year 3	TOTAL
1. Continue to Engage the Wine & Health Debate	$0.75m	$1.25m	$0.75m	**$2.75m**
2. Grow the demand opportunity				
2.2 Rebuild WAC's operating budget	$2m	$2m	$2m	**$6m**
2.3 Marketing programmes				
1. Trade Shows	$1m	$1m	$1m	**$3m**
2. Tourism Australia initiatives	$2.5m	$2.5m	$2.5m	**$7.5m**
3. In-Market Education	$0.5m	$0.5m	$0.5m	**$1.5m**
4. Visitors Program	$0.5m	$0.5m	$0.5m	**$1.5m**
5. Savour Australia	$2m			**$2m**
6. Aussie Wine Month	$0.5m	$0.5m	$0.5m	**$1.5m**
2.4 New Initiatives				
3. Regional promotions	$0.5m	$0.5m	$0.5m	**$1.5m**
3. Correcting Supply				
3.1 National Vineyard database/ Foundation data collection	$2m	$1m	$1m	**$4m**
3.2 Vineyard and supply-side research	$1.5m			**$1.5m**
3.5 Research of 'sticky supply'	$.5m			**$0.5m**
4. Open and Fair Competition	N/A	N/A	N/A	
5. WET Rebate reform				
5.7 Review of the WET rebate	$0.5m	Government savings measure	Government savings measure	**$0.5**
6. Managing Future Wine Tax Arrangements	N/A	N/A	N/A	
TOTAL				**$33.75m**

Action 8: Other Areas for On-going Work

Throughout the consultation a number of additional initiatives and work streams have been suggested that fall outside the Actions listed above but which WFA believe are important to highlight and continue to take forward. These Actions will be progressed and incorporated in our advocacy and programme activities in partnership with WGGA, GWRDC, WAC and regional and state wine organisations.

➢ Action 8.1

Improving our understanding of cost pressures and working with the broader business community to reduce the costs of doing business.

The Expert Review has highlighted ongoing cost pressures on the supply chain at a time when our competitiveness is being challenged at home and abroad. On average it is estimated that cost of goods sold for domestic sales have increased 15% over the last five years. This trend is likely to continue as grape supply potentially tightens and as producers continue to struggle with passing these costs through to international and domestic markets. The Review has also shown that putting downward pressure on costs will be critical if a profitable commercial and bulk wine export segment capable of competing against low-cost commodity producers is to emerge.

In response, WFA will dedicate internal resources to analyse cost pressures on wine businesses including energy, water and labour (especially penalty rates) and the impact this may be having on our competiveness and productivity. Where appropriate, policies will be developed in partnership with other wine organizations (including trade supplier groups) to inform our advocacy activities with all levels of government. The potential to work with other industry and business groups on these issues will also be assessed. WFA will also review the process and funding required to develop an accurate, sophisticated system to track costs of doing business, and how best this information and data can be communicated to Industry in a manner that supports business planning.

➢ Action 8.2

Promoting Innovation and prioritising R&D spend.

The Expert Review process and developing the Actions have been aimed at arresting the decline in industry profitability over the short term and at developing Actions that can be immediately taken to support the recovery of the Industry. A key objective is to attract the finance and capital required to maintain levels of investment in innovation. Without this support, innovation strategies will be hard to deliver and the adoption of specific outcomes by individual businesses will remain challenging.

That said, identifying the funding priorities for limited levy and Australian Government funding for R&D remains an important priority for Industry. The consultation highlighted the important role of innovation and increased productivity for the Australian wine sector given the on-going challenges it faces particularly as a high-cost producer.

In their submission, AWRI pointed out that "*Australia currently spends approximately 2.2% of its GDP on research and development – putting Australia in the middle of the OECD table. By way of context, 5% of GDP was invested in agriculture R&D in Australia in the 1970s*."

In response, WFA will work with the incoming board of the merged statutory authority in its review of the scope and priorities of the current GWRDC 5-Year Plan to ensure it continues to be aligned with the Actions and feedback received during *consultation*, particularly the importance placed on R&D relevant to the wine and health debate and at reducing costs of production. Other areas include improving vineyard flexibility which is discussed in Actions 3.1 and 3.2.

More broadly, WFA will continue to advocate the importance of a strong financial and policy commitment from the Australian Government to R&D in the agriculture sector, the collection of data and for our research institutions.

➢ Action 8.3

Leveraging the Australian wine industry's environmental credentials.

Globally, the Australian wine industry is highly regarded for its commitment to sustainable production methods and the environment and this reputation is becoming increasingly important for some leading retailers. For example, major international buyers, including the Liquor Control Board of Ontario, Marks & Spencer and the Nordic monopolies, are introducing environmental benchmarks into their purchasing criteria. In recent months in the domestic market, Coles has required all their major fresh produce suppliers to hold third party environmental certification.

Reinforcing our image by integrating the Australian industry's narrative on sustainability with the category marketing activities of WAC presents an opportunity to further reinforce our branding with a unique sense of place and premiumisation.

WFA's Entwine Australia programme (which provides a systematic and verifiable approach to managing the environment and measuring performance) is an existing vehicle through which this potential can be realised. WFA will review its current communications of the environmental measures and performance indicators being produced through Entwine with a view to consolidating the data into a 'markable' story that reinforces our existing credentials. This work will include discussing with WAC how these messages can be best integrated into their programme development and branding activities. It will also include development of communication tools and sources for industry to use directly in their marketing activities and customer engagements.

Entwine can also reinforce the industry's behaviours and image at a regional level and within local communities. It helps to highlight the wine industry's major contribution through regeneration of native bushland and creeks, engagement in local tourism activities and protection of local plant and animal species. Capturing these opportunities will also be considered by the review.

All industry participants are encouraged to continue their participation in Entwine or consider joining if not already members. More information can be found on the WFA website[7].

➢ Action 8.4

Leading Organisational Reform

WFA believes that the consultation with Industry has strengthened the case to rationalise limited sector resources. It has also highlighted the importance of educating important stakeholders on the current state of the industry and its prospects to ensure a partnership approach with government evolves and that ad hoc regulation is avoided. The issues the Actions cover touch all levels and regions of the sector.

Successful implementation of the Actions will also depend on alignment and coordinated advocacy from the two national member organisations and the two statutory authorities across multiple national, state and local government jurisdictions. This view and support for exploring the potential to secure efficiencies through closer working relations across all levels of wine organisations has widespread industry support.

As a priority, legislation for the merger of GWRDC with WAC and its implementation should be supported by all industry participants and expedited through the Parliament. There is widespread support for the merger of the two industry statutory authorities and appreciation for the inherent synergy between growing the demand opportunity and improving vineyard flexibility in response to a changing marketplace which would be best captured by a single authority.

While the merger of the two statutory bodies is underway, WFA and WGGA will continue to explore through the JPF and at the operational level ways and means to further integrate.

WFA will also work with state and regional bodies on an industry framework for representation with the aim of achieving better efficiencies across regional, state and national industry associations. In an environment where the wine industry is but one of several manufacturing industries vying for government support and attention, we believe it is important that the limited resources of the representative associations at national, state and regional level are maximised and all efficiencies captured. It is important that the current lack of an agreed framework for industry representation be addressed to ensure levy and membership payers throughout the industry are receiving a valuable return on their investment.

[7] www.wfa.org.au/entwineaustralia

➢ Action 8.5

Improving market access

The Expert Review has highlighted that improved access to export markets will be a key determinate of industry profitability and growth. It is not just exporters that rely on international trade however, as growth and increased market share in international markets will ease the intense competition among local producers for limited domestic retail shelf space.

Market access can be restricted by tariffs or by non-tariff measures (NTMs) such as differing labelling and compositional requirements and onerous certification requirements. Increasingly, governments and industry are looking to bilateral and plurilateral trade agreements to enhance market access. The most obvious market access impediment is tariffs but other important benefits can occur in the agreements through the reduction in NTMs.

WFA and the Australian Government (including Department of Foreign Affairs and Trade; Department of Agriculture, Fisheries and Forestry; Department of Innovation, Industry, Science and Research; and supported by WAC and GWRDC) work together to increase Australian wine exports by advocating for and developing preferential policies and practices in a number of international and bilateral trade forums. Action 2.6 makes some specific recommendations to improve market access, and WFA will continue to seek improved market access across the globe including reducing certification, harmonising labelling and oenological practices, working within the expanding network of FTAs to reduce tariffs, reducing analyses and testing requirements and protecting Australia's wine trade interests in the face of unilateral trade barriers raised in our markets.

Attachment 1

Refer to

"Expert Report on the Profitability and Dynamics of the Australian Wine Industry"

WINE INDUSTRY REPORT

Expert Report on the Profitability & Dynamics of the Australian Wine Industry

PREPARED FOR WINEMAKERS FEDERATION OF AUSTRALIA BY CENTAURUS PARTNERS – AUGUST 2013

CENTAURUS PARTNERS

wfa Winemakers' Federation of Australia

This proposal is solely for the use of WFA. No part of it may be circulated, quoted or reproduced for distribution outside the addressees without prior written approval from Centaurus Partners.

INTRODUCTION AND REPORT CONTENTS

The Australian (and global) wine industry is highly fragmented with many different business models, and significant variations in performance. Players within the industry make decisions based on their individual position, strategy and view of economic fundamentals. The intention of this review is to provide facts and perspectives to help WFA determine where it should focus its industry efforts and how it can support individual participants in their decision-making processes.

The Report has four sections:

- Summary Findings of the Expert Review
- Recommendations for the WFA Board to Consider
- Executive Summary of the Fact Base Supporting the Findings and Recommendations
- Appendices
  - Recommended Next Steps for WFA
  - Overview of Approach, Analysis, and Sources
  - Additional Analyses and Exhibits—Available on the WFA Website www.wfa.org.au/review

Segment Definitions. To enable clear evaluation of the Australian wine industry quality segments for grapes and wine were developed and agreed with the WFA Board. There are five segments—A, B, C, D, E/F. The definitions are:

	Grape Price	Domestic Retail Price	Export FOB Price
A	> A$2,000/tonne,	> A$30/bottle,	> A$10/litre
B	A$1,501 – 1,999/tonne,	A$15 - 30/bottle,	A$7.50 – 9.99/litre
C	A$601 – 1,500/tonne,	A$10 - 15/bottle,	A$5.00 – 7.49/litre
D	A$301 - 600/tonne,	A$7 - 10/bottle,	A$2.50 – 4.99/litre
E/F	< A$300/tonne,	< A$7/bottle,	< A$2.50/litre
Bulk wine is allocated to its quality segment. Under $1 per litre FOB to E/F, over $1 per litre FOB to D			

Data Sources and Limitations. Due to its fragmentation, predominately private ownership and modest investment in data gathering the Australian wine industry lacks publicly available quality information. This review has used an extensive combination of data sources to address this issue, including: confidential interviews and surveys of WFA board members and industry stakeholders, and detailed company financial and market data provided on a strictly confidential basis. Limitations of the data sources and the related analyses are noted through the report and in Section 2 in the Appendices.

SUMMARY FINDINGS OF THE EXPERT REVIEW

The Australian wine industry enjoyed considerable success from 1991 to 2007.

It more than tripled in size from less than 400 million litres to 1.2 billion litres and achieved total revenues of $5 billion in 2007. The value of exports grew from $212 million to $3,004 million. The industry and many of its participants built an enviable global reputation for producing quality wine and created strong export markets particularly in the UK, US and Canada. Analysis of available information suggests, on average, the industry enjoyed good profitability. From 2007 a number of factors resulted in tough times for the industry—the impacts of which and possible solutions are discussed in this Report.

Despite the recent difficulties facing the industry there are number of positives.

There has been a significant increase in domestic consumption of quality wines. From 2007 to 2012 the domestic consumption of Australian wine sold above $15/bottle increased by $268 million (64%) in value terms and 11.6 million litres (42%) by volume. Unfortunately for the overall industry this only accounts for 16% of all wine produced in Australia by value and 3% by volume.

Another bright light has been China. From 2007 to 2012 exports to China rose 144% (26 million litres) by volume and 333% ($186 million) by value. Continued growth is predicted and will help the industry but it has limits:

- China is still just 6% of total export volume and 13% of value
- From 2007 to 2012 the value of wine exports fell by $1,336 million (excluding China). The increase in exports to China mitigated 14% of this fall
- Over half the increase in the value of exports to China came from A and B quality wines of which there is limited supply.

A good number of company success stories continue to emerge. In particular:

- Producers of high-quality fruit and/or wine
- Lowest cost producers of fruit and wine at each quality level—especially C, D, and E/F
- Players able to establish a niche—brand, market, and/or method of distribution.

Unfortunately, a number of players in the industry will find it difficult to transition to one or more of these models.

**The recent fall in the A$** will benefit Australian producers through higher A$ export prices (FOB) for existing volumes, and/or increased volumes.

The wine industry remains important and highly valuable to Australia and Australians. Its benefits extend well beyond the direct economics to elements of our global reputation, tourism, and the economics and vibrancy of our wine regions. As such it is critical that the industry works together (and with government) to rebuild its global/export franchise and address domestic profitability.

It is important to recognise and understand the issues facing the industry to ensure the correct next steps are taken by: the industry, groups of stakeholders working together, and individual players.

Industry profitability has fundamentally lowered over the last 5 years and will remain under pressure for the foreseeable future.

The key drivers of this change are:

- The collapse of export returns due to the appreciation of the Australian dollar (A$), falling demand, and issues in key markets
- The ability of retailers to extract margins from growers and winemakers
- Oversupply of grapes and winemaking capacity

(relative to domestic and export demand—at profitable prices) and the 'negative feedback loops' this has created.

In this environment the business models under the most profit pressure are:

- Higher cost growers of C, D, and E/F grade grapes
- Winemakers with significant portion of their portfolio in wines with retail prices around and below $10/bottle (and <$5/litre export FOB). Especially if highly exposed to exports
- Small to mid size (higher-cost) winemakers without significant volumes in more profitable distribution channels (mail order/online, unique market niches); and with less attractive portfolios (price points below $15 per bottle retail or $7.50/litre FOB).

The Australian wine industry is likely to remain in transformation for some years:

- The industry was built on expectations of continued strong export growth
- The majority of the growth and total volume is in lower priced/quality wines that are under profit pressure in domestic and export markets—in 2012 30% of the wine produced in Australia was sold domestically at retail prices less than $10 per bottle, another 52% was exported at FOB prices below $5 per litre
- Demand cannot solve this problem quickly. Domestic demand is relatively flat in volume terms. Export demand is experiencing both volume and price pressure. While the unprofitable supply of grapes and wine is significant
- The fragmented nature of the industry makes it difficult to respond in a coordinated way. And, individually 'capacity is slow to adjust' for numerous reasons including:
  - Winemakers buying uneconomic fruit and wine to maintain high production to make contribution to fixed costs—this can provide marginal growers with some income and hope. In the growth phase many winemakers invested in additional capacity and brands
  - Growers have significant sunk costs in their vines and vineyards with few attractive alternative uses for the land
  - Human and emotional factors
  - Some level of uneconomic production supported by the WET Rebate.
- As the supply of grapes tightens—and more growers make acceptable returns—winemakers will experience an increase in their cost of goods sold (COGS) from the cost of grapes. The likely inability to pass this cost on to domestic or export markets will then force further rationalisation of winemaking volume and companies.

Though needed it is likely the rationalisation of supply (grapes and winemaking) will not lead to an immediate fundamental improvement in industry profitability. A common view that reduced volumes will allow winemakers to increase margins and profits through: renegotiating margins with retailers, higher retail prices, and higher export prices is questioned by this Review. The majority of any benefit will likely flow to successful growers via higher prices. The benefits to winemakers will be limited by:

- Higher average COGS due to increased grape prices and lower volumes
- Retailers well placed to limit net wholesale price increases and/or extract, at least a significant share, of any improvement in margins from individual wine companies
- 62% of industry volume is exported—significant improvement in export returns requires: further depreciation of the A$, fundamental increase in demand relative to competitors in export markets, new/expanded export markets, and a reversal of the current trend in mix to lower value wines
- 94% of export volume (675 million litres) is C, D, and E/F wine (FOB below $7.50/litre). Export margins at each quality/price segment are significantly below domestic margins.
- The domestic market is higher margin but it is not large enough or growing fast enough to absorb significant quantities of wine currently being exported.

Though a major driver of the fall in industry profitability it is unlikely further significant depreciation of the Australian dollar will generate a proportionate rise in profitability. A lower A$ clearly benefits Australian producers. However, the following factors will likely prevent an immediate return to previous profit levels:

- There has been fundamental fall in demand for Australian wine in, at least, our two largest export markets (US and UK) in their currency—this is in addition to the impact of the higher A$
- Competition from wine exporting countries has increased, including—Italy, Spain, Chile, France, Argentina, and South Africa
- Many of those interviewed believed that foreign

retailers, importers and distributors have the market power and sophistication to extract some portion of improved returns from a lower exchange rate. The fragmentation of Australian producers means many will likely trade off margin for volume

- The analysis in this report for the period 2007 to 2012 used an average rate of 83.7 US cents for 2007 and 103.6 US cents for 2012. Since finalising the report the $A has fallen to circa 90 US cents. We believe this fall, while beneficial to the industry, has no material impact on the findings or recommendations of this report.

Opportunities exist for: the industry, groups of stakeholders, and individual companies to address these issues and in doing so build a stronger and more profitable wine industry for future generations.

RECOMMENDATIONS FOR THE WFA BOARD

This review recommends 6 actions to be taken by the WFA and its members to help re-build a more profitable and sustainable industry:

1. Urgent efforts to build export demand and improve market access.

Particular focus on US, UK and China; and possibly other large wine importing and 'niche' countries such as Canada, Sweden, Netherlands, and Switzerland, *WFA to:*

- Support development of fact base and insights as to issues and opportunities by market. For example, need to genuinely understand the causes of the massive deterioration in the performance of Australian wine in the US and UK markets, and what solutions exist for each wine segments—the issues and opportunities for A and B wine differ to those for C, and D, and E/F
- Identify and advocate actions for government. Advocate to link savings from reforms to the WET Rebate (discussed below) to funding for export market development
- Explore opportunities to 'match' our industry to the needs and purchasing decisions of these markets—such as: regionality/appellation, variety, understanding/recognition; and consumer trends especially varietal and high volume branding opportunities for commercial (C and D) wine in the US.

2. Seek improvements in retailer behaviour through a code of conduct.

Consider lobbying Government with a recommended set of reforms to address the impacts arising from retail consolidation. Including: restrictions on further vertical integration and acquisition growth in distribution/retail including on-line; and a mandatory code of conduct if an appropriate code cannot be negotiated voluntarily. *WFA to:*

- Provide fact base showing impact and need for action. Develop feasible changes
- Coordinate efforts and fact base with other industry bodies
- Manage advocacy/negotiations to protect individual companies from possible retaliation
- Possibly support the development of alternative distribution options for winemakers.

3. Provide proactive advice to Government on how to remove all significant inappropriate uses of the WET Rebate.

WFA to:

- Continue to build fact base, in planned consultation phase, on current impacts of WET Rebate and benefits of proposed changes to support advocacy. Seek ATO to improve the way it records tax payments, credits and rebates for the wine industry to allow proper understanding of who is using the Rebate
- Advocate Rebate reform. Including: limit Rebate eligibility to growers and/or manufacturers of Australian wine sold in packaged format under their own label. No controlling or collaborating entities to claim or benefit from more than one rebate. All grapes and wine must be sourced, manufactured and packaged in Australia.
  Wine must be fit for human consumption
- Lobby to have some portion of the savings from Rebate reform allocated to the industry to invest in export demand building and wine region development
- Upon reform of the Rebate allow the market to work, and reassess the Rebate (its purpose and effectiveness) in 3 years when better information is available.

4. Careful management of key downside demand and profit risks —

in particular the anti-alcohol lobby and tax changes. *WFA to:*

- Fund/call for more fact-based research and dialogue on health impacts of wine and issues of alcohol abuse
- Ensure any tax regime debate is well understood. Seek to maximise unity within the industry.

5. Support decision making of industry players—particularly marginal players—with quality information and opportunity for dialogue and support.

WFA to:

- Continue to build and engage industry participants on the fact base and independent perspectives on the industry—support decision making
- Seek government funding for rural support programs—decision-making assistance not subsidies
- Ensure key data sources are retained and where necessary enhanced.

6. Continue communication with government, regulatory bodies and media as to the true current state and potential futures for the Australian Wine Industry.

WFA to provide the 'back story' and fact base to build awareness, and support constructive dialogue and action. Messages to provide context for recommended actions include:

- The importance of the wine industry to Australia
- The industry is caught in a 'perfect storm' of a high $A, falling export demand, oversupply, and retailer power
- The industry is in the process of significant and difficult restructuring
- During this process the industry is fragile and risks permanent damage—including: massive reduction in size and scale; ongoing poor profitability preventing necessary reinvestment; and loss of key success factors including: talent, innovation, image and reputation (domestic and international)
- The WFA and key stakeholders have a plan to support the industry towards a more profitable and sustainable future.

EXECUTIVE SUMMARY OF SUPPORTING FACT BASE

The following summarises the reasoning and fact base used to develop the Summary Findings and Recommendations.

Contents of Executive Summary

1. The Australian wine industry has tripled in size and been very successful at building export markets

2. Since 2007 the profitability of the Australian wine industry has declined significantly

3. This decline in profitability has been driven by a 'perfect storm' that has intensified
   - Export returns have declined sharply
   - Domestic margins have been squeezed by retailers, low-demand growth, and increased imports
   - The decline and shift in export demand has created an 'oversupply/under-demand' of grapes and wine in certain quality segments.

4. Efforts to improve profitability have, in many cases, only reduced the extent of the decline

5. There are foreseeable circumstances that would put further pressure on profitability

6. The other side of this 'perfect storm' is that no single lever will 'fix' the problem

7. The industry is not being impacted equally—some players/segments are more affected than others. There are a number of success models

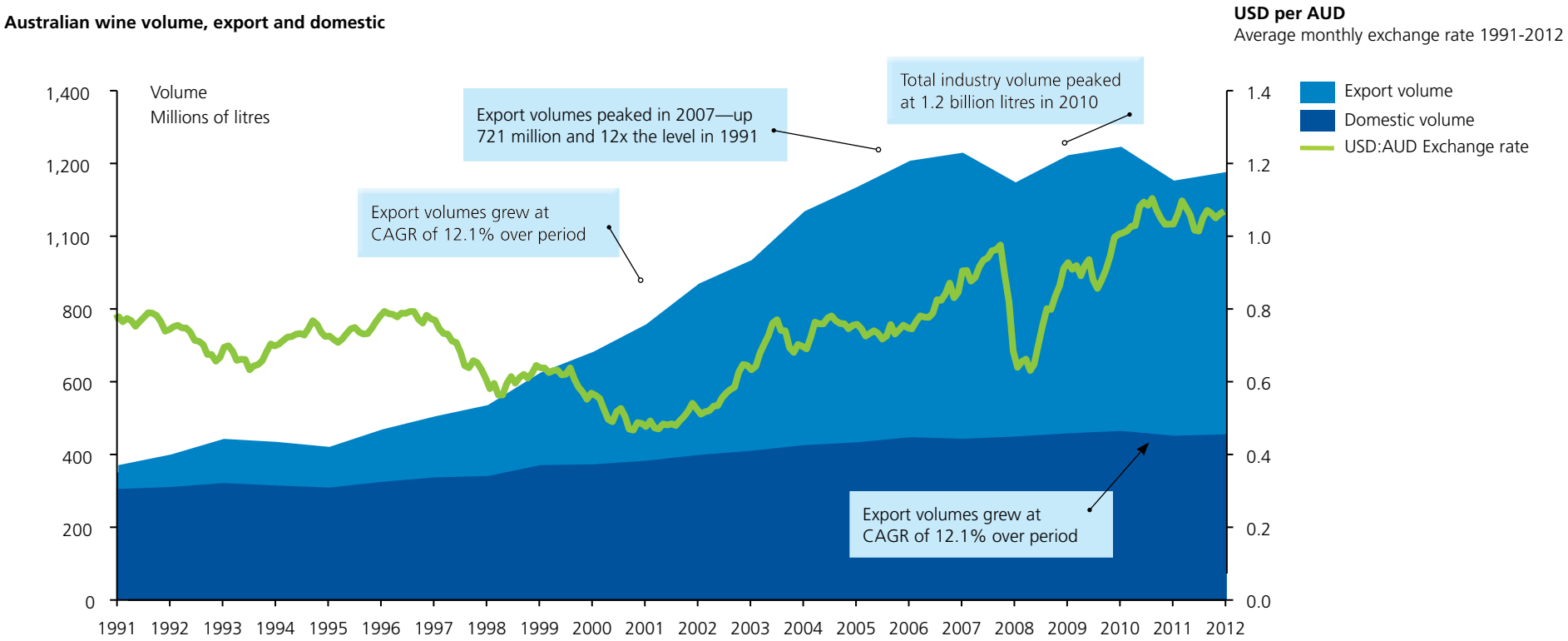
8. Tax has been an issue for the industry. The solution in the current environment is relatively clear.

1. The Australian wine industry has tripled in size and been very successful at building export markets

From 1991 to 2007 the Australian wine industry tripled in size. Almost 100% of this growth was exported (Exhibit 1). In 2007 Australia exported 64% of its wine production by volume and 60% by value. In 2012 these figures were 62% and 43% respectively.

Exhibit 1: Growth of the Australian wine industry export and domestic market volume

Millions of litres, 1991–2012; USD per AUD



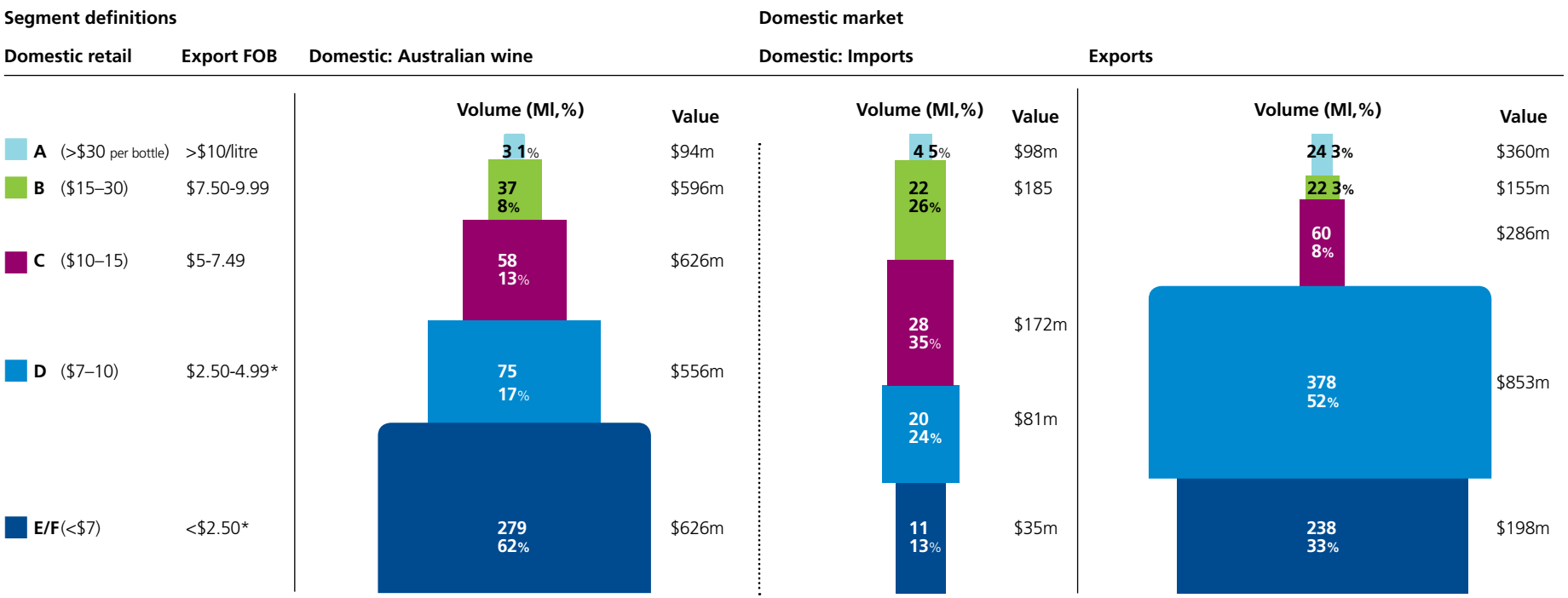
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
USD: AUD	0.78	0.74	0.68	0.73	0.74	0.78	0.74	0.63	0.65	0.58	0.52	0.54	0.65	0.74	0.76	0.75	0.84	0.85	0.79	0.92	1.03	1.04
GBP: AUD	0.44	0.42	0.45	0.48	0.47	0.50	0.45	0.38	0.40	0.38	0.36	0.36	0.40	0.40	0.42	0.41	0.42	0.46	0.50	0.59	0.64	0.65

Source: ABS; Wine Australia; xe.com; US Treasury

For the purpose of this review wine segment definitions—A, B, C, D, and E/F—have been agreed with the WFA Board (bulk wine is allocated to its quality segment). Exhibit 2 shows these definitions and the breakdown of volume and value by segment across domestic consumption of Australian wine, imports and exports.

Exhibit 2: Illustration of wine demand by quality/price segment

2012 volume, (Millions of litres) and value (AUD millions)



	Domestic: Australian wine	Domestic: Imports	Exports
Total volume (Ml)	**452**	**84**	**721**
Total value ($m)	**$2,498**	**$571**	**$1,853**

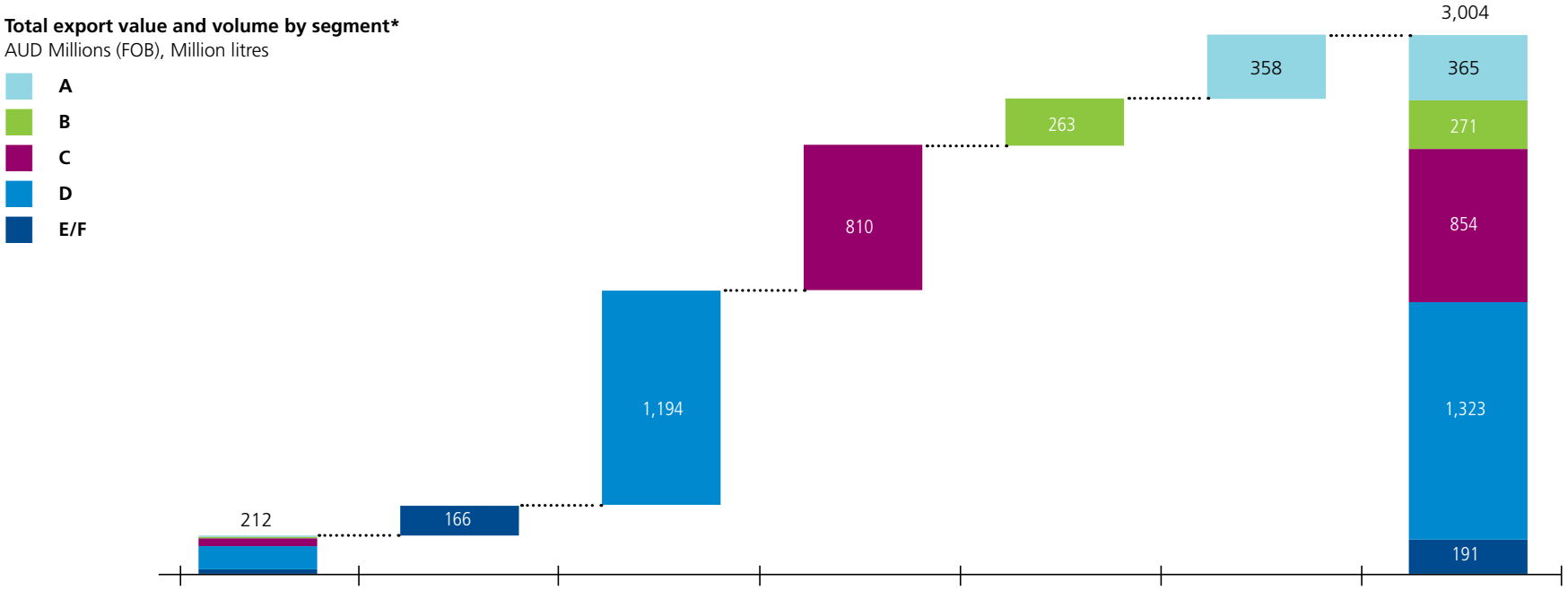
* Bulk under $1.00 per litre is classified as E/F and above $1.00 per litre as D

Source: ABS; Wine Australia; Nielsen; analysis

Data back to 1991 shows that exports (and therefore Australian production) is dominated by lower end commercial (C) and commodity (D, E/F) wine (Exhibit 3).

Exhibit 3: Export value growth to 2007 was driven by D and C. A and B grew by the biggest multiples off a low base

Total export value and volume by segment*
AUD Millions (FOB), Million litres



	1991**	E/F	D	C	B	A	2007
Volume Millions of litres	**47**	147	405	136	30	21	**786**
2007 as multiple of 1991		8x value 19x volume	10x value 15x volume	20x value 19x volume	36x value 32x volume	58x value 44x volume	14x value 17x volume

* Segment definitions held constant in AUD terms
** Total export volume 2007 was 47 million litres
Source: Wine Australia; analysis

An overall picture of the Australian wine market by segment including domestic production, domestic consumption, exports and imports is shown in Exhibits 4, 5 and 6. Further detail for each individual segment can be found in the Appendices.

Exhibit 4: Value of Australian wine industry – domestic production and consumption, exports and imports. Changes from 2007 to 2012

$ Millions, 2007–2012[1, 2]

Segment and definition			Domestic production consumed domestically[3]				Export values[4]				% of total domestic production		Import values[5]			
Grade	Domestic retail price/bottle	Export FOB/litre	2007	2012	Change	%	2007	2012	Change	%	2007	2012	2007	2012	Change	%
A	>$30	>$10	64	94	30	46.9	365	360	(5)	(1.1)	8.5	10.4	73.8	97.9	24.1	32.6
B	$15–30	$7.50–$9.99	358	596	238	66.5	271	155	(116)	(42.8)	12.6	17.3	166.3	184.9	18.6	11.2
C	$10–15	$5.00–$7.49	667	626	(41)	(6.1)	854	286	(568)	(66.5)	30.4	21.0	82	171.7	89.7	109.5
D	$7–10	$2.50–$4.99	329	556	227	69.0	1,323	854	(470)	(35.5)	33.0	32.4	40	81	41	102.6
E/F	<$7	<$2.50	586	626	40	6.8	191	198	7.0	3.7	15.5	18.9	27.3	34.5	7.2	26.2
Totals			**2,004**	**2,498**	**494**	**24.7**	**3,004**	**1,853**	**(1,151)**	**(38.3)**	**100**	**100**	**389.3**	**569.9**	**180.6**	**46.4**
Total domestic production			**5,007**	**4,350**	**(657)**	**(13.1)**	**Market share of imports**						**16.3%**	**18.6%**		
Total domestic consumption (domestic and imports)			**2,224**	**2,975**	**751**	**33.8**										
Total domestic production and consumption			**5,227**	**4,827**	**(400)**	**(7.7)**										

1 All value are FOB or wholesale equivalent
2 Export figures include bulk; domestic figures include on- and off-premise
3 Total value and volume from ABS. Distribution by segment in glass based on Nielsen data on retail glass bottle sales. All cask and soft-pack assumed to be E/F
4 Based on export data by price point from Wine Australia. Segment definitions held constant in destination currency terms
5 Total value and volume from ABS. Distribution by segment based on Nielsen data on retail glass bottle sales
Source: ABS; Wine Australia; Nielsen; analysis

Exhibit 5: Volume of Australian wine industry—domestic production and consumption, exports and imports. Changes from 2007 to 2012

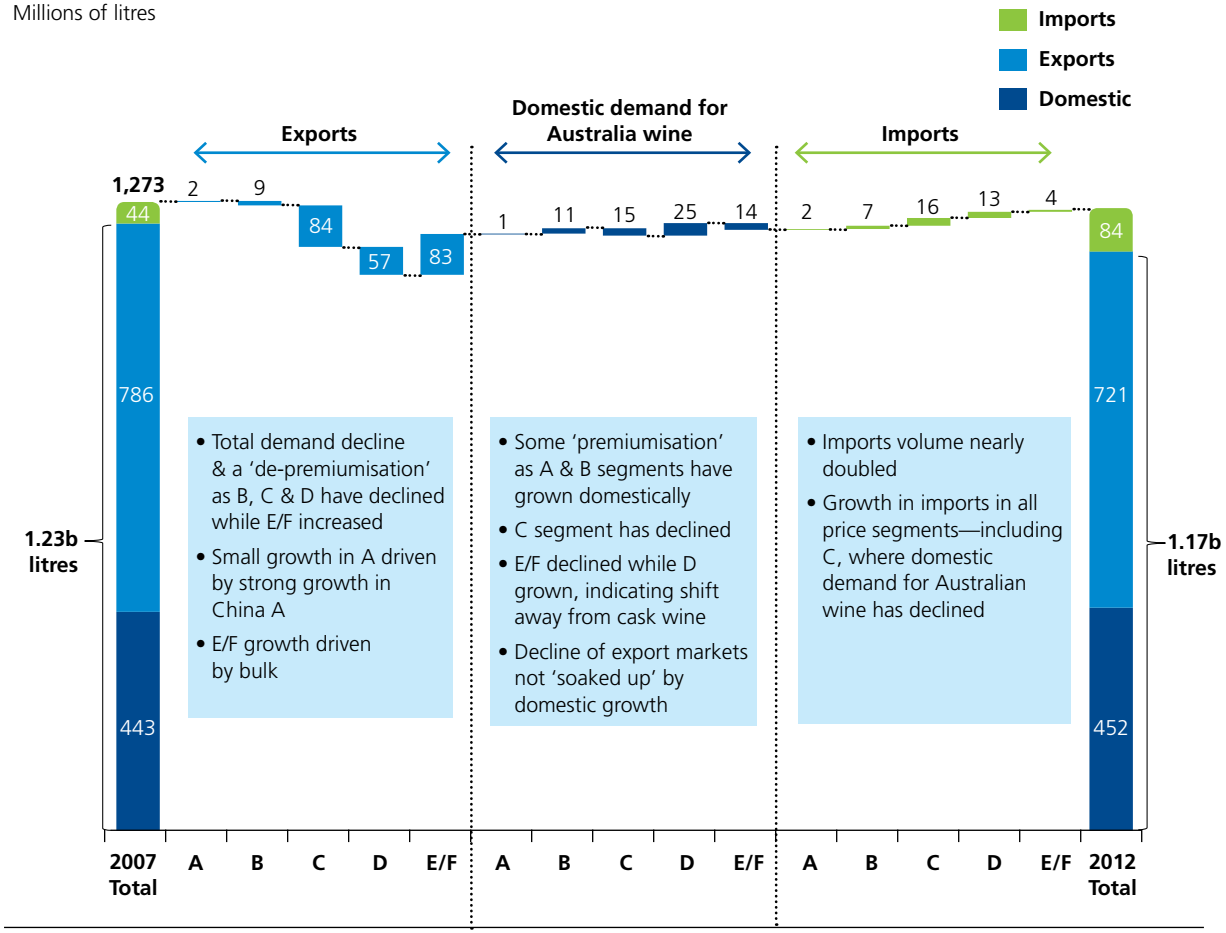
Millions of litres, 2007–2012[1]

Segment and definition			Domestic production consumed domestically[2]				Export volumes[3]				% of total domestic production		Import volumes[4]			
Grade	Domestic retail price/ bottle	Export FOB/litre	2007	2012	Change	%	2007	2012	Change	%	2007	2012	2007	2012	Change	%
A	>$30	>$10	1.7	2.5	0.8	47.1	21.8	23.9	2.1	9.6	1.9	2.3	1.9	3.5	1.7	89.8
B	$15–30	$7.50–9.99	26	36.8	10.8	41.5	31.4	22.3	(9.1)	(29.0)	4.7	5.0	15.1	21.8	6.6	43.9
C	$10–15	$5.00–7.49	73.1	58.2	(14.9)	(20.4)	143.6	59.6	(84.0)	(58.5)	17.6	10.0	12.3	28	15.7	128.3
D	$7–10	$2.50–4.99	49.8	75.1	25.3	50.8	434.0	377.5	(56.5)	(13.0)	39.4	38.6	7.3	19.8	12.5	170.1
E/F	<$7	<$2.50	292.7	279	(13.7)	(4.7)	155.4	238.1	82.7	53.2	36.4	44.1	7	10.9	3.9	57.2
Totals			**443.3**	**451.6**	**8.3**	**1.9**	**786.2**	**721.4**	**(64.8)**	**(8.2)**	**100**	**100**	**43.6**	**84**	**40.5**	**93.0**
Total domestic production			**1,229.5**	**1,173**	**(56.5)**	**(4.6)**	**Market share of imports**						**8.9%**	**15.7%**		
Total domestic consumption (domestic and imports)			**464**	**492.9**	**28.9**	**6.2**										
Total domestic production and consumption			**1,250.2**	**1,214.3**	**(35.9)**	**(2.9)**										

1 Export figures include bulk; domestic figures include on- and off-premise
2 Total value and volume from ABS. Distribution by segment in glass based on Nielsen data on retail glass bottle sales. All cask and soft-pack assumed to be E/F
3 Based on export data by price point from Wine Australia. Segment definitions held constant in destination currency terms
4 Total value and volume from ABS. Distribution by segment based on Nielsen data on retail glass bottle sales
Source: ABS; Wine Australia; Nielsen; analysis

Exhibit 6: Change in volume of Australian wine and imports to Australia from 2007 to 2012

Australian wine production and imports to Australia—Volume
Millions of litres



Value AUD Millions	2007 Total	A	B	C	D	E/F	A	B	C	D	E/F	A	B	C	D	E/F	2012 Total
	$5,228	($4)	($116)	($568)	($470)	$7	$30	$238	($41)	$227	$40	$40	$61	$98	$45	$13	**$4,829**

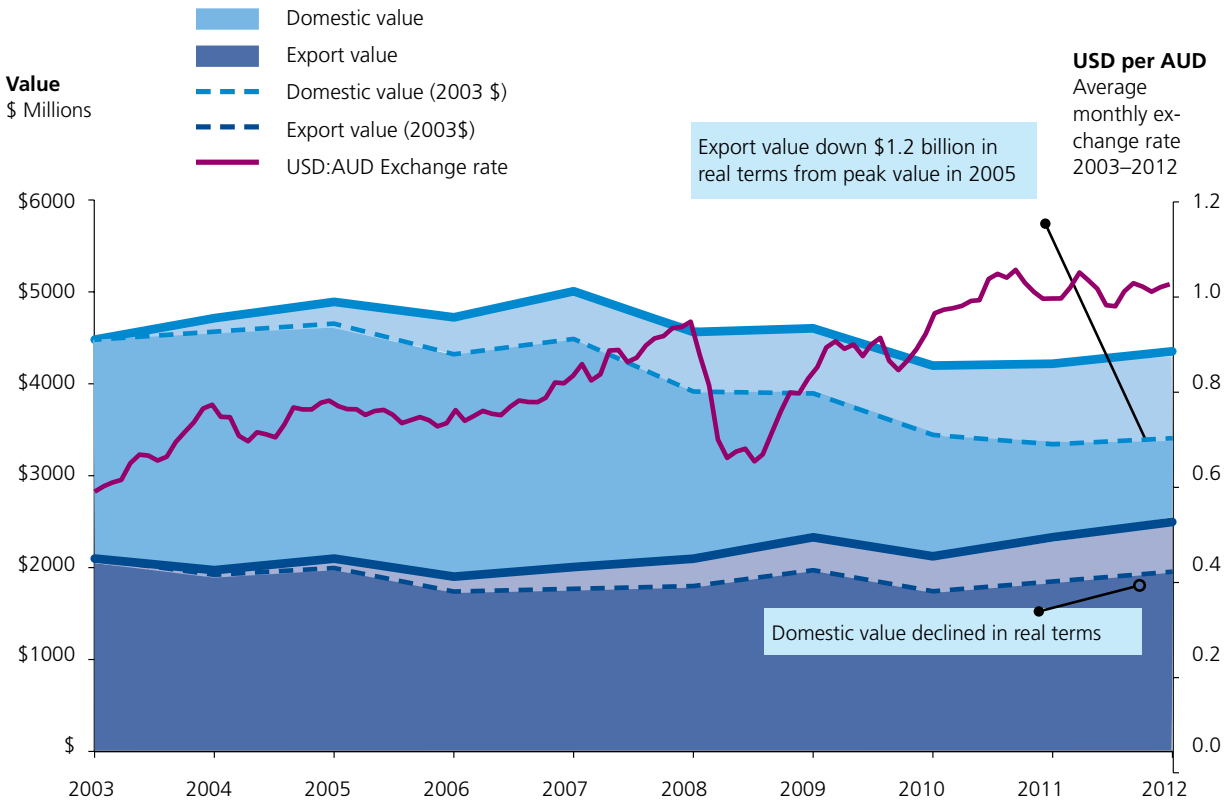
* Imports are glass bottle only
Source: Wine Australia; Nielsen; ABS; analysis

A few key points of context on the overall industry:

- The number of wine producers has grown dramatically—from 617 producers in 1991, to nearly 1,800 in 2004, and over 2,400 in 2012
- Australia is now the fourth largest exporting country with 8% of the global wine trade by volume. The other key exporters are: Italy (26%), Spain (24%), France (15%) and Chile (7%). Australia has significant shares in 4 of the top-10 wine importing countries (Exhibits in Appendices)
- By volume 75% of Australian wine exports goes to four countries—UK 35%, US 27%, Canada 7%, and China 6%. By value the top four countries total 69%—US 24%, UK 22%, China 13%, and Canada 10%
- From 1991 to 2012 to the export volumes of A and B wine grew by 36 times (52 million litres), C by 19 times (136 million litres), D by 15 times (405 million litres), E and F by 19 times (147 million litres). D is 56% of this growth in volume
- In 2012 30% of the wine produced in Australia was sold domestically at retail prices of less than $10/bottle, and 53% was exported at less than $5/litre FOB. 83% of total wine produced in 2012 was D, E or F
- A and B wines account for just 7% of total domestic production—A is 2%, B is 5%, C is 10%, D is 39% and E and F are 44%
- A and B wines are higher in value—the 7% of total volume translates to 28% of Australian industry revenue. However, the majority (72%) of revenue comes from lower quality wines (21% from C, 32% from D, and 19% from E and F)
- The gross margins of wine differ significantly by

Exhibit 7: The value of the Australian wine industry has declined in real terms since 2003

Australian wine sales, export and domestic



USD:AUD	0.65	0.74	0.76	0.75	0.84	0.85	0.79	0.92	1.03	1.04
GBP: AUD	0.40	0.40	0.42	0.41	0.42	0.46	0.50	0.59	0.64	0.65

Source: ABS; Wine Australia; xe.com; US Treasury

segment and export versus domestic—much lower for lower quality segments and export.

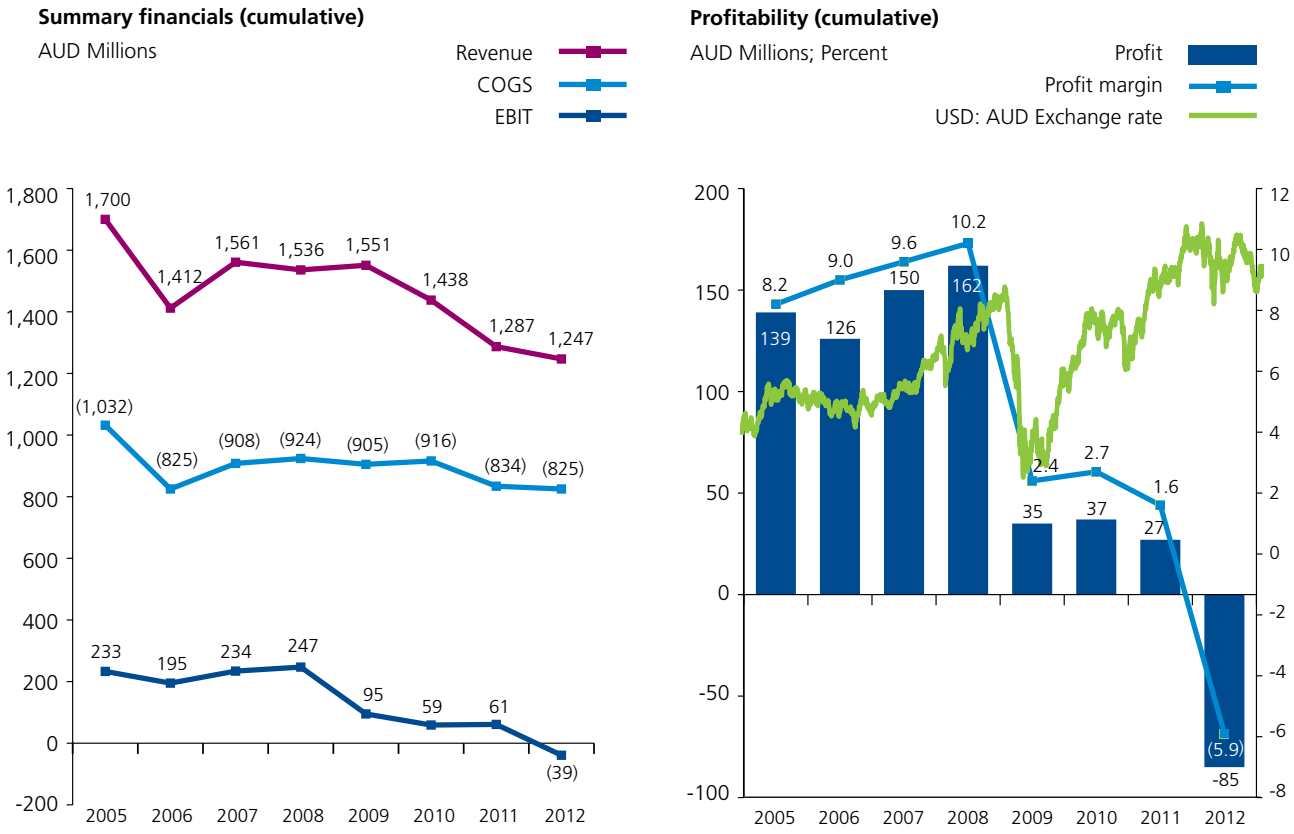
- In real terms the industry has declined since 2003, in both domestic and export sales, shown in Exhibit 7. The actual size of the industry has shrunk in real value terms almost 25% – from $4.5 billion to $3.4billion

2. Since 2007 the profitability of the Australian wine industry has declined significantly

Four separate analyses indicate a significant decline and structural shift in industry profitability over the last 5 years. The analyses are:

- ONE: Financial data for 9 wine companies from FY05 to FY12 summarised in Exhibit 9. These companies provide a representative cross section of the industry. In the 4 years from 2005 to 2008 their combined profitability and margins grew—peaking at $162 million and 10.2% in FY08. The aggregate profit of the 9 companies fell by 82% in FY09 and into loss in FY12. While much of these falls are due to asset write-downs and restructuring costs, it is clear that 8 of the 10 companies we have detailed data for (over a shorter time period FY07 to FY12) have experienced sustained reductions in margins and profit. In 2007 the average profit margin across these companies was 9.6%, in FY09 it averaged 2.4%; and in FY12 it was (5.9)%

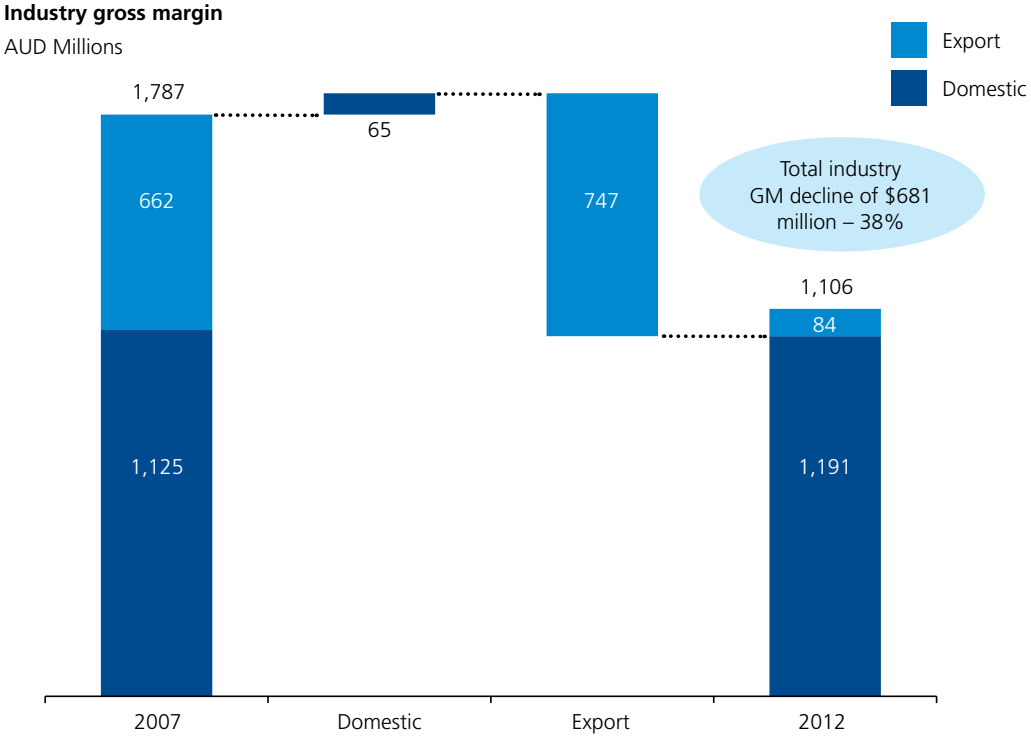
Exhibit 8: Profit performance of nine representative wine companies, 2005–2012



Source: Company information, US Treasury, analysis

- TWO: Modelling of industry profitability leveraging previous work by Deloitte and WFA, industry and ABS data, and using key assumptions developed via by confidential access to the detailed financials of a number of Australian wine companies, plus confidential interviews and surveys. The analysis estimated total industry gross margin declined by 38% to $1,107 million in 2012, from $1,787 million in 2007. This was driven by a $747 million decline in export gross margin. Whereas domestic gross margin rose by $66 million, just 6% over the 5 years—Exhibit 9.
- THREE: Confidential financial data provided by wine producers, and information on margins by product segment and market provided by 13 of the companies engaged in the Review process. Participants mostly indicated declines in gross margins. Several interviewees observed that the industry and individual companies (including themselves) "needed to re-set profit expectations..."
- FOUR: Numerous interviews, anecdotes and reports suggest a significant number of grape growers are currently unprofitable. The modelling of a representative selection of 13 growing regions comparing average costs of production to prices paid for grapes in 2012 suggests much of the volume across those regions was unprofitable in that year. This analysis is covered in detail in **Section 3.3** on 'oversupply'.

Exhibit 9: Estimated total change in industry gross margin, 2007–2012



Source: ABS; Wine Australia; Ready Reckoner; Deloitte Winemaker Survey; interviews; winemaker survey; Nielsen; team analysis

3.0 The decline in industry profitability is being driven by a 'perfect storm'

As the industry reached its peak in volume (and in recent history profitability) a 'perfect storm' began. From 2007 a number of forces combined to hit the Australian wine industry:

- The global financial crisis (GFC) hit world markets starting in August 2007 and accelerated through 2008—coinciding with a significant fall in Australian wine exports. Export volumes recovered through 2009, only to fall again in 2010 and 2011
- Fall in demand for Australian wine in key markets, especially the US, UK and Canada, from 2007 to 2012—further detail in Section 3.1
- From 2004 the A$ rose steadily from 80 US cents to almost parity in July 2008. A sharp fall to 62 cents in August 2008 preceded a steady climb to parity in November 2010. Historical movements in the A$ are shown on Exhibits 1, 7, and 8
- Domestic retail consolidation, supplier management, and vertical integration into wine accelerated through the period. Woolworths (WLG) accelerated its growth of Dan Murphy, acquired Langton's in 2009, and Cellarmasters in 2011. Wesfarmers acquired Coles in 2007 and began to transform its management, strategy and performance—including its liquor business
- The situation has not been helped by the low domestic demand growth and increasing imports.

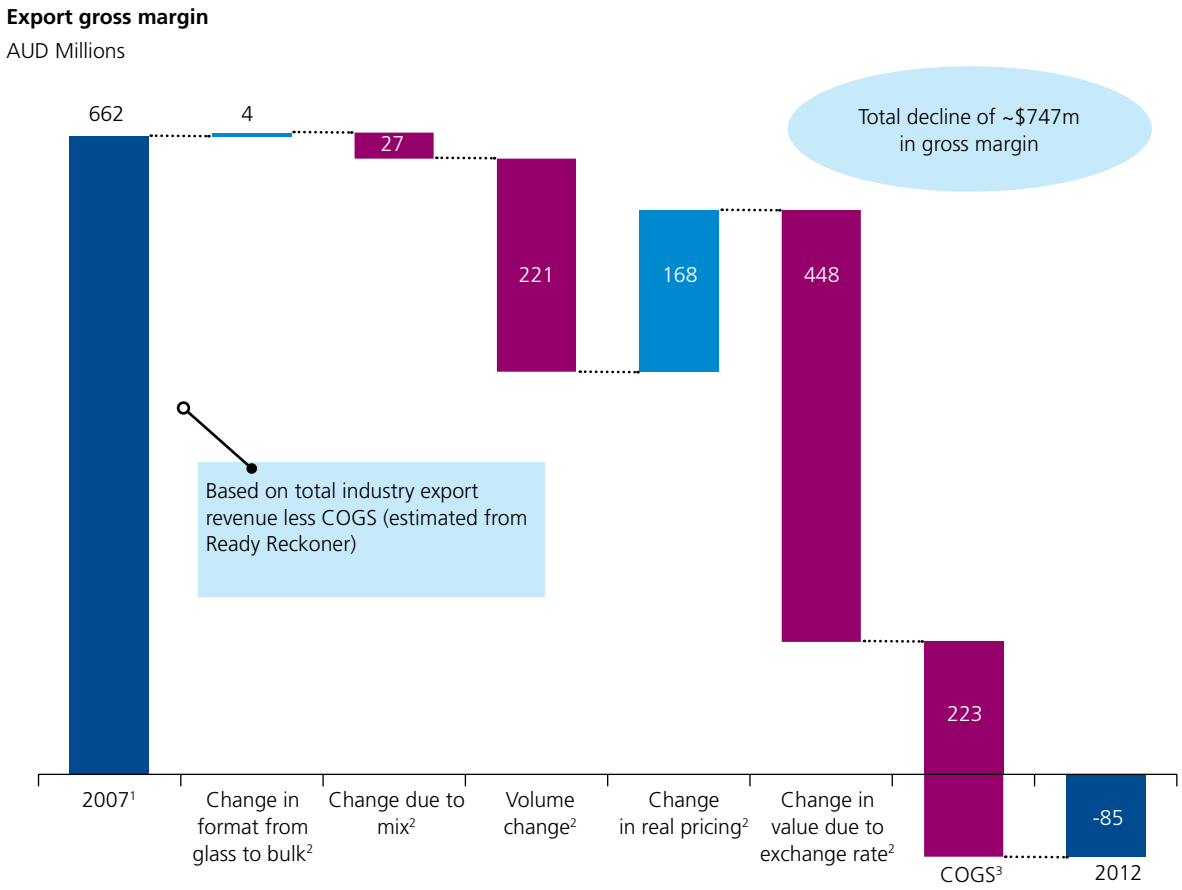
However, the 'storm' has intensified due to the oversupply of wine that resulted from excess planting and wine making capacity given the 'unexpected' fall in export demand and rise in the $A. This has created a series of responses with negative 'feedback loops' that: provide a market for uneconomic grapes and wine (ensuring supply is slow to respond to the fall in profitability), put further price and volume pressure on winemakers, educates the market to expect low price wine, and potentially further damages 'Brand Australia' and demand for exports. These responses include:

- Retailers are able to source cheap wine to support their private label and promotional strategies
- Flood of cheap Australian wine onto the export market (much of it in bulk or packaged without proper branding support)
- Winemakers accessing cheap fruit to maintain or increase wine production to amortise fixed costs—provides market for uneconomic grapes, and puts further price and volume pressure on winemakers
- Increased focus of some grape growers, winemakers, retailers, and opportunists on 'leveraging' the WET Rebate.

3.1 Export returns have declined sharply

From 2007 to 2012 export volumes fell by 64 million litres (8%) and value by $1.15 billion (38%)—causing an estimated $750 million fall in total industry gross margin (Exhibit 10). The primary drivers of this are: a higher A$, falling demand, increased competition from other wine exporting countries, higher costs, and a deteriorating mix. The biggest factor is the exchange rate, estimated to have caused a $448 million fall in industry gross margin—though this was partially offset by efforts to increase prices that generated $168 million of gross margin.

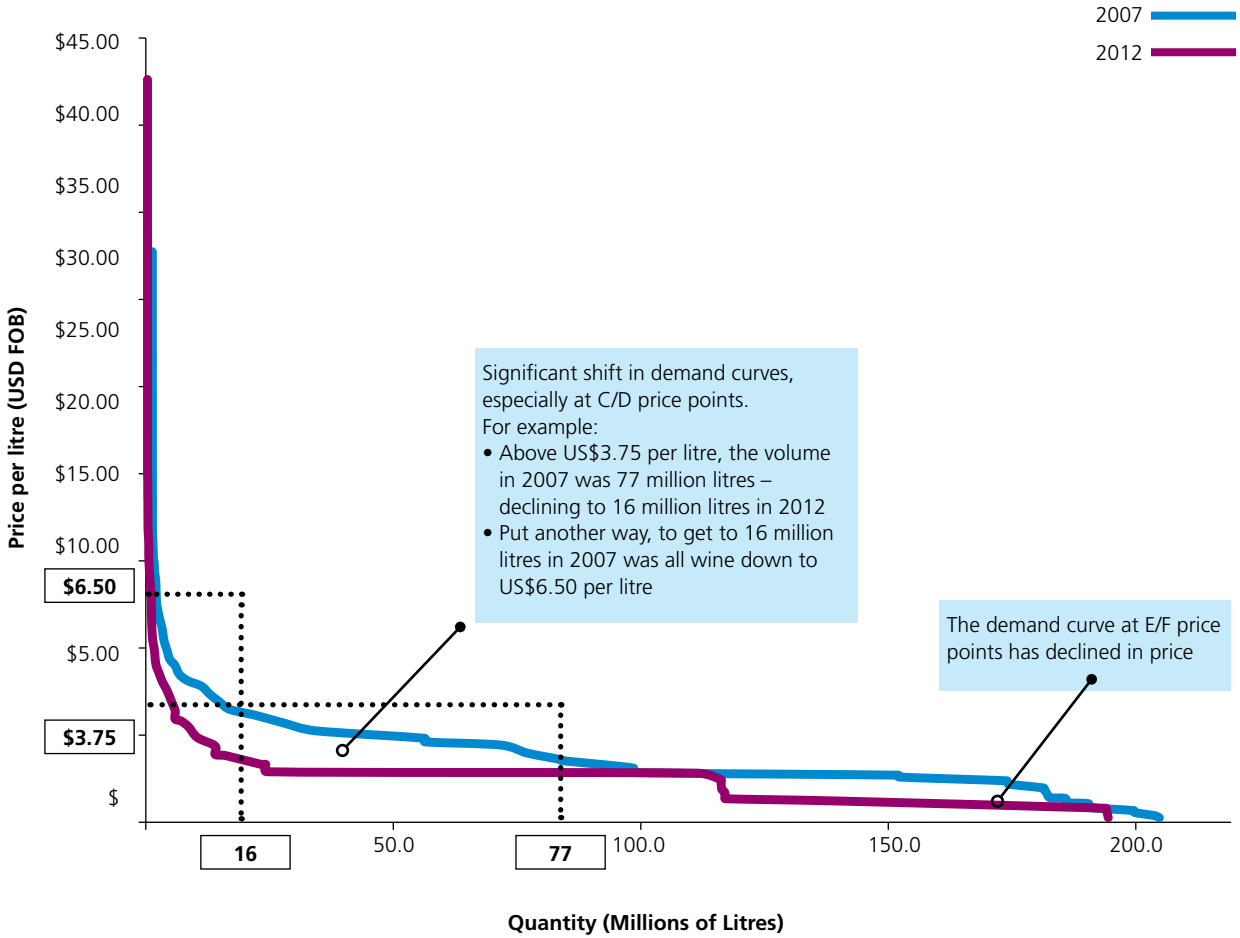
Exhibit 10: Estimate of total gross margin change from exports, 2007–2012



1 Based on total export value from Wine Australia less COGS per litre estimated from Ready Reckoner
2 Based on detailed Wine Australia export data
3 Based on interviews, winemaker survey, and company financials
Source: ABS; Wine Australia; Ready Reckoner; Deloitte Winemaker Survey; interviews; winemaker survey; Nielsen; analysis

Exhibit 11: US demand for Australian wine has fallen in USD terms*

USD FOB per litre; Millions of litres



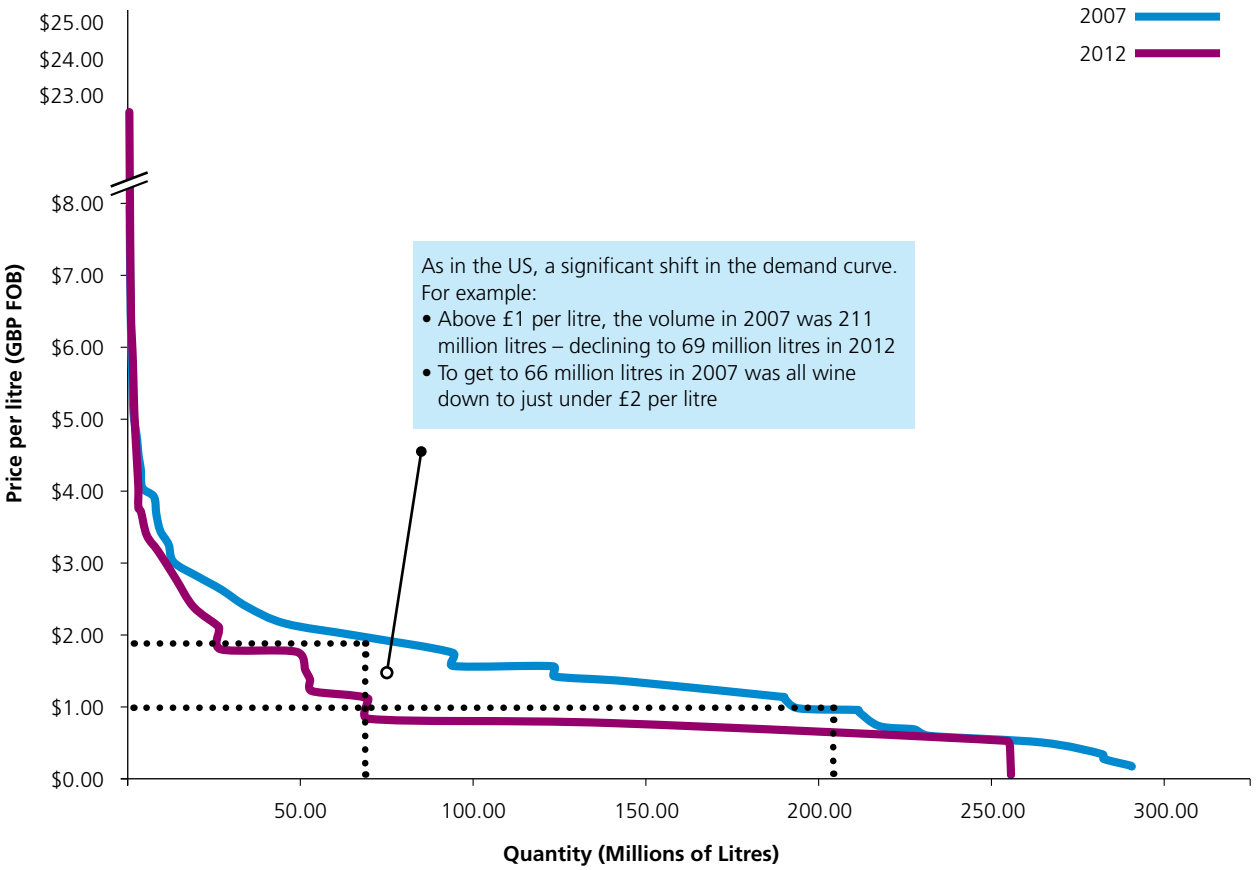
* All formats—glass, bulk, and others
Source: Wine Australia; xe.com for foreign exchange rates; analysis

Declining export demand has also reduced gross margins. In the US and UK markets demand has fallen at local currency price points (Exhibits 11 and 12). Defining the demand curves in the destination currency removes the impact of the appreciation of the A$. The US demand curves show that in 2007 US consumers purchased 77 million litres of Australian wine at USD prices of $3.75 and above—in 2012 they only purchased 16 million litres for the same price range; a decline of 61 million litres. While a number of interviewees commented on this fall in demand, separate to the impacts of the $A, we believe it is somewhat hidden and the reasons for it need to be better understood. The key drivers noted by the interviewees were:

- Increased competition and choice from other exporters including: France, Italy, Chile, Argentina, Spain and South Africa
- 'Damage to Brand Australia' by a number of factors including: exports of low quality wines, brand proliferation, loss of 'story and identity'

Exhibit 12: UK demand for Australian wine—in GBP terms*

GBP FOB per litre; Millions of litres

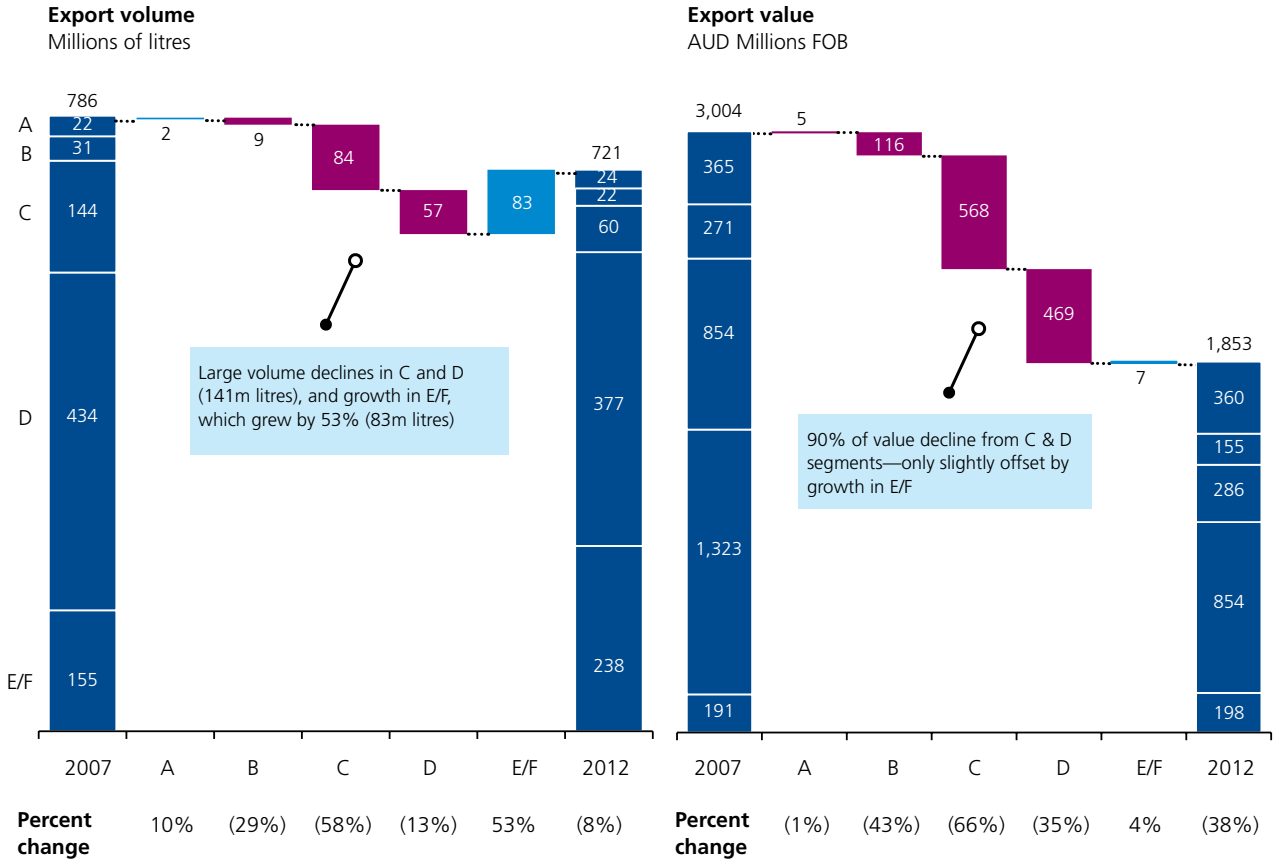


* All formats — glass, bulk and others
Source: Wine Australia; xe.com for foreign exchange rates; analysis

In the face of this declining demand the appreciation of the A$ has resulted in lower FOB prices (a 'double whammy'). While some Australian exporters have been able to increase prices in destination currencies on average this has not covered the increase in the A$, and fall in volumes. Further the sustained rise of the A$ has 'ended' hedging strategies that protected some exporters. This plus asset write-downs may be a primary driver of the accelerated fall in profit of a number of players in FY11 and/or FY12 (Exhibit 8 and analysis in Appendices).

Exhibit 13: Change in export volume and value by segment, 2007–2012

Segment definitions constant in destination currency terms*



Further detail on the overall situation for exports from 2007 to 2012 is shown on Exhibits 13, 14, and 15, including:

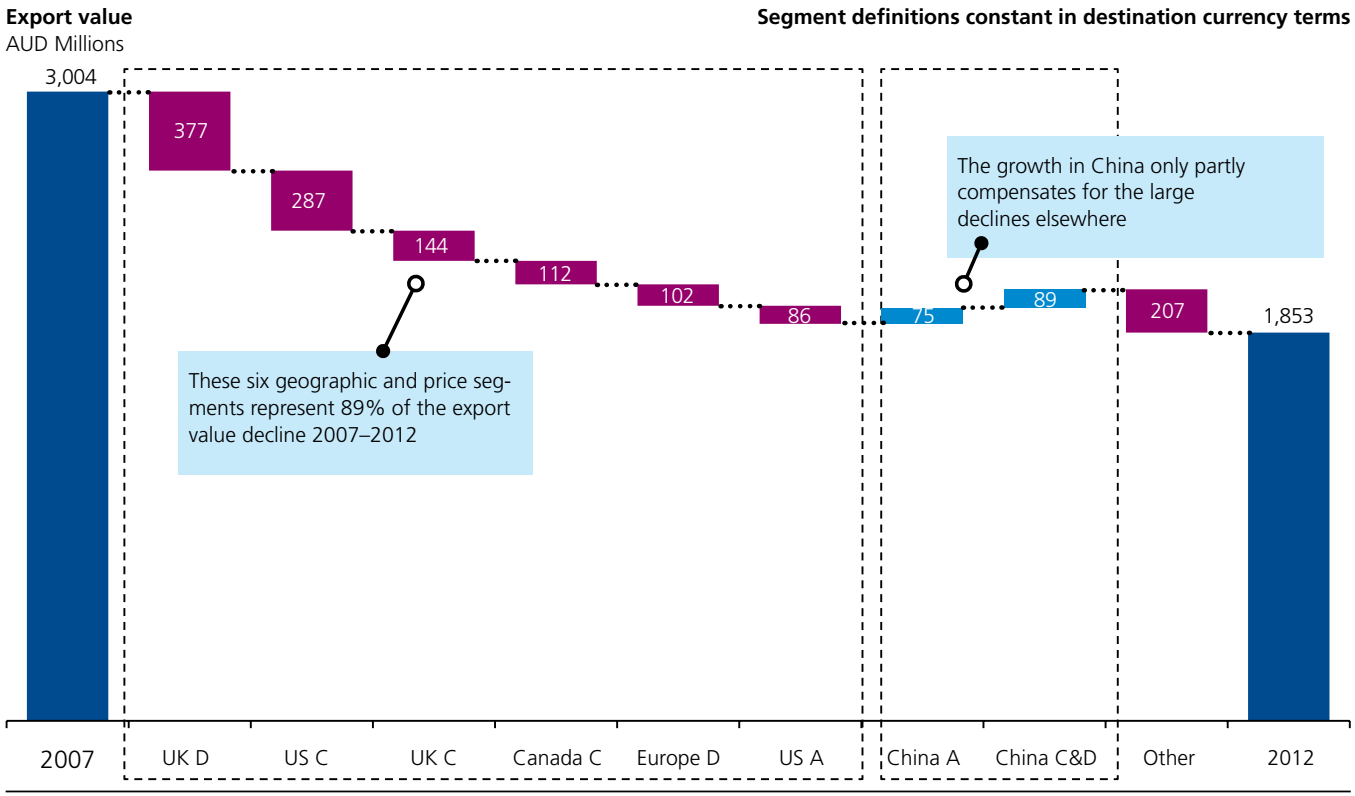
- 220% of the fall in export volume came from C and D wines. A 53% increase in the export of E/F wines kept the overall fall at just 8% (Exhibit 13)
- 90% of the fall in value comes from C and D wines. And, exports of B have fallen 29% by volume and 43% by value
- Switch to low quality/value wine—the volume of B is down 29%, C down 58%, and D down 13%, while E/F are up by 53%
- Significant issues in our major export markets—the US and UK account for 91% of the total fall in value. Canada previously our third largest single country market has maintained volumes but is down 35% in value (Exhibit 15)

* The analysis kept the segment definitions (price points) constant in the destination currency to prevent distortions to segment values due to the rising $A For example: In 2007 wine exported to the US at A$10/litre FOB was classified 'A'. The value in USD was US$8.39/litre. In 2012 the US $8.39 equates to A$8.10 suggesting B analysis adjusts this so that 'A' is wine > A$8.10/litre FOB

Source: Wine Australia; analysis.

- Just six country and segment combinations represent 89% of the decline in value and almost 3 times the fall in total volume. The combinations are UK D & C, US C & A, Canada C, and Europe D

Exhibit 14: Decline in export value and volume by country and segment



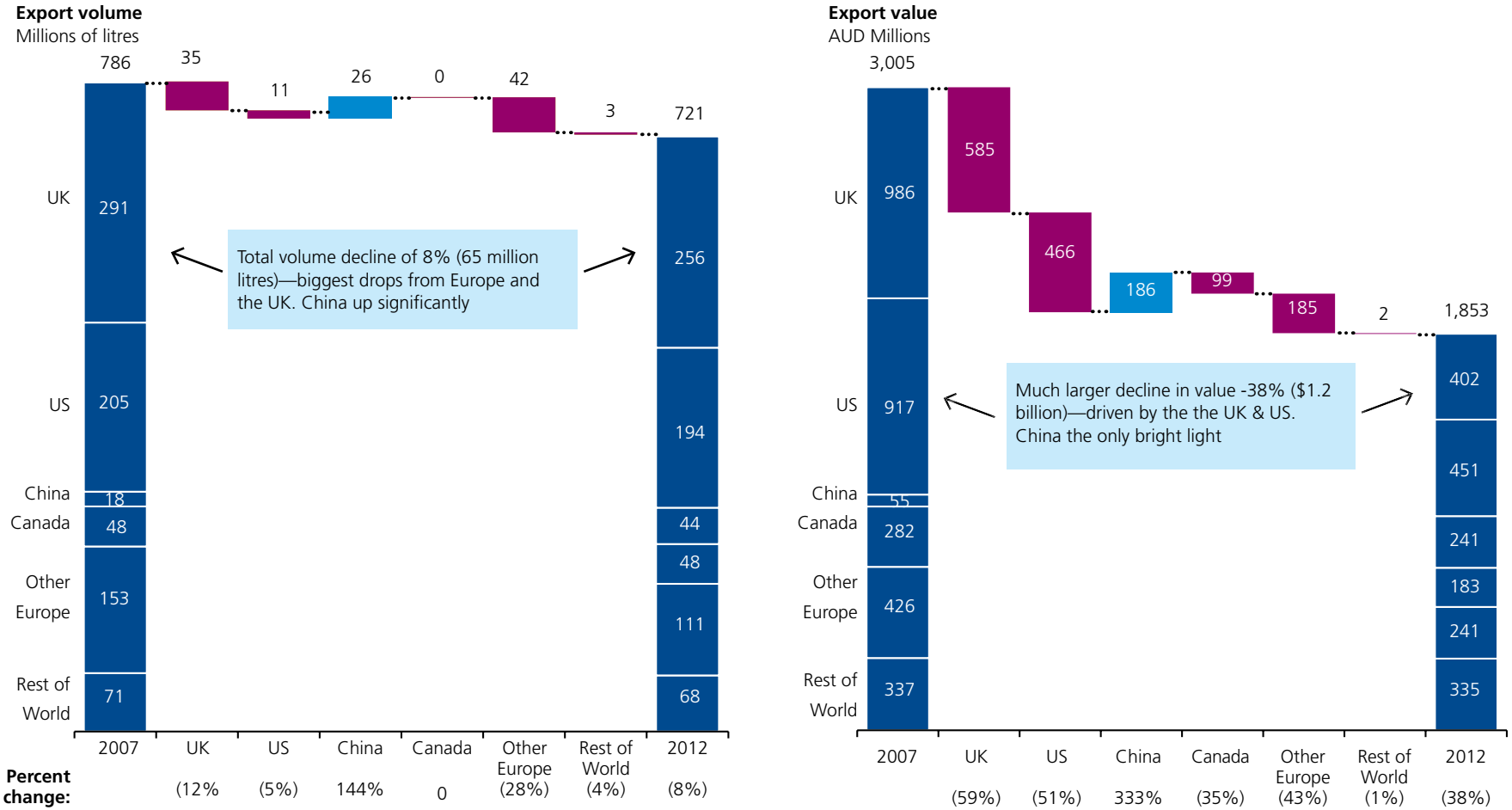
Volume Millions of litres

2007	UK D	US C	UK C	Canada C	Europe D	US A	China A	China C&D	Other	2012
786	(71)	(47)	(20)	(17)	(28)	(5)	4	24	95	721

Source: Wine Australia; analysis

- China is the bright light but unfortunately still small—volume is up 144% (26 million litres) but is still just 6% of total export volume. The value story is better, up 333% ($186 million) to $241 million and 13% of total export value. A continuation of this growth will help the industry but has limits:
  - Excluding China the value of wine exports fell by $1,336 million from 2007 to 2012. The increase in exports to China mitigated $186 million just 14% of this fall
  - Over half ($97 million) of the increase in exports to China came from A and B wines of which there is limited supply
  - Australia is the second largest exporter to China (almost 40% the size of France by value). In the last year imports of wines from Spain, Chile, Argentina, US, and South Africa grew at similar or higher rates.

Exhibit 15: Change in export volume and value by country, 2007–2012



Source: Wine Australia; analysis

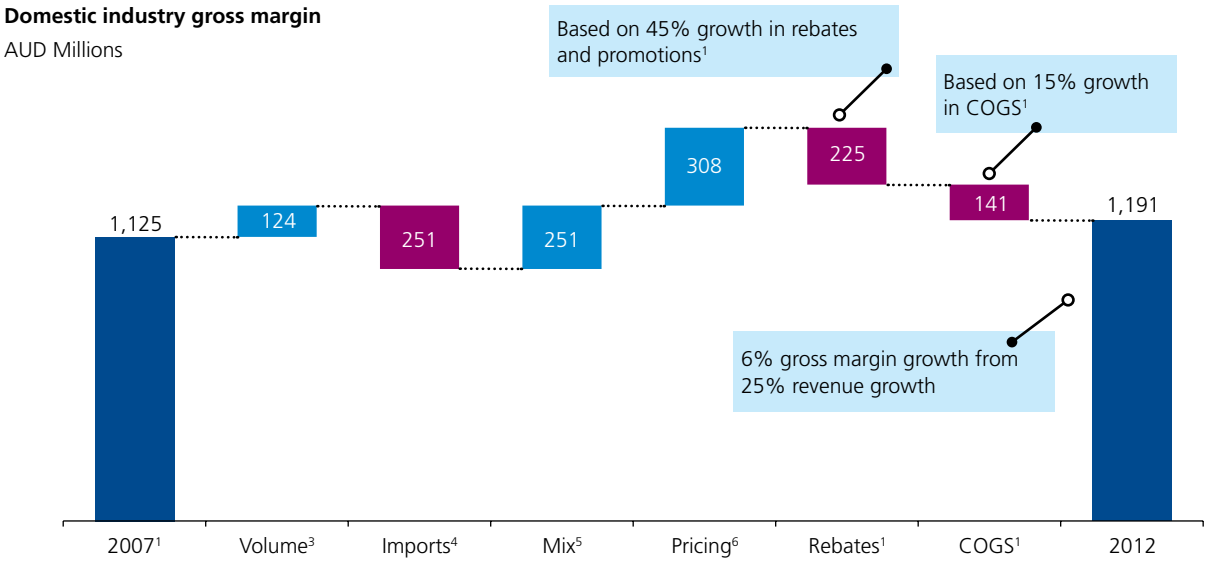
3.2. Domestic margins have been squeezed by retailers, low demand growth, and increased imports

- Another possible opportunity is broadening and deepening the export base. Currently 80% of Australia's exports go to five countries. This concentration is significantly less for Australia's key competitors including: France (58%), Spain (57%), Chile (56%), South Africa (60%), Italy (64%), Germany (53%), US (70%), and Argentina (70%). Importing countries in the top 5 of competitors but not in Australia's top 5 include: Netherlands, Japan, Russia, Sweden, Hungary, France and Italy.

Previous Exhibits 8 and 9 show the marked fall in profitability of Australian wine makers. The analysis in Exhibit 16 shows that imported wine and increased rebates and discounts paid to retailers all but negated the gross margin benefits of premiumisation (increased sales of higher value wines—mix), increased prices, and volume growth. Domestic industry gross margin for the period grew just $66 million (6%) from revenue growth of 25% (refer Exhibit 4).

Retailer Consolidation and Power. It is estimated the combined groups of Coles and WLG distribute and sell up to 77% of all wine sold off premise (Exhibit 17) up from circa 60% in 2007. This translates to about 70% of all domestic sales, on and off-premise. The data required to accurately determine market shares is not available, therefore these shares are estimates based on our interpretation and analysis of numerous sources. WLG is now an integrated wine player—owning and/or controlling most elements of the wine making

Exhibit 16: Estimate of total gross margin change from the domestic market, 2007–2012



1 Based on interviews, winemaker surveys and company financials. Not the case for all companies with respect to COGS, a number of larger companies claim to have achieved better performance than this
2 Based on total industry value from ABS less COGS per litre estimated from Ready Reckoner
3 Volume change from ABS
4 Imports volume from Nielsen
5 Mix change from Nielsen
6 Pricing change from Nielsen and ABS
Source: ABS; Wine Australia; Ready Reckoner; Deloitte Winemaker Survey; interviews; winemaker survey; Nielsen; analysis

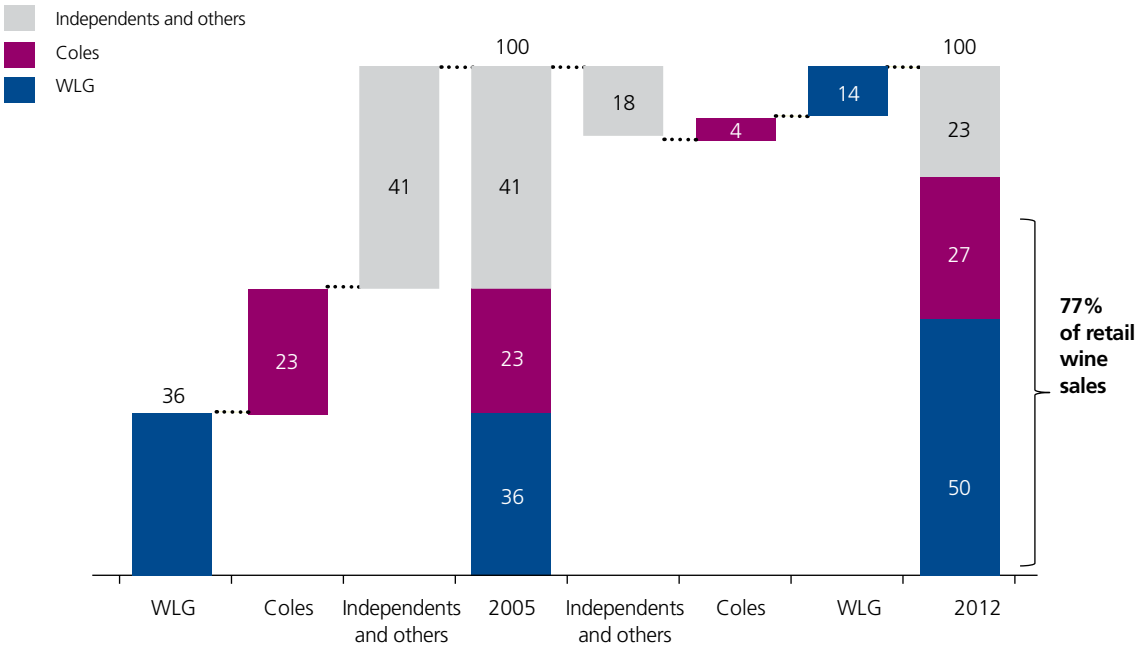
process from winemaking, bottling and packaging, and distribution to retail sales (on and off premise). It also has a significant number of contracted growers. The private, exclusive and controlled labels of both major retailers are estimated to account for at least 16% of domestic sales (off premise). A number of winemakers interviewed noted, 'the retailers' are both their biggest customer and competitor and this is a major issue affecting their profitability. In contrast to this retail and distribution consolidation, the Australian wine industry is highly fragmented—with circa 2,400 producers and 30,000 retail SKUs. Though the 38 largest producers account for 88% of total production (already a large number of alternate suppliers for retailers to leverage) the single biggest producer has less than 15%, much of which is exported. (refer Exhibit 29)

The retailers have numerous sourcing options to leverage due to: this fragmentation, the excess supply of grapes and wine, and the ability to sell imported wine at attractive margins. As a result:

- Many wine producers report a significant increase in discounts and rebates (producer selling costs). Average discount levels being achieved by the major retailers are estimated to be about 30% and as high as 40%—up from 10–15% five years ago (Exhibit 17). One of the retailers briefed on these findings stated that 25% was more representative and strongly disagreed with the 40% level. They also suggested that in cases where producers had switched to direct distribution to the retailer some of the increase in discounts reflects a sharing of the savings from not using a third party distributor
- Winemakers are affected directly and indirectly by the ability of retailers to significantly impact a

Exhibit 17: Estimated change in domestic retailer market shares

Estimated retailer market share of Australian domestic retail wine market by value 2005–2012*
Percent



* WLG share does not include Cellarmasters & Langtons. Off-premise only. MetCash is not include as a separate entity.
Source: Estimates based on interviews; company filings & analyst reports; media; analysis

company's volume/sales and brand strength by controlling: access to shelf space, promotional activity, pricing, volume for exclusivity, and de-listing. The risk of these behaviours to winemakers is extensive as they make production decisions far in advance of sale, have expensive inventories, and have extremely limited alternate distribution options

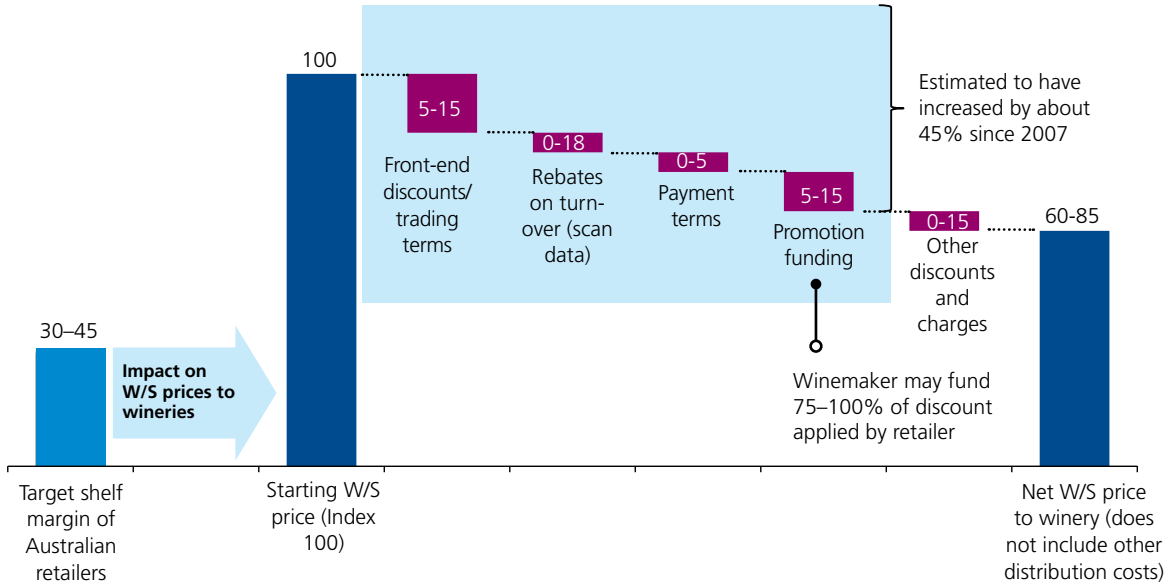
- The strong growth in market share of private label—including controlled and exclusive brands
- Many winemakers stated they struggle to pass on genuine cost increases to retailers that are not then taken away by increased rebates and discounts.

Our confidential analysis of a small number of producers shows that from 2007 to 2012 retailers captured a significant portion of these winemakers profit margin. The analysis also indicates the majority of this margin was not transferred to consumers.

- The change in consumer price varied across different product lines—with certain lines decreasing in price and some increasing. However, when adjusted for volume, the total amount paid by consumers on these products increased compared to what they would have paid in 2007. It should be noted that this is in nominal terms—prices (retail and net wholesale) have not been adjusted to reflect inflation over the period
- For the wines analysed, this total increase in consumer cost was combined with an increase in retailer profit margin, and a decrease in winemaker margin. This was due to falls in net wholesale prices (driven by rebates, discounts and promotions)
- Further work is required with a larger number of winemakers to enable this to be better proven and shared without putting individual companies at risk of recognition.

Exhibit 18: Indicative increase in retailer discounts and margins – impact on winemakers

Change in retailer discounts, rebates, and promotions
Percentage of starting wholesale price



Source: Interviews; WFA Retail Discussion Paper; WFA board member survey; analysis

The retailers briefed on these findings strongly believe their customers have benefited from overall lower wine prices. One of the retailers has shared summary data that indicates from August 2008 to August 2013 the average retail price paid for a domestically produced bottle of wine has fallen 4% from $10.55 to $10.13. Based on consumers buying the same quantities as in 2008 at 2013 prices (again these numbers are not adjusted for inflation). This is for the top 131 domestic wine SKUs (stock keeping units) by revenue. The data set excludes imported wines and domestic wine SKUs that were not sold in 2008. The total revenue of this basket is $1.06 billion, 61% of the total for the top 200 SKUs including imported wines (as per data

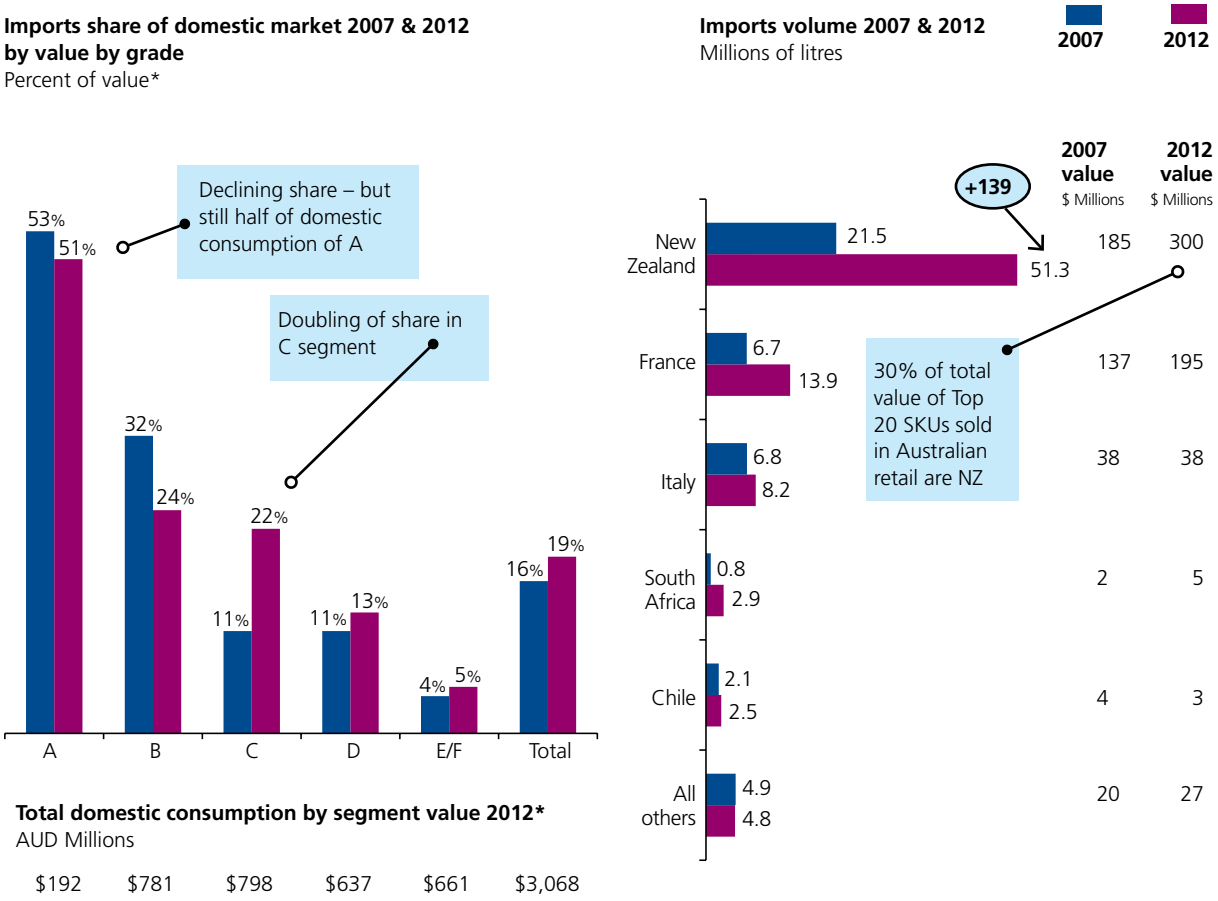
provided by the retailer), and approximately 42% of the value of all Australian wine consumed domestically in 2012 (as per data in Exhibit 4).

The differences in the results of the separate analyses illustrates a number of the challenges facing the industry:

- The retail sector, including independents, has been aggressive in discounting the most popular wine brands. In cases this has been supported or led by winemarkers seeking volume. This has contributed to a 'bargain mentality' and expectation of the consumer to buy quality wines at low prices
- Individual winemakers are affected differently by their relationships with the retailers. The major retailers are clear about targeting specific gross profit margins for SKUs and suppliers and manage to these targets. The dependence of most producers on the retailers to sell a major portion of their wine (many of those interviewed stated that 40 and up to 80% of their volume is sold by the 2 major retailers) means if they are not meeting the retailers gross profit targets they come under pressure to 'transfer more of their margin' to the retailer/s
- How/if winemakers and retailers can work together to refocus the consumer on quality at prices/margins that better support a strong and sustainable domestic wine industry. Any such solution requires continued focus on costs, efficiencies, and making wines consumers' want, in addition to a reduction in the use of low prices and discounting as the primary sale levers.

The major retailers are in the process of responding to a number of views and analyses in this report that may allow for revisions after its release. Any changes will be highlighted and made available on the WFA website.

Exhibit 19: Growth in imports' share of domestic market 2007–2012



* On & off premise
Source: Nielsen; ABS; Wine Australia; analysis

Slow growth in domestic demand combined with rapid growth in imports (2007 to 2012).

There are three key stories with respect to domestic demand:

- Strong trend to consumption of higher priced/ quality wine (*good story*)
- Slow growth in overall wine consumption by volume, but solid growth by value (*bad and good story*)
- Significant growth in imports value and volume (*bad story*)

On the positive side, from 2007 to 2012:

- Domestic consumption increased in value terms by 34% ($751 million). Domestic consumption of domestic wine increased by 25% ($494 million)
- Sales of Australian wine sold above $15/bottle (A and B) increased by $268 million (64%) in value terms and 11.6 million litres (42%) by volume
- Total demand for A and B wines (domestic and imported) has grown by 62 and 43% by volume, and both by 66% in value terms.

On the negative side:

- By volume, total domestic demand has grown by just 6% in 5 years, and just 2% for wine produced in Australia (up 8.3 million litres (Ml)—comprising 11.6 Ml growth in A & B, 25.3 Ml growth in D, and a 28.6 Ml fall in C, E, & F)
- The volume of imported wine doubled from 2007 to 2012 and value rose by 116%. The domestic market share of imports has grown from 8.9% to 15.7% by volume and from 16.3 to 18.6% of value (Exhibit 19)
- Imports provided 71% of the growth in domestic volume consumed and 34% of value. A, B and C wines account for 80% of the value of total imports
- Unfortunately, the strong growth in demand for locally produced A and B wine only benefits a small portion of the industry—only 16% of all wine produced in Australia by value and 3% by volume.

With respect to imports, this growth is dominated by New Zealand, with France second in both volume and value (Exhibit 19). Other countries—Italy, South Africa, Chile and others—are just 22% of the volume and 13% of the value of all imports. NZ wines fill 6 of the top 20 domestic wine SKUs and represent 30% of the retail sales value of those 20 SKUs.

The overall growth in imports has been driven by:

- Purchasing strength of $A—increased competitiveness of imports
- Strategic sourcing by retailers—for increased margins, customer choice, differentiation, and supplier management
- Strong Australian consumer response to smart marketing and product development by NZ and possibly supported by the WET Rebate—205 NZ 'based' producers received a total of A$25 million in WET Rebate in FY12. (refer Exhibit 30)

However, the NZ Sauvignon Blanc phenomenon demonstrates both the opportunity to create new consumer demands, especially with a clear brand message, and the vulnerability of the Australian industry to 'imported trends'—particularly as the domestic consumer palate becomes more sophisticated and 'premiumised'. The industry should look to this as an opportunity.

3.3 The decline and shift in demand (primarily export) has created an 'oversupply/under-demand' of grapes and wine in certain quality segments

Falling export demand has created excess vineyard and winery capacity. This has particularly impacted growers of higher cost, lower quality fruit. It has also impacted the volumes and prices of many winemakers—as volumes in excess of demand search for a buyer. The oversupply has come from:

- Reduction in exports—portion of this volume is 'stuck' in domestic market
- Excessive and/or poorly planned planting (quantity, quality, variety). Too much commercial and commodity wine struggling to compete profitably in more competitive export markets and at higher $A levels
- Excessive wine making capacity/growth strategies of many wine industry players, creating 'pull through' of grapes to amortise high fixed costs.

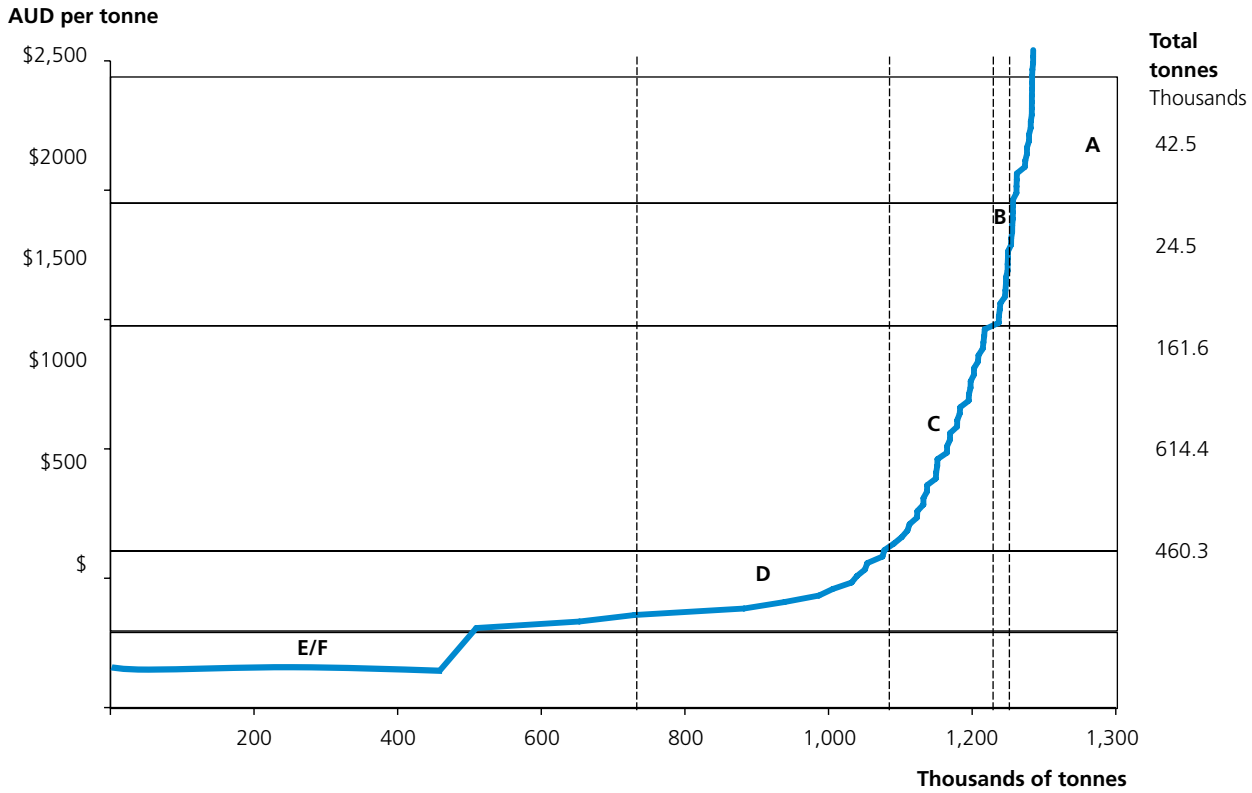
The issue of 'oversupply' causes significant debate within the industry—how much is it, where and what is it, how much impact of what type does it have, is it 'oversupply' or 'under-demand', and why doesn't it leave? These are difficult questions, especially given the available fact base. Our analysis (quantitative and qualitative) provides the following perspectives:

The analysis of 13 growing regions suggests the oversupply is significant.
The initial analysis of 13 growing regions suggests 70% of total volume in 2012 was likely unprofitable—summarised in Exhibit 21. The 13 regions were chosen by the WFA Board and WGGA as representative, combined they provided 78% of total Australian grape supply in 2012 (1.3 of 1.6 million tonnes crushed).

Exhibit 20: Grape supply profile by sale price—13 regions

AUD per tonne; Thousands of tonnes; 2012 vintage

Purchase price and quantities, 2012 vintage from: Barossa Valley, Langhorne Creek, Mudgee, Riverland, Yarra Valley, Coonawarra, Hunter Valley, Margaret River, McLaren Vale, Mornington Peninsula, Murray Darling—Swan Hill, Riverina, Tasmania



* Assumes price distribution of owned grapes matches that of those sold. These regions represent 78% of total tonnage in 2012.
Source: Wine Australia price dispersion data; ABS for total crush tonnage; analysis

Exhibit 21: Estimated portions of grape supply that is profitable by region and segment in 2012 vintage

AUD per tonne; Thousands of tonnes; 2012 vintage

Based on estimated growing costs by region and quality level* compared to actual prices paid in 2012, it appears significant volumes of C, D, and E/F do not cover growing costs

	A		B		C		D		E/F	
	Current total	Unprofitable	Current total	Unprofitable	Current total	Unprofitable	Current total	Unprofitable	Current total	Unprofitable
Barossa Valley	11,820	-	3,454	-	33,430	19,409	8,760	8,760	1,466	1,466
Langhorne Creek	4,088	-	275	-	27,148	17,109	17,176	17,176	47	47
Mudgee	-	-	-	-	1,929	1,929	4,363	4,363	-	-
Riverland	-	-	-	-	1,821	-	255,322	188,434	174,520	174,520
Yarra Valley	2,877	-	3,415	-	5,287	1,459	441	441	-	-
Coonawarra	4,927	-	4,307	-	19,590	8,874	1,288	1,288	-	-
Hunter Valley	-	-	311	-	7,433	7,399	2,691	2,691	-	-
Margaret River	2,121	-	8,906	-	24,644	13,650	9	9	134	134
McLaren Vale	9,220	-	2,772	-	22,476	5,206	5,564	5,564	14	14
Mornington Peninsula	2,131	-	717	-	430	257	-	-	-	-
Murray Darling – Swan Hill	-	-	-	-	14,713	-	226,744	198,310	138,931	-
Riverina	11	-	-	-	2,706	-	92,055	90,147	145,218	145,218
Tasmania	4,989	-	390	-	-	-	-	-	-	-
Total	**42,184**	**-**	**24,547**	**-**	**161,606**	**75,291**	**614,414**	**517,185**	**460,330**	**321,400**
Total if 'loss' grapes exited	**42,184**		**23,227**		**86,315**		**97,229**		**138,930**	

Individual companies with better cost performance than typical will reduce these numbers

Individual companies with higher costs – and who are not getting enough of a price premium – will increase these numbers

* Initial growing cost estimates from WGGA, refined with input from WFA Board Members. Estimated cost per hectare of $9000 for A grapes; $8000 for B; $7500 for C, D, E & F. Total cost by region based on these and the average yield by region, based on 2006, 2008, 2010, and 2012 vintages. 2007 excluded as it was a drought year and data not available for 2009 and 2011.

Source: Price dispersion for 2012 vintage; Wine Australia; ABS; WGGA; analysis; WFA Board Members.

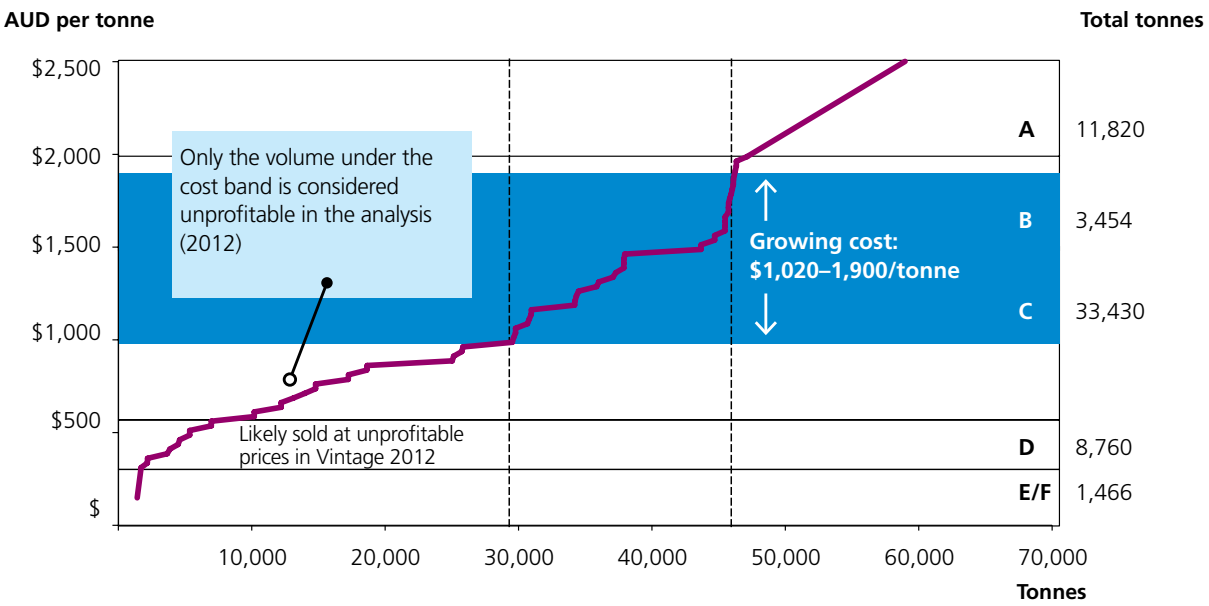
Exhibit 20 illustrates the supply curve (volume by sale price) for the 13 regions combined. The WGGA and members of the WFA Board have provided further guidance on cost and yield assumptions for each region—however, it remains a work in progress that needs to be improved with further input from growers in the proposed consultation phase.

The situations in the Barossa, Riverland, Margaret River, and Hunter Valley are shown in Exhibits 22, 23, 24, and 25 (the other 9 regions are in the Appendices). Overall the analysis suggests A and B grapes are profitable on average, but 47% of C, 84% of D, and 70% of E/F were unprofitable. However:

- Determining how much of this 'unprofitable production' is 'over-supply' depends on assumptions on: costs, future demand, 2012 vintage, and future economic conditions—including the value of the $A
- Some of the 'unprofitable supply' in D and E/F is likely being driven by artificially low prices due to winemakers taking advantage of C and D grade fruit at E/F prices.

Exhibit 22: Barossa grape supply and growing costs

Purchase price and quantities, 2012 vintage



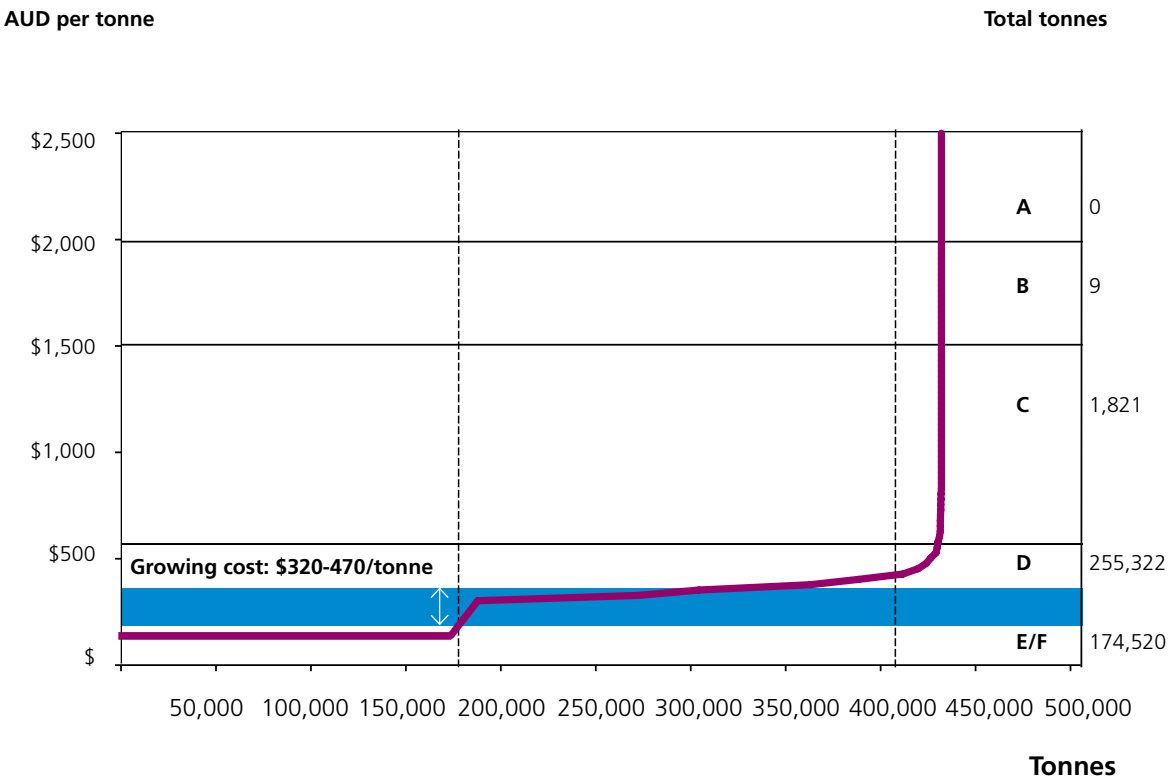
* Assumes price distribution of owned grapes matches that of those sold. Based on $7500 per ha for C/D/E/F; $8000 per ha for B; $9000 per ha for A & average yield from 2006–2012 (7.3 tonnes per ha)

Source: Wine Australia price dispersion data and yields; ABS for total crush tonnage; WGGA for growing costs per ha; WFA board input; analysis

- Very large volumes of E/F and D in warm inland regions are being sold 'just' below average growing costs. (refer Exhibit 23 for for Riverland) Whereas significant volumes are being sold from cooler and more temperate regions at hundreds of dollars below typical growing costs, likely depressing prices for the warm inland fruit
- However, based on the 13 regions analysed, just 13% or 117,246 of the 913,876 estimated 'unprofitable' tonnes comes from the cooler temperate regions (and over half this 13% comes from Barossa and Langhorne Creek)
- Improved data and further modelling is required to determine how much capacity in warm inland regions would be made economic by less supply of C and D from cooler areas such as the Barossa and Langhorne Creek.

Exhibit 23: Riverland grape supply and growing costs

Purchase price and quantities, 2012 vintage

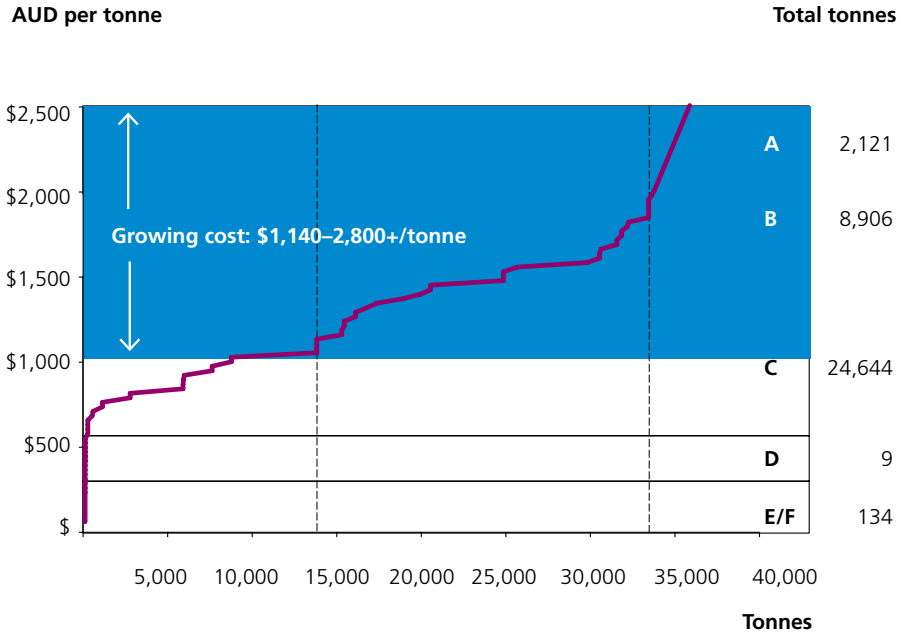


* Assumes price distribution of owned grapes matches that of those sold. Based on $7500 per ha for C/D/E/F; $8000 per ha for B; $9000 per ha for A & average yield from 2006–2012 (19.2 tonnes per ha)

Source: Wine Australia price dispersion data and yields; ABS for total crush tonnage; WGGA for growing costs per ha; WFA board input; analysis

Exhibit 24: Margaret River grape supply and growing costs

Purchase price and quantities, 2012 vintage

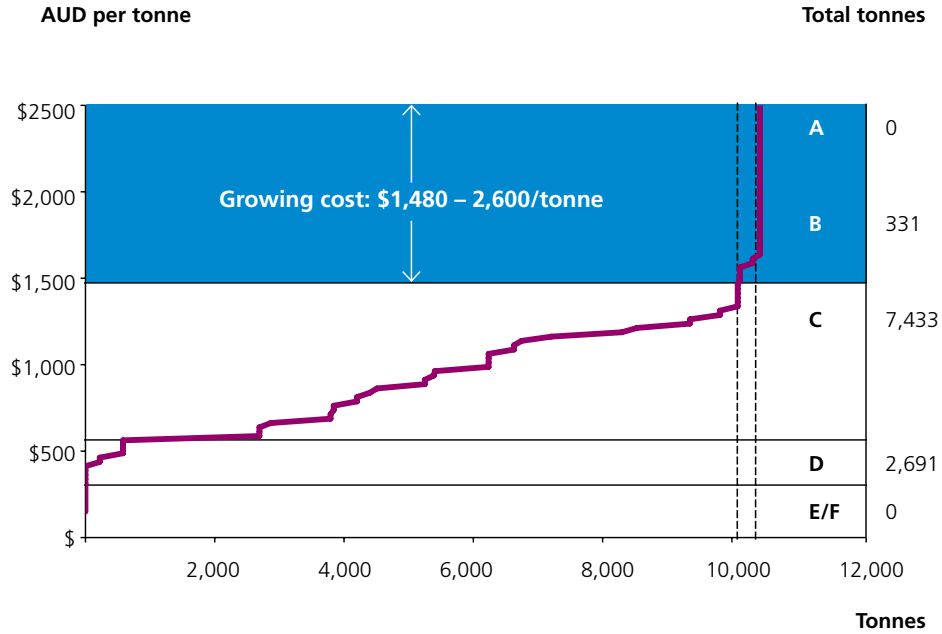


* Assumes price distribution of owned grapes matches that of those sold. Based on $7500 per ha for C/D/E/F; $8000 per ha for B; $9000 per ha for A & average yield from 2006–2012 (7.3 tonnes per ha)

Source: Wine Australia price dispersion data and yields; ABS for total crush tonnage; WGGA for growing costs per ha; WFA board input; analysis

Exhibit 25: Hunter Valley grape supply and growing costs

Purchase price and quantities, 2012 vintage



* Assumes price distribution of owned grapes matches that of those sold. Based on $7500 per ha for C/D/E/F; $8000 per ha for B; $9000 per ha for A & average yield from 2006–2012 (5.1 tonnes per ha). High end of range above due to premium fruit production & weather impact in 2012 vintage

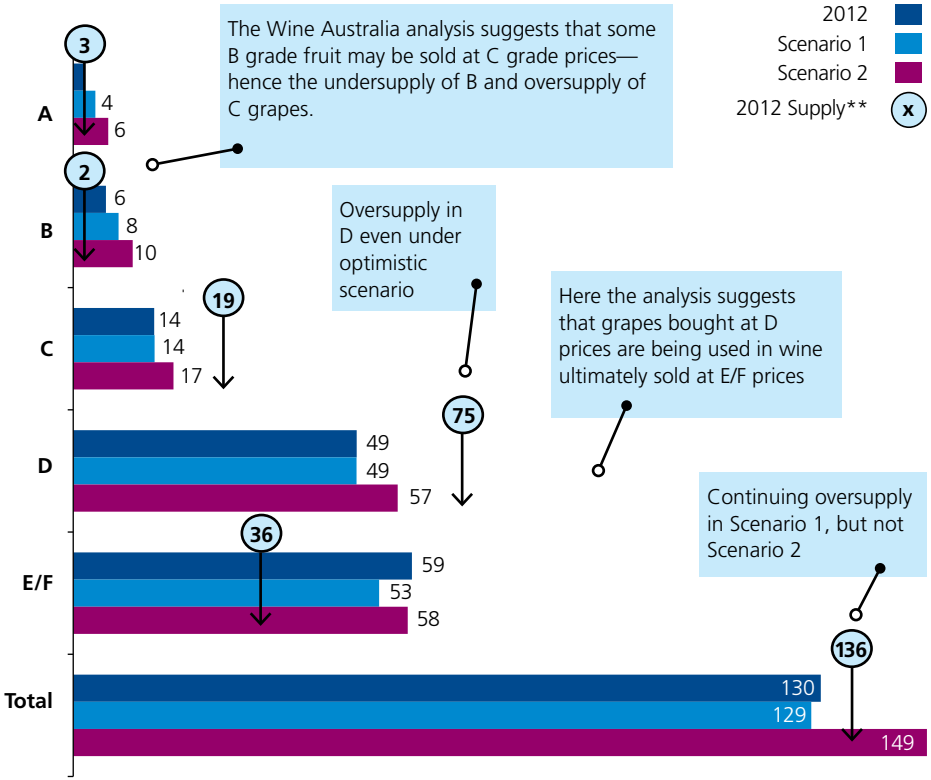
Source: Wine Australia price dispersion data and yields; ABS for total crush tonnage; WGGA for growing costs per ha; WFA board input; analysis

Exhibit 26: Wine Australia volume growth scenarios based on recent demand growth

Millions of 9 litre equivalent cases

Value
AUD Millions FOB

	2007	2012	Sc 1*	Sc 2*
A	429	384	703	1,090
B	630	713	959	1,183
C	1,587	914	939	1,110
D	1,586	1,474	1,487	1,669
E/F	777	866	782	844
Total	5,009	4,352	4,870	5,886



* WAC scenarios based on recent demand growth by segment by market. Domestic growth based on Euromonitor data. Scenario 2 assumes decline in AUD, significant marketing investment will bring growth to pre-GFC levels
** Based on grape price dispersion data and yields
Source: Wine Australia; Euromonitor; ABS; analysis

Scenarios generated by Wine Australia indicate demand will not solve this oversupply

Wine Australia's analysis of domestic production, domestic consumption and exports indicates some combination of significant over-supply and 'under demand' in C and D grapes/wine. Wine Australia data suggests that the oversupply of fruit in C (5 million cases equivalent) and D (26 million cases equivalent) is more than filling an undersupply of A and B (3 million cases equivalent) and E /F wine respectively (23 million cases equivalent), Exhibit 26. However, it is reasonable to assume much of this 'excess' demand for E/F is being created by the sale of wine at low and unprofitable prices.

Further, the scenarios of domestic and export demand provided by Wine Australia indicate that, if current trends continue, demand will not correct this over-supply in C or D by 2017—even in the optimistic scenario of growth returning to pre-GFC levels. However, their predictions indicate a likely growing undersupply of A and B.

Supply response (capacity leaving the industry) is likely to remain slow

Without significant changes in the perspectives of growers and winemakers further re-adjustment of supply is likely to remain slow. There are a numerous drivers of this:

- Winemakers are providing a market for uneconomic fruit and wine—providing marginal growers with some income and hope. Many winemakers have built their businesses on volume and need to maintain production to contribute to fixed costs
- Significant sunk costs with few attractive alternative uses for the land. It will take time for the assets to be written down and/or sold at values that enable economic returns from alternate uses

- Human and emotional factors such as: the existence of real success stories ("that could be us"); 'hope' in an environment of uncertainty ("it will all be ok when the exchange rate falls back to 80 US cents"); an unwillingness to 'let go' and/or realise the loss in value; and high perceived option value from 'hanging on' in a highly variable market
- Some level of uneconomic production supported by the WET Rebate
- A number of those interviewed believed that many loans in the industry are 'upside down', and the common banking strategy is to: limit further lending to the sector, extract as much loan repayment/interest as possible, and delay foreclosure until it is the best financial outcome for the bank.

4. Efforts to improve profitability have reduced the extent of the decline

Based on our interviews and analyses of company financials, many players in the industry have already pulled a number of the profit improvement levers available to them. The levers most commonly mentioned are:

- Leverage lower grape costs (at some grades)—benefit to wine makers not growers. Including renegotiation/ exit of onerous grape contracts
- Use of volume to lower average costs. Including purchase of distressed (cheap) grapes to maintain/ increase winery throughput; and 'toll' winemaking
- Boost grape yield (risk to quality); crop to more economic wine solution such as shift to sparkling (higher yield); to optimal fruit quality/cost (if 'always' going to be B then don't crop for and incur A costs)
- Improved product quality, mix and brand ('Premiumisation Strategy'). Stated by 10 of the producing companies interviewed as their strategy (numerous others on the public record). A number of companies have undertaken significant restructuring and incurred significant costs
- Cost cutting: overheads; vineyard and winery efficiencies and costs (including levers that may affect quality such as yield, chemical, vine & trellis management, use of oak, ageing); offshore bottling and packaging for export to reduce these costs and transport; and renegotiation of distribution margins, or going direct to retailers
- Pursued exclusive relationship with one of the retailers—to better secure volume and pricing. Usually includes direct distribution
- Product innovation and search/capture of niche markets (domestic and export)
- Increasing direct sales/alternative distribution channels
- Leveraging/increased reliance on the WET Rebate
- Other sources of income especially for grape growers and smaller wine makers.

5. Additional Profit Pressure is a possiblility

There are a number of factors that may lead to greater and/or more sustained profit pressure, including if:

- Long-term uneconomic supply (grapes and winemaking) remains slow to exit the industry. This could cause:
  - Sustained poor profitability and poor access to capital negatively impacting necessary investment and innovation in the industry. Industry needs to reconfigure (variety, style, quality, techniques) to support greater and more profitable demand
  - Operators that would be profitable in a more balanced market leave the industry, for example low-cost producers of E/F grapes
- Increasing global demand for wine does not increase the FOB prices for the majority of Australian wine exports (C, D, E, & F)
- Demand for Australian wine continues to fall in the US and the UK (two of the world's biggest wine markets)
- Wine's status as 'the cheapest form of alcohol' and its separate tax structure to beer and spirits exposes it to beer and spirits companies and the anti-alcohol lobby. The risk is this lobby is successful in reducing demand for wine in Australia—via changes to taxes, labeling, pricing and/or sale restrictions

- Imports continue to grow or the growth accelerates—across all segments
- Retail power and impact on producers increase. For example:
  - Further margin and volume pressure on producers (cost to access consumers—listing, shelf space and promotions)
  - Inability to create, develop or extend brands—space controlled by retailers
  - Industry fragmentation leads to less collaboration and more fierce competition for a 'smaller pie' potentially diluting the brand and quality message of Australian wine both domestically and overseas
  - Retailers support continued growth in imports across all segments
  - Further vertical integration and growth of private label including controlled and exclusive brands—including accelerated shift up into C, B, [and possibly A] wines
  - Increased control of distribution (including secondary) and on-line retailing making it even more difficult for producers to access consumers directly at a meaningful scale.
- Increased on-line wine selling creates further discounting pressure and 'bargain mentality' in the market.

6. The other side of the 'perfect storm' is that no single lever will 'fix' the problem

Popular commentary often points to a single major cause/savior—typically oversupply, exchange rate, or global demand. The consolidation and power of domestic retailers is another oft quoted cause. Unfortunately, the issue is more complex than that.

With respect to 'oversupply': without significant improvement in export returns and domestic profitability (retailer power) it is unlikely any feasible reduction in supply will return the industry to previous profit levels:

- Many winemakers have constructed their businesses on current or higher volumes—they will continue to buy the volume of grapes to support their cost structures for as long as low priced grapes are available
- Any significant decline in grape supply will likely increase grape prices for that grade/variety and further reduce winemaker profitability—this will be difficult to pass on to domestic retailers and 'impossible' to pass on to export for lower value wines. This will force further rationalisation and restructuring of winemakers before profit levels for those that remain can improve
- There may be some benefit from shifting export sales to domestic—higher margins—but limited 'room' domestically and retailers still have enough sources of supply to manage winemaker margins.

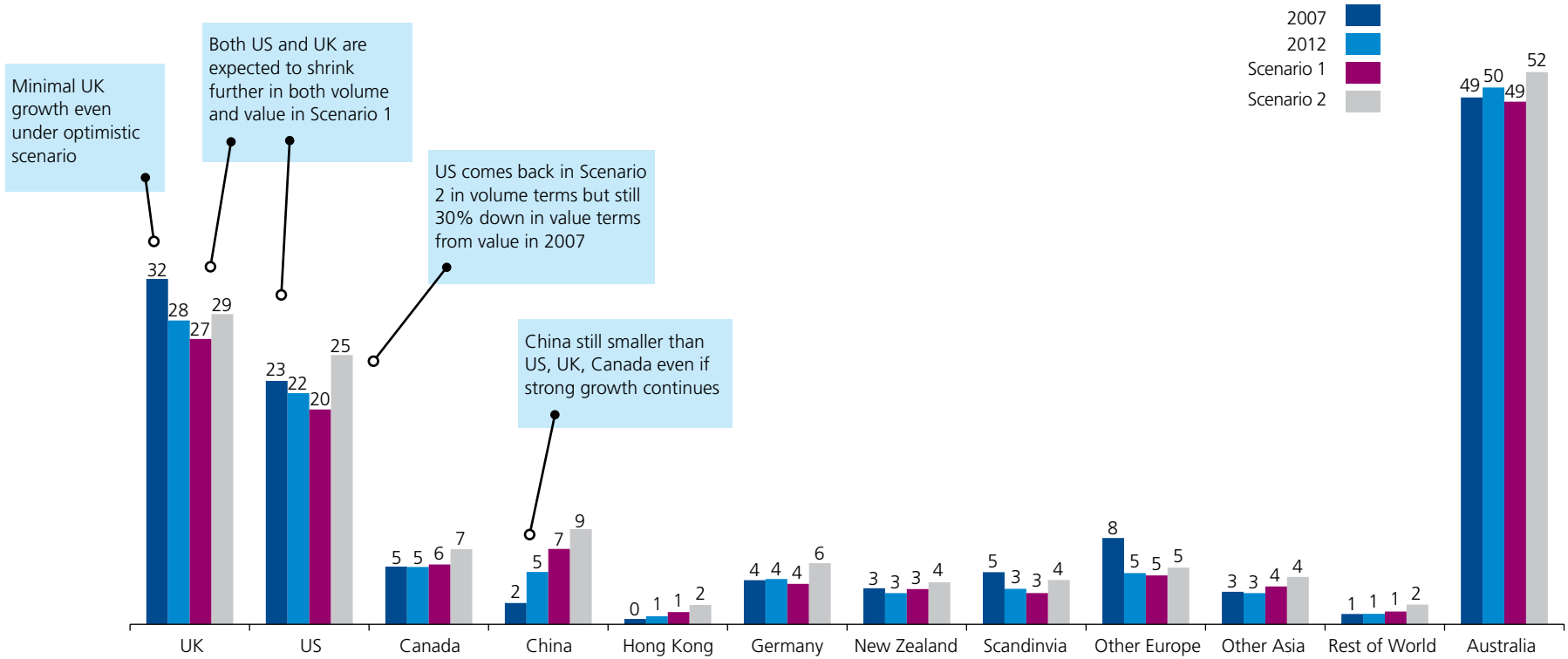
With respect to the exchange rate most economic forecasts suggest significant falls beyond the recent fall is unlikely in the foreseeable future. However, even if it was to occur it is unlikely there will be a proportionate increase in profitability:

- 85% of exports by volume are D, E and F wines that will still compete with low-cost commodity producers. To grow volumes and margins they must be even lower-cost and/or have successful innovative/niche marketing. It will take time to convince export markets (consumers) that Australian wines on average are higher quality at each price point (so they should pay/buy more). This is especially important for C wines (8% of current export volume) that appear to have suffered from a perceived fall in value with consumers in the US and UK in particular
- Access to consumers in export markets is a real issue especially given the fragmentation of Australian producers and the retail and/or distribution power that exists in key export markets. The two markets Australia is most dependent on are the UK and US—players in these markets will likely seek to capture price/margin gains from a lower exchange rate
- Export margins were low to marginal for many wine companies even at lower exchange rates. In many cases most of their profits came from domestic sales and exports of A, B [and C]. Clearly some winemakers will benefit far more than others
- Export volume has fallen by 65 million litres since 2007—exporters will need to balance increasing volume or increasing A$ FOB prices and margins.

With respect to global demand: The only 'silver bullet' solution for the whole industry is a massive and immediate increase in export demand for Australian

Exhibit 27: Wine Australia volume growth scenarios based on recent demand growth

Millions of 9 litre equivalent cases



Value (AUD Millions FOB)

2007	986	917	282	56	31	61	96	131	234	168	42	2005
2012	401	451	183	241	65	56	65	78	107	167	38	2499
Sc 1	393	417	204	477	146	63	77	72	110	200	53	2659
Sc 2	462	622	268	652	249	90	101	108	144	254	89	2845

* WAC scenarios based on recent demand growth by segment by market. Domestic growth based on Euromonitor data. Scenario 2 assumes decline in AUD, significant marketing investment will bring growth to pre-GFC levels

Source: Wine Australia; Euromonitor; ABS; analysis

wine—higher volumes at higher prices in destination currencies. Further falls in the A$ would also help. Though the industry can work toward this it is not an immediate solution.

Wine Australia's scenarios for global demand growth indicate that even under their optimistic scenario (in which growth returns to pre-GFC levels) the US and the UK will not return to their 2007 value by 2017, see Exhibit 27.

On the positive side, Wine Australia scenarios demonstrate continued strong growth in China and Hong Kong, which while remaining below the US & UK in volume, grow to be larger in value terms in both scenarios.

With respect to retailer power: it was the most cited of the key issues facing the industry in interviews with industry stakeholders—followed by exchange rate and grape oversupply, and then tax and imports. However, the negative impacts on winemaker profitability discussed in **Section 3.2** are difficult to address. And, even if successful it does not directly impact the poor profitability of exports—62% of the wine produced in Australia in 2012 was exported.

7. The industry is not being impacted equally—some players/segments are more affected than others. A number of success models exist

It is important to recognise that the 'tough' situation and outlook for the industry as a whole does not apply to all participants. It appears from our analysis of company profitability and interviews that in general, better performing companies have either:

- An 'in balance' portfolio of higher priced brands with strong domestic sales; and competitive costs or
- Globally competitive costs of production for bulk/commodity wine (without the significant costs associated with supporting consumer brands).

Whereas, companies with portfolios weighted more to commercial (C & D) and commodity wines (E & F) with branded cost structures and high export exposure are under more profit pressure.

A and B quality wines appear to remain more profitable on a stand-alone basis across domestic and export markets—indicated by the range of gross margin's provided by participants in the review and the tight demand and supply situation. While volume and margins have fallen in key export markets (US, UK & Canada) those in China have grown. The earlier Exhibit 22 on grape grower profitability suggests that growers of A & B grapes are on average profitable. However, growers and winemakers at the higher end of the supply cost curve for wines below $15/bottle (domestic retail) or $7.50/litre (Export FOB) are under significant pressure. These higher-volume wines started with lower margins and higher proportionate exposure to export markets.

Therefore:

- They experience more competition domestically and internationally—from other winemakers
- Retailers (domestic and internationally) have more supply options providing them more negotiating power
- Any increase in the A$ or retailer discounts has a proportionately greater negative impact on the profitability of lower margin wines.

Though there is no single success model for companies this review identified a number of existing and potential models, including:

- Growers of high-quality grapes needed by makers of A and B wines; or lowest cost grapes by quality
- Large high-quality wine companies with 'well purchased assets', globally competitive scale and costs, the correct size, quality and cost balance, and a portfolio of wines/brands that have sufficient market power to extract commercial returns from retailers domestically and internationally
- Mid-sized players with a combination of competitive costs and high-quality established and desired brands. Brands must enable preferred terms with retailers and access to export markets. The majority of their volume is in the desired brands
- Smaller high-quality wine company—circa 25 to 50,000 cases, selling mostly direct to loyal customers. Higher prices achieved allow for profit over higher

average costs (grapes, production, distribution, marketing). This model includes 'Iconic' wineries—where a wine has national and/or international acclaim and is sold at premium prices. This works when the wine accounts for a significant amount of total volume and/or the effect cascades to the rest of the range. Companies in this space should be careful of investing in expansion beyond their unique market demand—as this may expose them to lower return distribution channels such as retailers and actions that may undermine their portfolio (such as unsuccessful brand/range extensions)

- Absolute lowest cost and globally competitive in a given wine/grape quality. Given the fragmentation and often times uneconomic behaviour of some players in the industry the low cost should be supported by good access to markets
- Companies able to create and/or capture unique market and consumer branding opportunities. Casella's success with Yellow Tail is an example. Such companies still require a competitive operating model and cost structure to be profitable. And, an ability to lead or quickly respond to changes in consumer trends and sentiments.

Strategies/levers to pursue these success models include; but are not limited to:

- Premiumisation—stated by many as their strategy. There are two primary forms: convince consumes to pay more for your wines; and/or up-rate your wine portfolio. This strategy requires access to quality grapes, and the capital/cash flow needed to invest in: vines & grape quality, wine making, inventory, brand building and access to markets/distribution. Unfortunately this not a viable solution for the whole industry
- Consolidation to improve performance. Consolidation applies to both winemakers and growers. Given the general oversupply of capacity in the industry it is more likely to be achieved by acquisition, merger or some form of collaboration—rather than new investment. Participants need to be wary of repeating past examples that over spent and/or failed to capture synergies. Levers include:
  - Genuine cost savings in vineyards and/or winery. Including operating and capital efficiencies. Also efficiencies and benefits of scale through the value chain including: distribution, transport, bottling (including offshore/in market)
  - Accumulate sufficient brand power to improve: negotiations with retailers, market access, and demand
  - Economies of scale in: talent (winemaking, viticulture, innovation, commercial & management), market development (including export markets), and overheads
  - Opportunity to restructure the businesses—balance sheet, grower contracts, and possibly provide the assets, scale and funding to support a 'premiumisation' strategy.

8. Tax has been an issue for the industry

Our analysis on the two key tax issues—the WET Rebate, and WET versus Volumetric tax does not reveal a 'best answer' for the industry. There is no solution that suits a majority of industry stakeholders—as each tax regime affects individual companies differently. And, there remains insufficient facts to prove a best strategy and therefore tax system for the industry as a whole—separate to its individual participants.

On the impacts—focussing on 'extremes':

- Abolishing the WET Rebate completely removes all 'unintended uses' of the rebate.
  It also should accelerate the removal of uneconomic grape supply and unprofitable winemakers. It may enable faster consolidation and improved financial performance through scale and knowhow. It may support 'premiumisation' of the industry—if it only 'knocks out' producers of lower quality grapes/wine. However, it will negatively impact a large number of small to medium players that depend on the rebate to remain viable and/or invest in their operation. How many players of what type and size will be sufficiently affected to exit nor the resulting impact on the industry is known
- Switching to a volumetric tax regime—even set at the very low rate required for overall tax equalisation—will negatively impact players that

sell large amounts/proportions of lower priced wine domestically. Given current profitability levels it could force companies with significant volumes of D, E and F to exit the industry—especially if profits from their domestic sales support their export activities.

The fact base and analysis on the WET Rebate

The ATO advised the WFA that the data requested to evaluate the WET Rebate was not available and provided the following qualification for the data it was able to provide. *"The data for the WET rebate is reported on the Business Activity Statement along with at least 12 other refund circumstances for Wine Equalisation Tax including the producer's Rebate. The BAS is designed for processing liabilities and refunds and not as a data collection mechanism. As such the information requirements are kept at a minimum to reduce compliance costs for the taxpayers."* The ATO data does not distinguish between WET Rebate and other refunds. The BAS format also means an entity can legitimately claim a WET Rebate without designating themselves as a grape grower or wine manufacturer. Therefore, the data recorded does not allow a proper understanding of who gets the rebate and therefore how effective the investment in the industry is.

The information provided by the ATO and Senate Estimates, summarised in **Exhibit 29**, combined with our analysis suggests:

- Of the $308 million recorded as WET tax refunds and rebates for FY12: $25 million is paid to NZ producers, about $222 million may be paid as WET Rebate, and about $61 million is likely some combination of refunds of WET that did not need to be paid (one of the other 12 refund circumstances) and WET Rebate to entities not designated as grape growers or wine manufacturers. Our analysis uses only those that report as grape growers or wine manufacturers—1,912 of the 3,108 entities receiving some type of WET rebate/repayment.
- The ATO data shows 214 entities received 70 to 100% of the full rebate in FY12. The WFA estimates this accounts for $88 million (29% of total WET rebates paid in that year). It also shows there were 1,411 recipients of less than $100,000
- Since completing this analysis the ATO has advised that the 1,912 entities received $189.5 million in FY12 not the estimated $221.4 million based on our mid point calculation for each the percentage of Rebate & Refund bands provided by the ATO. Any further analysis and updates will be posted on the WFA website.

The analysis in Exhibit 29 attempts to link the WET Rebate and wine volumes in total and by estimated size of producer. It is based on our interpretations of the ATO data. Key points:

- The largest 21 winemakers produce about 84% of total domestic wine production volume, and the top 38 produce 88%
- Assuming each of these 38 producers only claim one full rebate—88% of total production only equates to $19 million of the possible range of $189.5 to 282.5 million WET Rebate paid to Australian entities in FY12
- If you assume the loss of the WET Rebate would not cause any of these players to exit then the absolute maximum impact of the Rebate on oversupply is 12% of total production
- Clearly this is not compelling logic. For example: it does not pick up the direct or indirect impact of the rebate on growers who supply to these large producers; or identify the other 176 entities that claim close to the full Rebate; or 'determine' if the loss of a small amount of Rebate will cause smaller participants to exit (the ATO data suggests hundreds of participants receive significantly less than $50,000 in Rebate)
- But, it does highlight the current inability to draw a quantitative link between the Rebate and oversupply with the information available (including from the ATO).

Finally, ATO provided data of total WET Rebate and Refunds show a continued increase in the total—from $211.6 million in FY08 to $269.3 million in FY11, to $307.5 million in FY12. And, the WET Rebate to NZ entities increased from $12 million in FY08 to $25 million in FY12. The ATO data also shows from FY08 to FY12 there was a 21% increase (365) in the number of claimants that designated themselves as grape growers or wine manufacturers. Given the industry is in downturn and is more likely consolidating than growing or fragmenting we believe this trend indicates increased use of structuring (legal and accounting) techniques to access the rebate and/or access it more than once. It clearly warrants close inspection by the ATO, and our interviews indicate many stakeholders in the wine industry want to be proactive on this issue.

Exhibit 28: The ATO has limited available information on the WET Rebate

The ATO does not know the exact amount of WET Rebate or the number of WET Rebate claimants that are winemakers or grape growers. The BAS Form (1D) covers those claiming WET rebate, repayment of WET that should not have been paid and the balance of both. Of the 3,108 reporters on (1D), 1,912 reported as a grape grower or wine manufacturer. Our understanding is it is not compulsory to designate therefore actual claimants of WET Rebate likely to be between 1,912 and 3,108.

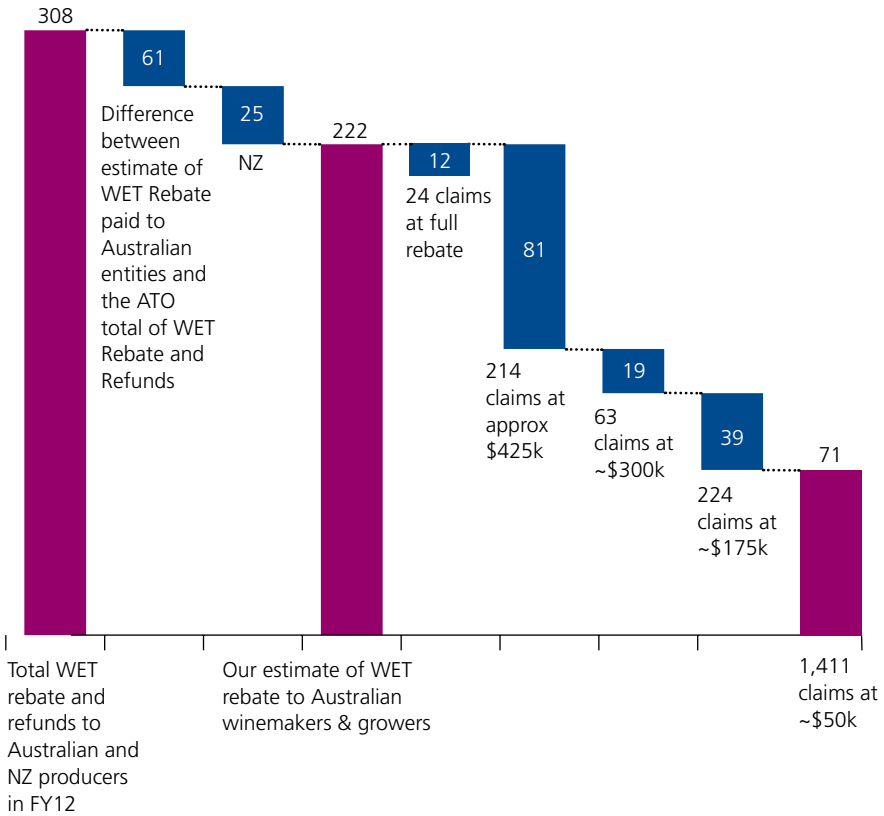
ATO breakdown of Australian WET rebate and refund recipients

	07/08		11/12	
% of Max rebate	#	$ Millions	#	$ Millions
0–20	1,258	—	1,411	70.6
20–50	169	—	224	39.2
50–70	46	—	63	18.9
70–100	142	—	190	80.8
>100	17	—	24	12
Total	**1,632**	**199.6**	**1,912**	**221.4****
			ATO (11/12)	**189.5**

ATO breakdown of New Zealand WET recipients

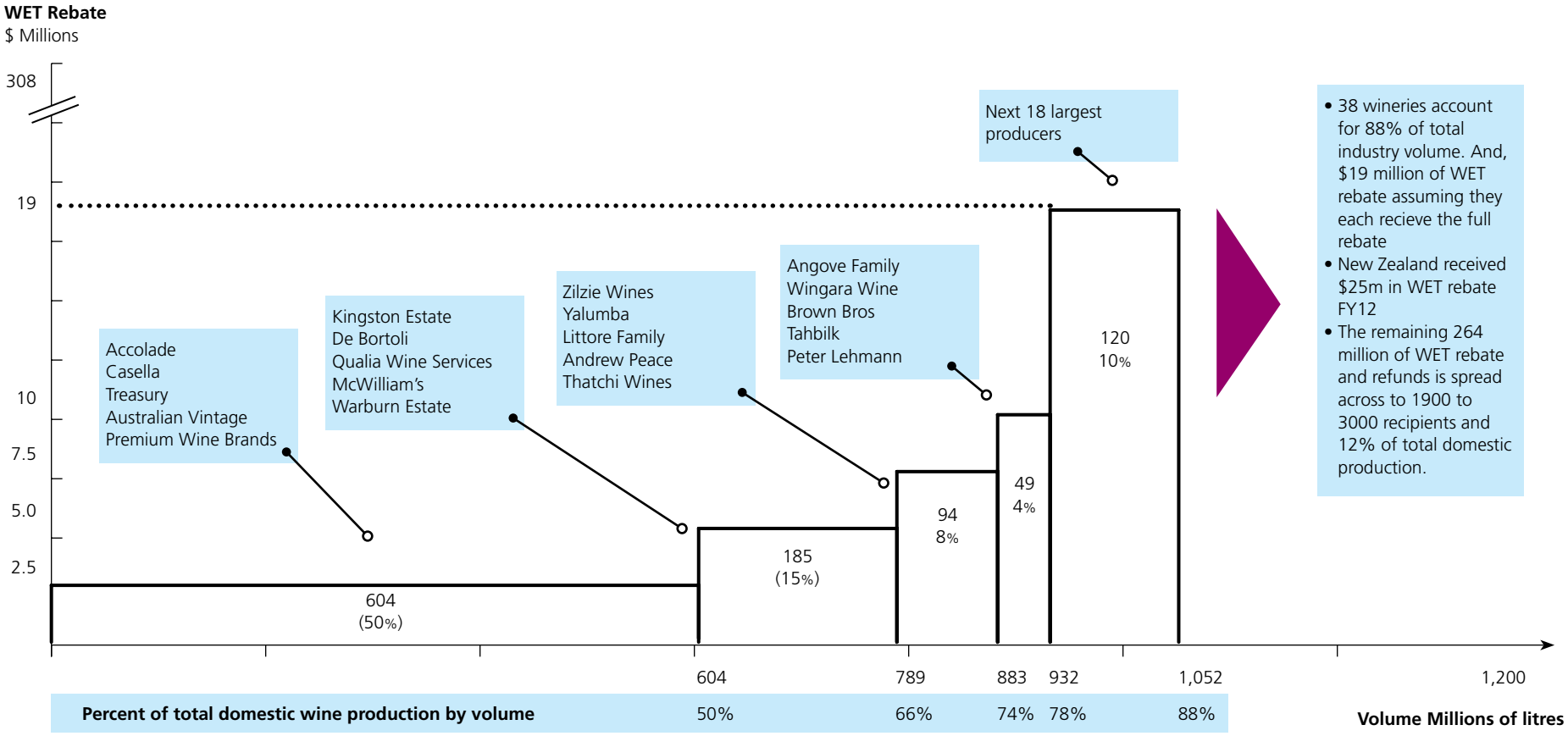
	07/08		11/12	
% of Max rebate	#	$ Millions	#	$ Millions
0–20	82	—	137	6.9
20–50	26	—	32	5.6
50–70	0	—	12	3.6
70–100	12	—	24	10.2
Total	**120**	**12**	**205**	**26.3****
			ATO (11/12)	**25.0**

Estimated breakdown of total WET rebate and refunds, 2011/12



* Estimated by WFA based on mid point levels of rebate by % group and assumed maximum of $500k for the > 100% category
** Different to ATO due to estimation approach
Source: ATO correspondence; Senate Estimates; analysis

Exhibit 29: Relationship between WET rebate and production volume, 2011/12



- 38 wineries account for 88% of total industry volume. And, $19 million of WET rebate assuming they each recieve the full rebate
- New Zealand received $25m in WET rebate FY12
- The remaining 264 million of WET rebate and refunds is spread across to 1900 to 3000 recipients and 12% of total domestic production.

Source: Wine Titles; Wine Australia; team analysis

Report postscript:

The original version of this Report was prepared for and presented to the WFA Board on 19 June 2013. Since this time there has been a number of economic developments and views expressed by industry stakeholders and observers. In particular:

- The Australian/US dollar exchange rate fell from circa 102 US cents when the review started in February to 95 US cents on 19 June to circa 90 US cents today (9 August 2013). The rates used in our analysis comparing 2012 to 2007 are 104 and 84 US cents respectively
- Initial feedback from retailers (Coles and WLG) on a number of findings in the Report.

The Report has been modified in parts to address these changes and views. Further work is required to fully address them; in particular the differences of views with the major retailers. Any updates will be posted on the WFA website.

APPENDICES

1. RECOMMENDED NEXT STEPS FOR WFA

Continue to build the 'fact base' to support your actions. The wine industry suffers from significant fragmentation and differences in models and views. The lack of quality information to inform debate and allow united decisions on actions that serve the best interests of the overall industry is a major problem. The WFA should continue to build the fact base to support the above 6 actions and future issues the industry needs to address. In particular, we recommend:

- A combined team of WFA, Wine Australia and industry players to work on better understanding the issues in major export markets (US, UK) and what can be done by: the industry as a whole, C & D segments, individual players, and combinations of players. We believe the issues are far broader than the high A$ and marketing 'Brand Australia'
- Another combined team focus on identifying opportunity markets and how individual and collaborative groups of companies can find and capture market niches
- Continued work on retailer power—including building a robust (and confidential) fact base on: relative profitability, the transfer of profits over time, and how much of this profit transfer has been shared with consumers
- Extend and refine the analysis on grape supply curves and economics by growing region—beyond the current 13 regions. This can be part of the consultation process and should help individual growers to assess their businesses and future strategy.

W2. OVERVIEW OF APPROACH, ANALYSIS, AND SOURCES

The conduct of this review involved:

- 24 in-depth confidential interviews of all WFA Directors and key wine industry stakeholders and experts
- Review and analysis of detailed financial, market, and operational data supplied by or sourced from:
  - Interviews and survey results from 13 participating companies (all data provided in confidence on condition of anonymity)
  - Wine Australia Corporation and their detailed data on exports and wine prices by region
  - Previous reports commissioned by WFA, Wine Australia and Wine Grape Growers Association including: The Wine Restructuring Action Agenda (WRAA) statements, reports and inputs (2009—2011), Wine Australia: Directions to 2025—An Industry Strategy for Sustainable Success (2007), The Marketing Decade: Setting the Australian Wine Marketing Agenda 2000 – 2010 (2000)
  - Wine Grape Growers' Association (WGGA)
  - WRAA Toolkit including the Gross Margin Ready Reckoner for Wineries
  - Deloitte Financial Benchmarking study for the Australian wine industry
  - International Organisation of Vine and Wine (OIV)
  - Australian Tax Office (ATO) and Senate Estimates Committee
- Australian Bureau of Statistics (ABS)
- Nielsen analysis
- Analyst Reports including those from: RaboBank, Morgan Stanley, Goldman Sachs, JP Morgan, Merrill Lynch.
- Creation of a reference fact base on the volume and value across domestic, export, and imports based on the sources above
- In-depth analysis on the data available through a variety of lenses – value, volume, profit, market, region, and company – to understand industry developments and drivers of performance
- Collaboration and work with Wine Australia and WFA to gather data, prepare analysis, and review initial findings
- Two full-day workshops with the WFA Board to review and debate the analysis and findings. These workshops were also used to access necessary additional information and focus the efforts of the review
- A final presentation of the Draft Findings and Recommendations to the WFA Board
- Additional consultation with a number of individual stakeholders and participants in the review.

Notes on specific data sources and limitations

Wine Australia Demand Projections. Australian wine shipments are projected forward from 2012 through to 2017 under two broad scenarios:

- Scenario 1 - Base Case where exchange rates remain at current levels, global economic conditions improve only marginally and growth rates for the Australian category are similar to those achieved in recent years. Category marketing investment remains static
- Scenario 2 - High Case where the Australian dollar depreciates to US$0.85-0.90, £0.45, and 0.60, global economic conditions improve significantly and growth rates for the Australian category are similar to pre-GFC levels. Assumes a significant boost in category marketing investment.

The projections are based on examining past growth rates for the market and the Australian category as well as key macroeconomic indicators and market fundamentals. Limitations provided by Wine Australia and WFA:

- The results are not forecasts rather projections to assist in identifying the size of market opportunities at each price segment
- Projections are made independent of supply and thus any growth opportunities identified may be constrained by supply availability.

Grape Production Profitability by Region (Vintage 2012). Analysis on production profitability is based on a representative sample of 13 selected growing regions, average costs of production and prices paid for grapes in 2012. The analysis used the following data:

- Average cost per hectare as advised by industry participants including WGGA

- Average yield (tonnes/hectare) for 2006, 2009, 2010 and 2012. Data was unavailable for 2009 and 2011. 2007 was excluded as it was a drought year and yields were down significantly. Data on yields is sourced from Wine Australia
- 2012 price dispersion data from Wine Australia
- The price segment assumptions (A, B, C, D, E/F) are based on industry feedback. The matching of prices paid for fruit and the resulting market price of the wine is based on industry feedback

This data and analysis has a number of limitations:

- Average cost per hectare and yield vary significantly across individual growers
- Price dispersion data is based on wine grape purchases only and therefore does not account for winery-owned fruit
- Tonnages purchased and reported at the aggregate level are estimated to represent an estimated 80% of the total purchases.

3. ADDITIONAL ANALYSES AND EXHIBITS

Are available on the WFA website—www.wfa.org.au/review

Centaurus Partners

Centaurus Partners, founded in 2004, is a boutique management consulting firm based in Sydney.

Centaurus works with executives, directors, owners, and teams to help them quickly distil the opportunities and problems in their business, understand why they exist, and design and implement practical solutions that quickly generate lasting bottom-line impact and growth options.

Centaurus has worked closely with a broad range of clients (large, small, listed, private, family, and industry bodies) on strategy, performance transformation & business restructuring, and people performance. Our industry coverage includes: professional & industrial services, resources, agriculture, distribution/logistics, construction & building materials, and property.

Our people model allows Centaurus to provide highly experienced and insightful individuals and teams that match each client's business, people, and the opportunity/issue to be solved.

The authors of this review are:

Melanie Kansil, Partner, Centaurus Partners.

- Previously a Manager at McKinsey & Co
- Over ten years of experience as a management consultant and entrepreneur in Australia, New Zealand, Asia, and the United States. Non-Executive Director of Heathley Limited
- MBA from Stanford University Graduate School of Business. BA in Physics *cum laude* from Harvard University.

John Roberts, Managing Director, Centaurus Partners.

- Previously a Partner of McKinsey & Co, and an economist at BHP Ltd and the Reserve Bank of Australia
- Over twenty years of consulting experience across a wide range of industries, geographies and areas. Non-Executive Director of several private companies. Primary producer
- Master of Philosophy (Management) at Oxford University, Rhodes Scholar (Victoria) & Oxford Blue. Bachelor of Economics with First Class Honours from Monash University.

CENTAURUS
PARTNERS

wfa
Winemakers'
Federation of
Australia

Changes following Consultation with Industry

The majority of the draft Actions released in late August for consultation are supported by industry and are included in the final Actions to help position the Australian wine industry for growth.

There was vigorous discussion and debate on a smaller number of Actions as you would expect from any genuine consultation process.

WFA has listened and carefully considered this feedback and some important changes, amendments and deletions have been made to the draft Actions which are outlined below.

We believe our final Actions are richer and stronger for the consultation and we now have the majority of the sector's support to implement this industry blueprint to help restore the profitability of Australian wine businesses.

The changes to the Actions are summarised as follows:

1. The Actions on **Wine and Health** have been brought forward to the first section of the Action Plan and expanded to include more detail on future work streams. This has been done in response to a strong message from industry that they expect WFA to take the national industry lead on these issues and that they are of critical importance to the future of the Industry. New Actions include working with the GWRDC to continue to build an evidence-based approach to our advocacy work and to develop a permanent research capability for the industry. WFA will also develop a range of initiatives including working with organizations such as DrinkWise Australia on a standard drinks education campaign for consumers and with Wine Australia on appropriately integrating a 'drink in moderation' message into the sector's marketing activities. WFA will also continue its important advocacy work to ensure any the regulatory framework delivers stability to wine businesses and that any policy reforms are balanced and evidence based.

The Actions that have been added are:

1.4 WFA will explore opportunities to promote moderation through the industry's broader marketing campaigns.

1.5 WFA will identify and meet the emerging research needs of the Industry as it prepares for the review of the NHMRC national consumer guidelines for safe alcohol consumption and the National Alcohol and Drug Strategy.

1.6 WFA will work with GWRDC to secure and develop a permanent research capacity for health issues in the wine industry

1.7 WFA will work with other alcohol industry associations and DrinkWise Australia on developing a national consumer-facing standard drinks campaign.

1.8 WFA will continue to advocate on behalf of the Industry for a balanced and evidence-based approach to the regulation of wine production, promotion and sales.

2. The Actions on **Growing the Demand Opportunity** now include a specific reference to working with WAC on analysis aimed at achieving a better understanding of the market challenges of key markets such as North America and China, especially in regards to route-to-market. This work will include better leveraging existing sources of research and insights into these markets in programme and strategy development.

In regard to the China market, the importance of supporting the Australian Government's pursuit of a FTA with China and other emerging markets has been highlighted. The proposal for an Australian Food and Wine Centre in Shanghai has not been progressed.

The Actions that have been changed are:

2.1 WFA will work with WAC on analysing the individual challenges in our key markets with a particular focus on route-to-market and ensure existing insights and research are leveraged in policy and programme development.

This Action has been amended to include further analysis on all our key markets and acknowledges that considerable research has already been undertaken on the challenges we face. The immediate priority will be on re-engaging distributors and gatekeepers in the crucial US market and route-to-market in the China market.

2.4 Wine Australia should be adequately funded to develop and execute new initiatives including:

1) A social media-based platform to promote Australian wine
2) Regional promotions

This Action has been changed with the removal of an Australian Food and Wine Centre in Shanghai from the proposed initiatives. Industry and WFA will continue to assess the business case for such a Centre against other priorities in the key China market.

2.7 The Australian Government to rigorously pursue the FTA with China and other regional trading partners and provide adequate resourcing to improve market access

This Action has been expanded to include a direct reference to the importance of FTAs with China and other markets.

3. The Actions on **Hastening the Supply Correction** now include further research on the 'stickiness of supply' as a potential foundation for developing further options to incentivize adjustment. While a vine buy back scheme was not supported, there is strong support for WFA to keep working on other options and to better understand the issues. A further research initiative on alternate uses for surplus grapes has also been included to help expand the business options available to grape producers.

The Action that has changed and consolidated draft Actions 2.2 and 2.3 is:

3.2 The Joint Policy Forum (WFA and WGGA) will review the need to commission research on:

a) **Lowering the cost of vineyard turnover and removal to facilitate greater responsiveness of vineyards to structural imbalances, economic cycles and changes in consumer preferences.**
b) **Vineyard flexibility to ascertain where there is excess supply and the technical priorities to support improvements in vineyard quality.**
c) **Alternate uses/ markets for grape oversupply.**

This Action now includes a further research stream on alternate markets for surplus grapes.

A new Action is:

3.3 The Joint Policy Forum (WFA and WGGA) will undertake research to better understand the reasons for the slow correction to the supply base in light of on-going poor profitability as a potential pathway to developing options to incentivise consolidation and rationalisation.

Although the Review consulted a number of sources on the reasons behind the on-going oversupply, there is no national body-of-work that analyses the issues and prioritises the drivers behind the slow supply side adjustment.

4. The Actions on **Fair and Transparent Domestic Competition** proposed in August are unchanged and have strong support among Industry. A new Action has been added to work with the retailers to ensure private label wine and 'clean skins' are appropriately labelled so that consumers are more aware of the origins of that wine.

The new Action is:

4.7 WFA to work with the national retailers to ensure appropriate labelling of all wine products.

5. The Actions on **Retaining with changes to the WET Rebate** have been a significant focus for the consultation which WFA has listened to and considered closely. A number of changes have been made. The Actions now include a three-step approach to changing the rebate including:

- working with the ATO to retain and apply the rebate in accordance with its original intent;
- pursuit of three policy changes regarding bulk & unbranded wine, the ability of foreign entities to access the rebate and transitional arrangements related to mergers; and,
- undertaking further analysis and a review of the rebate in 3 years.

Actions that have changed are:

5.1 WFA will work with the ATO to identify any changes that can be made to the interpretation and application of the existing provisions so that implementation is in line with the original intent.

5.2 WFA will, for example, work with the ATO to identify and assess claim accessibility for uncommercial arrangements (for example when the ATO forms the view that the growers/winemakers have split their activities or have colluded in the establishment of business activities with the substantial purpose of claiming multiple rebates), and for schemes with the sole or dominant purpose of accessing the rebate contrary to the anti-avoidance provisions.

These Actions are directionally consistent with the draft Actions but the wording has been tightened to ensure a clearer focus on the objective of working with the ATO within the existing eligibility requirements to ensure the rebate is only being accessed by those who make a contribution to regional communities.

5.3 Remove eligibility for the WET rebate from bulk, unpackaged, unbranded and wine for the private label of retailers and from wine that is not a finished product fit for retail sale. That is, limit the rebate to those who :

a) manufacture and sell wine in a form that is packaged ready for retail sale and where the finished product is identifiably theirs;
or
b) grow grapes and sell wine in a form that is packaged ready for retail sale and where the finished product is identifiably theirs.

Bulk wine is defined as wine in containers over 25 litres.

The measure will be introduced with the rebate on bulk and unbranded wine phased out at 25% per year starting at 75% of the rate as of 1 July 2014.

In the draft Action 4.3 released back in August, it was proposed that future rebate eligibility be restricted to those who have 'production assets', meaning a producer with a "Substantial Investment in physical grape growing and wine production". This was colloquially referred to during the consultation as the 'skin in the game' test.

This specific proposal attracted significant debate and comment during the consultation. The focus of the feedback typically centered on whether the test was consistent with WFA's stated aim to return eligibility to the original policy intent, that is, to support businesses that support and invest in regional communities.

Specifically, the argument was put that the proposed test as currently worded would see those who contract or lease production assets excluded from future eligibility. This would discriminate against branded wine producers who may have invested in non-fixed assets (such as the marketing of their brands) or those who could not raise the capital to acquire physical assets. Removing the rebate from these producers would potentially introduce a competitive disadvantage with other brand owners, cost jobs and pose a risk to the diversity of the category. Also, it would be a potential barrier to the next generation of winemaker.

The point was also made that at a time where the industry was in significant over-supply and over-capacity, proposing to restrict the rebate to those who already owned production assets or could develop these assets seemed counter intuitive to the stated aims of the Actions.

The test was seen as potentially encouraging further investment in physical production infrastructure rather than the more efficient use of the existing production base.

WFA has listened to this input and will not move forward with the proposed Substantial Investment test.

The proposal to remove rebate eligibility from bulk and unbranded wine was also a focus of some discussion, but less so than the Substantial Investment test discussed above.

WFA believes that the case to remove rebate eligibility for bulk and unbranded wine remains. WFA believes brands and 'brand power' at all price points enable producers to engage consumers and command loyalty, take price, maintain sustainable margins and generate profit growth that can be reinvested back into regional communities and infrastructure. They are critical to developing category equity and a compelling consumer franchise that can support both above inflation retail pricing and increased margin share with the retailers.

WFA believes 'cleanskins', other unbranded wine and the private labels of the retailers work against these objectives and therefore do not play a long term role in encouraging regional development. For this reason unpackaged, bulk and unbranded wine, wholesale and retail private label, and wine that is not fit for retail sale also should not be eligible for the WET rebate.

However, WFA believes it is also important to provide time for the industry to plan and adjust to this Action and will therefore advocate for the removal of rebate eligibility for bulk and unbranded wine to be phased out at 25% per year starting at 75% of the rebate rate as of 1 July 2014.

5.4 Remove eligibility to foreign entities

This Action has been amended to capture all foreign entities, not just New Zealand claimants.

5.6 WFA will analyse the impact of the reform measures outlined above and continue the analysis of the WET rebate which forms part of the Expert Review and carry out the following further work in consultation with, and making all results available to, Industry:

a) On-going assessment of whether the rebate is causing unintended industry consequences, distorting supply and impacting profitability and if so how it should be dealt with.

b) A formal review of rebate policy arrangements 3 years from implementation of the reform measures to assess all options which could include keeping the rebate or a substitute, further restricting rebate eligibility, reducing the cap (the maximum claimable amount) or a timetable for phasing out the rebate.

This Action has been reworded but is directionally consistent with draft Action 4.7 and with the need for WFA to continue to analyse the issues and conduct a formal review in 3 years to consider further changes.

The following draft Actions has been deleted from the final Actions as it has been incorporated into Action 5.3 as discussed above:

(draft Action 4.4) Remove eligibility for the WET rebate from bulk, unpackaged and unbranded wine and from wine that is not a finished product fit for retail sale.

6. The Actions on **Monitoring the Future of Wine Tax Arrangements** remain unchanged.

7. The Action to **Secure the Funding** for the Actions remains unchanged and we now refer in the text to a number of funding options that were raised during consultation and given a commitment to report back to Industry on the feasibility of these options and next steps. This will follow consultation with government and industry stakeholders on the options.

8. A further section titled **Other Areas for On-Going Work** has been added to cover important areas of work not highlighted in the original Actions but deemed important to industry including; Working on Cost Pressures; Innovation; Leveraging our Environmental Credentials; Organisational Reform and Improving Market Access. These Actions will confirm that the good work of WFA will continue and expand across a broad range of industry issues not specifically covered in the draft Actions.

   The new Actions are:

   8.1 Improving our understanding of cost pressures and working with the broader business community to reduce the costs of doing business

   8.2 Promoting Innovation and prioritising R&D spend

   8.3 Leveraging the Australian wine industry's environmental credentials

   8.4 Leading Organisational Reform

   8.5 Improving market access

Summary of Consultation

Evidence-based research underpins all the Actions, which have been developed in close consultation with other wine industry organisations and from direct industry feedback.

In August 2013, WFA released independent expert analysis on the state of the industry and 33 recommended Actions aimed at restoring profitability to Australian wine businesses for consultation.

During the consultation period that followed in September and October, over 70 written submissions from individuals, regional, state and national wine organisations were received. Submissions from those organisations that have given their permission have been posted on the WFA website.

During this time, 11 regional road shows were also held to also gather feedback and advice on the proposed Actions. The Comments and Questions from these forums and our response can also be found on the WFA website.

The final Actions that have been developed following this consultation now cover 43 initiatives and represent a blueprint to help restore the profitability of Australian wine businesses.

Attachment 3

WINEMAKERS' FEDERATION OF AUSTRALIA BOARD – 2013/14

President

D'ALOISIO AM, Tony
Director
Oakridge Wines Pty Ltd
Victoria
tony.d'aloisio@oakridgewines.com.au

Vice Chairs

McNAB, Stuart
Chief Supply Officer and Vintrepreneur
Treasury Wine Estates
South Australia
stuart.mcnab@tweglobal.com

HILL SMITH, Robert
Managing Director
Yalumba Wine Company
South Australia
rhillsmith@yalumba.com

LOWE, David
Winemaker
Lowe Wines Pty Ltd
New South Wales
david@lowewine.com.au

Directors

ALPEN, David
Chief Financial Officer
Casella Wines
New South Wales
david.alpen@casellawines.com

ANGOVE AM, John
Managing Director and Chairman
Angove's Pty Ltd
South Australia
john.angove@angove.com.au

BURT, Alexandra
Managing Director
Voyager Estate (WA) Pty Ltd
Western Australia
aburt@voyagerestate.com.au

CAMPBELL, Colin
Chief Executive
Campbells Wines
Victoria
colin@campbellswines.com.au

EAST, Michael
General Manager, Australia & New Zealand
Accolade Wines
New South Wales
michael.east@accolade-wines.com

KAY, Andrew
Managing Director
Wirra Wirra
South Australia
akay@wirra.com.au

OMOND, James
Lawyer
Omond & Co
Victoria
james@omond.com.au

TAYLOR, Mitchell
Managing Director
Taylors Wines Pty Ltd
New South Wales
mitchell.taylor@taylorswines.com.au

THOMPSON, Kate
Legal and Corporate Affairs Director
Pernod Ricard Winemakers Pty Ltd
South Australia
kate.thompson@pernod-ricard.com

Attachment 4

Acknowledgements

This Expert Review has been made possible by the generous financial and in-kind support of a broad coalition of industry stakeholders. WFA would like to express its thanks to the following organisations for their backing and input:

- The Wolf Blass Foundation
- Grape and Wine Research and Development Corporation
- Wine Australia Corporation
- Nielsen
- Finlaysons Lawyers
- Wine Grape Growers Australia

WFA would particularly like to thank Centaurus Partners for their committed and thorough approach to the Review. We believe it will prove to be an invaluable analytical foundation to inform decision making within the wine industry for many years to come.

Attachment 5

ACRONYMS AND WINE SECTOR ORGANISATIONS

WFA	**Winemakers' Federation of Australia** Peak industry body representing Australia's wineries across a broad range of national and international issues. Funded by voluntary levies.
WGGA	**Wine Grape Growers Australia** Established in 2006 to represent the interests of the national wine grape growers. Funded by voluntary levies.
WAC	**Wine Australia Corporation** Australian Government statutory authority primarily funded by wine sector levies, market program membership fees, sponsorship and charges for compliance services and information products. Principal roles include domestic and international marketing activities.
GWRDC	**Grape and Wine Research and Development Corporation** Australian Government statutory authority funded by wine sector levies and matching Government finance. Principal role is to fund and manage research and development initiatives to advance Australian viticulture and winemaking.