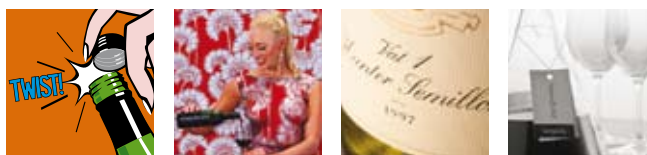


WINE AUSTRALIA: DIRECTIONS TO 2025



BENCHMARKING GUIDE MEDIUM WINE BUSINESS



Australian Government
Australian Wine and
Brandy Corporation

wfa Winemakers'
Federation
of Australia
For the Industry by the Industry

Introduction

This guide is one of three that has been developed as part of the '*Directions for the Australian Wine Sector*' project. The joint Wine Makers Federation (WFA) Australian Wine and Brandy Corporation (AWBC) project management team, in conjunction with Deloitte Touche Tohmatsu, have developed these guides and a Gross Margin Ready Reckoner (Ready Reckoner).

This guide has been developed focused on Medium Wine Businesses. For the purposes of this guide we have defined a medium wine business to have the following characteristics:

- wine sales of between 50,000 and 350,000 cases and between \$5 million and \$20 million in bottled wine sales revenue. It does not incorporate other revenue such as merchandise sales at cellar door, sales of grapes and bulk wine, and income from contract processing and packaging, unless specifically identified;
- typically owner operator businesses although many businesses of this size could be in transition from a state where all operations are conducted by the proprietors to one where delegation of tasks to employees or external providers is a necessity. In some cases where the proprietor is the operator there may exist 3rd party equity investors;
- production capacity of between 750 and 5,000 tonnes; and
- the business owns/controls its wine making facility and has a combination of estate vineyards and contracted grape purchases.

Wine businesses outside these specific parameters may also benefit from the information and examples provided in this guide.

The objective is to present information that wine businesses can analyse to identify potential areas where they could improve their businesses, and to assist with the development of sustainable business plans that will meet the challenges of an ever changing domestic and global beverage market.

The financial information presented is based on the results of the Deloitte/WFA annual financial benchmarking survey for the Australian wine industry (**Wine Survey**) and other wine industry research. Judgements are based on industry best practice and are presented regarding sustainable performance levels. These judgements are the view of the authors with overview from wine industry practitioners and will need to be considered in light of individual business variations. The 'Best Performing' wine businesses are the top 25% for the medium wine business category.

This guide is intended to be used in conjunction with the **Ready Reckoner**. The objective of this model is to utilise the information available to the Industry to provide wine business operators with a tool that will assist them with pricing and gross margin analysis.

Finally, it is very difficult to achieve consistency across publications and industry commentary with respect to terminology used to describe retail price points, particularly when comparing across different markets. It is also recognised the categories may overlap to some extent. For the purposes of these Benchmarking Guides, the following terminology and price point comparisons are used:

Retail price point terminology

	Australia AUD/750ml	United Kingdom GBP/750ml	United States USD/750ml
Luxury	>50	>30	> 50
Ultra premium	25-50	15-30	20-50
Super premium	15-25	9-15	14-20
Premium	10-15	6-9	9-14
Premium	5-10	3-6	5-9
Basic	<5	<3	<5
Cask/jug – 4 litre	10-12	n/a	6-9

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1. Executive summary

The objective of this guide is to present information that wine businesses can analyse to identify potential areas where they could improve their businesses. For the purposes of this guide, a medium wine business is defined as having gross case sales revenue of \$5 million to \$20 million.

A key consideration for medium wine businesses is whether they are focusing strategic decisions as a large 'small' wine business or a small 'large' wine business. The guide indicates that cost structures tend to favour wine businesses in the medium category focusing on higher price point, lower volume brands rather than attempting to compete with larger wine businesses in the sub \$10 per bottle prices.

Sustainable small wine business

Annual revenue	\$0-1 million best	\$1-5 million best	Sustainable
Sales	100%	100%	100%
Cost of goods sold	49%	45%	50%
Gross margin	51%	55%	50%
Sales and marketing expenses	12%	20%	16%
General and administration expenses	14%	10%	11%
Earnings before interest and tax	25%	25%	23%
Interest	6%	3%	8%
Earnings Before Tax	20%	22%	15%

A sustainable medium wine business should return an Earning Before Tax (EBT) margin (as a proportion of revenue) of at least 15% and more likely 20% in order to provide the owners with an appropriate return on investment and also to provide a sound basis for sustainable future growth.

Long term sustainability with a return on investment of at least 15% would indicate that medium wine businesses must target a minimum gross margin of 50% of case sales revenue.

Included below are examples of strategies employed by the best performing medium wine businesses. Further details of each strategy and general commentary on other areas of a medium wine business are discussed in the body of this report.

Sales & distribution

The best performing medium wine businesses generally focus on the following items in terms of sales and distribution with varying emphasis depending on the precise nature of the business to achieve the minimum gross margin of 50%:

- development of a portfolio that spans all price points;
- realistic expectation of sales volumes at various price points;
- matching of price points and marketing strategy with brands;
- selecting the appropriate sales channels each brand;
- maximising the return on dollars spent on sales and marketing support; and
- utilising additional income sources to supplement revenues and profitability.

Medium wine businesses should focus on the development of sustainable brands with a spread over the spectrum of price points. Growth based on pursuing higher volume, sub \$10 per bottle wines is generally not sustainable in the long term for wine businesses in this segment of the industry. Medium wine businesses must therefore capitalise on other competitive advantages to maximise their position in the market-place.

Sales channels

The transition from a small wine business to a medium wine business requires the development of strong relationships with distributors and agents, both in the domestic and export markets.

The management of distributor/agency arrangements and a clear and definitive understanding of the sales and depletion reports of inventories are critical for the medium wine business.

Management of multiple sales channels is a key aspect of the transition from a small wine business where all aspects of the business are generally handled by the proprietors, to a medium wine business where delegation of these tasks to employees or third parties will most likely be required.

Sales and marketing

The sales and marketing objectives for a medium wine business are not materially different from those of the small wine business.

The critical challenge for a medium wine business is to ensure that it develops an overall marketing strategy which supports a wine portfolio that spreads across all price points.

In many situations, medium wine businesses that build and market themselves as a large 'small' wine business tend to be more profitable than those that position themselves as a small 'large' wine business.

Export

It is important for any medium wine business to explore opportunities in the export market. There are, however, many significant differences in the structure of export jurisdictions. It is critical that all wine businesses understand the detailed costs involved in selling wine into a particular export market.

The **Ready Reckoner** has been designed to provide guidance on the different levels of taxes, distribution and import costs in the US and UK markets, with more markets to be added over time. This will allow wine businesses to analyse the economics of exporting a particular wine into those markets given the expected end retail price and the cost structure of the business.

Cost of goods sold and inventory

Similar to the situation with small wine companies, many medium wine businesses do not fully evaluate the true cost of producing wine.

Processing costs should capture all wine related costs including labour, overheads and depreciation. Exclusion of depreciation (due to a fully depreciated wine business) and other capital costs provides an artificially low assessment that, for example, does not adequately allow for machinery replacement costs.

Grape supply

Medium wine businesses must develop a grape supply strategy that will ensure a grape cost that is sustainable for the targeted volumes and price point of the wine in question. This strategy must consider all aspects of the balance between estate grown grapes and grapes sourced from other grape growers. It is important to consider the medium term cost of grapes and avoid creating brands at lower price points built on very low grape prices driven by short term oversupply. This could lead to brands in low price points that are not sustainable when grape prices increase.

Wine businesses that buy grapes must have an adequate system to manage grape purchases and understand the consequences of formal and informal documentation of the agreements with growers. This has been highlighted in recent years with excess grape supply which has seen the price paid per tonne decrease significantly since 2002.

Oak

Many medium wine businesses produce high quality wine which is oak fermented. The significant cost of oak barrels and associated depreciation is often not apportioned by medium wine businesses to the cost of goods sold.

Full absorption costing should be adopted to more clearly reflect the true costs of wine production and provide more accurate information on which to base sales and pricing decisions.

Medium wine businesses need to be particularly diligent in determining the cost of producing wines targeted at the lower price points as they are generally at a significant cost disadvantage to the larger wine businesses.

General and administrative costs

General and administration expenses should not include costs that should either be allocated to the production of inventory or to sales and marketing. This is a common problem for wine businesses and distorts business decisions regarding wine costs and pricing.

Taxation

Wine businesses operate in an environment of multiple and complex taxation regulations particularly when dealing with multiple export jurisdictions. Examples of the taxation that apply to a wine business are:

- i. Wine Equalisation Tax (WET);
- ii. Goods and Services Tax (GST);
- iii. stamp duty;
- iv. income tax;
- v. capital gains tax;
- vi. Fringe Benefits Tax (FBT);
- vii. payroll tax;
- viii. customs and import duties;
- ix. overseas taxes and duties for exporters; and
- x. employee superannuation.

This complexity of taxation issues requires the operators to develop a sound process to ensure that they are properly managing and optimising their taxation affairs across all taxation regimes.

Balance sheet structure

Examples of key areas in which the best performing medium wine operators structure their business and minimise costs are not materially different to those for small wine businesses.

One significant difference is that to finance the quantum of working capital necessary to either sustain or grow a successful medium wine business will generally require a significantly increased level of debt funding.

This will often necessitate some form of cashflow financing. This type of finance requires careful negotiation with financiers and may be approached through specialist finance companies rather than traditional bank lending.

Medium wine businesses planning substantial sales growth should consult their financial or accounting advisors to develop a detailed cash flow model that accurately depicts the working capital needs corresponding to the targeted increase in sales. These cashflows then need to be discussed with the business's financiers or bankers to determine the best approach to financing the targeted growth.

2. Sustainable medium wine business

Medium wine businesses should target a gross margin of at least 50% of case sales revenue.

The following table indicates the current financial performance of the best medium wine businesses and a suggested 'sustainable performance'.

Table 1: Sustainable medium wine business (2005 Wine Survey)

Annual revenue	\$5-10 million best	\$10-20 million best	Sustainable
Sales	100%	100%	100%
Cost of goods sold	49%	45%	50%
Gross margin	51%	55%	50%
Sales and marketing expenses	12%	20%	16%
General and administration expenses	14%	10%	11%
Earnings before interest and tax	25%	25%	23%
Interest	6%	3%	8%
Earnings Before Tax	20%	22%	15%

1. adjusted to include branded wine businesses and exclude contract processing only businesses.
2. figures presented as percentages relative to total bottled wine sales revenue.
3. modified to aggregate other non-operating income /expenses with Administration expenses.
4. interest is relatively low for average and best performers representing mature businesses with low borrowings; in contrast, the sustainable model assumes a level of borrowings that equates to approximately 55% of total assets.

The best performing wine businesses with \$5 million to \$10 million of revenue are returning Earnings Before Tax (EBT) of 20% and wine businesses with \$10 million to \$20 million of revenue are returning EBT of 22%.

A sustainable medium wine business should return an Earning Before Tax (EBT) margin (as a proportion of wine sales revenue) of at least 15% and more likely 20% in order to provide the owners with an appropriate return on investment and also to provide a sound basis for sustainable future growth.

Long term sustainability with a return on investment of at least 15% would indicate that medium wine businesses must target a minimum gross margin of 50% of case sales revenue.

The 50% sustainable gross margin level is the minimum required to provide an Earnings Before Tax (EBT) of 15% based the following assumptions:

- **sales and marketing expenses** of 16% of case sales revenue;
- **general and administration expenses** of 11% of case sales revenue; and
- **interest** of 8% of case sales revenue.

The EBT level of 15% assumes the wine business has already included appropriate salaries for owners and family members who work within the business and also includes sustainable levels of depreciation and interest.

Table 2: Gross margin

Wine business sales	Average gross margin	Average gross margin	Average gross margin	Best performers gross margin
	2003	2004	2005	2005
\$5-10 million	34.3%	38.0%	41.2%	51.5%
\$10-20 million	29.6%	24.4%	34.6%	55.4%

The minimum gross margin of 50% is somewhat higher than that reported by the average medium wine businesses from the **Wine Survey** as shown in the table above.

The best performing wine businesses from both the \$5 million – \$10 million and \$10 million – 20 million revenue category as shown above indicates that a gross margin in excess of 50% is achievable.

The **Ready Reckoner** assumes a sustainable gross margin of 50% and highlights scenarios that generate gross margins below this level.

3. Sales and distribution

The best performing wine businesses generally focus on the following items in terms of sales and distribution, with varying emphasis on different aspects depending on the individual nature of the business:

- identification and targeting appropriate price points;
- matching of price points and marketing strategy with brands;
- selecting the appropriate sales channels for their brands;
- maximising the return on dollars spent on sales and marketing support; and
- utilising additional income sources to supplement revenues and profitability.

Each item is discussed in more detail below.

3.1 Price points

What proportion of wine is sold in each price segment?

The following charts demonstrate that medium wine businesses sell between 26% (\$5 million – \$10 million) to 34% (\$10 million – 20 million) of wine at between \$15 and \$20 per bottle and a further 18% to 23% at between \$20 and \$50 per bottle.

This is consistent with their position in the market where the large wine businesses tend to sell a high proportion of wine below \$10 per bottle and the small wine businesses sell a significant portion above \$20 per bottle. Medium wine businesses tend to target this segment of the market as it best fits their cost structures; the prices of their wines are generally offered at the higher end of the two price ranges (around \$14-\$15 and \$19-\$20 per bottle).

Chart 1: Revenue by price point (\$5 million–\$10 million)

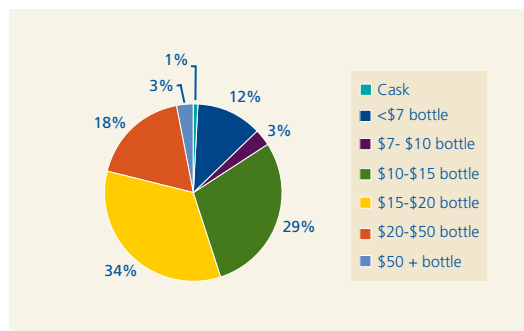
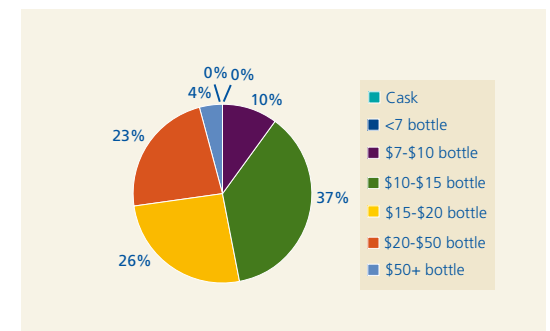


Chart 2: Revenue by price point (\$10 million – \$20 million)



The charts below show the proportion of wine sold at each price point globally (Chart 3: Rabobank) and the proportion of advertised wine prices in the Australian retail sector (Chart 4: LMA Database).

Chart 3: World wine sales (Rabobank)

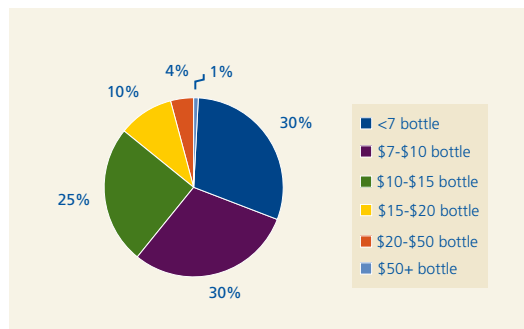
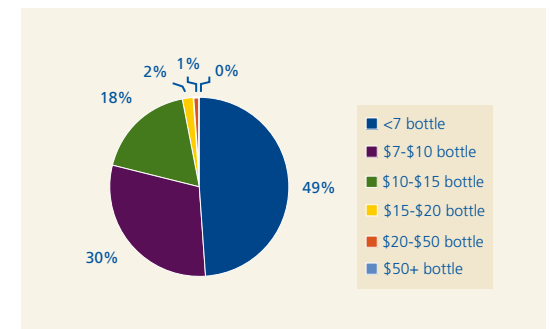


Chart 4: Advertised retail wine prices (LMA Database)



The Liquor Merchants Association (LMA) database collects information on advertised wine prices in media throughout Australia and this data provides an indicator of the promotional price points targeted by the retail trade (off-premise).

The charts show that 85% of wine sold globally and more than 95% of wine advertised in Australia is less than \$15 per bottle by volume. Further analysis of the Australian advertised sales indicates that over 85% was sold below \$12 per bottle by volume.

Insight: A medium wine business – a big version of a small wine business or a small version of a big wine business?

Based on the poor profitability results demonstrated in the Wine Survey \$5 million to \$20 million wine businesses over the past five years, the inability to drive significant volume increases in the mid price points (\$10-\$20 per bottle) to sufficiently cover overheads, capital expenditure and general expenses is a significant challenge for medium wine businesses.

The best performing medium wine businesses tend to act as larger versions of small wine companies, generating volumes of 100,000 to 200,000 cases but maintaining an average price per case of \$100. Modelling would indicate that an average price per case of greater than \$70 is generally required to create a sustainable medium sized business. This does not preclude medium wine businesses selling targeted wines below \$70 per case to satisfy specific business requirements.

When compared to some medium wine businesses that achieve \$50 per case, it can be clearly seen that the extra \$20 per case produces a gross margin increase of between \$2-4 million which is then available to be reinvested into the business in areas such as increased marketing or upgraded capital equipment. Profitability impacts from portfolio mix are demonstrated in Appendix A – Australian Medium Sized Wine business Comparison.

The information contained in Appendix A shows a comparison between two wine businesses which have a case sales turnover of approximately \$17.5 million. The two businesses have a similar structure. The major difference is that Wine business 1 has adopted a strategy of increasing revenue through producing higher volumes of lower price point wines. This is compared to Wine business 2 which has adopted a strategy of producing a portfolio mix equivalent to the mix contained in Chart 3 – being the retail price mix of the top quartile of wine businesses in the \$10-\$20 million revenue range as per the **Wine Survey**.

The messages that this table dramatically demonstrates are:

- A wine business in the \$5million – \$20 million case sales range that invests in the development of a portfolio of wines that contains a balanced mix of price points will often achieve a significant increase in profitability compared with the wine business focusing on lower price point, higher volume strategies in this turnover range;
- There is little profitable incentive for a medium sized wine business to attempt to compete with the large and major wine businesses in the 'Under \$10 per bottle' segment of the business. This does not exclude medium wine businesses offering wines below \$10 for specific business requirements where clearing wine is required (as long as brands are not devalued in the process);
- The Wine Survey demonstrates that large wine businesses have significant cost advantages over medium wine businesses in areas such as processing and packaging costs. Processing costs for medium wine businesses average \$1 per litre compared to \$0.50 per litre for large wine businesses. Packaging costs for medium wine businesses are, on average, \$15 per case, whereas large wine businesses can reduce this to \$10 per case if they have in-house bottling facilities. This alone can cause a \$10 difference in the cost of each case of wine when the margins and taxes are added before the wine reaches the customer; and
- An increase in the volume of wine sold has a corresponding increase in the cost of logistics and marketing which can further erode profitability for Medium wine businesses focusing on lower price points.

Medium wine businesses must therefore capitalise on other competitive advantages to maximise their position in the market-place.

It should be noted that individual wine businesses are impacted by many factors which need to be taken into account when considering analysis of 'model' information. The survey data does, however, provide a very clear message: wine businesses that are targeting major retail chains must realise the lower case price that is generally achieved means the cost structure for these wines must be on a par with efficient large wine business operations in order to be sustainable.

3.2 Sales channels

The following charts illustrate the proportion of wine sold through each sales channel by Australia's medium wine businesses.

Chart 5: Sales channel (\$5 million - \$10 million)

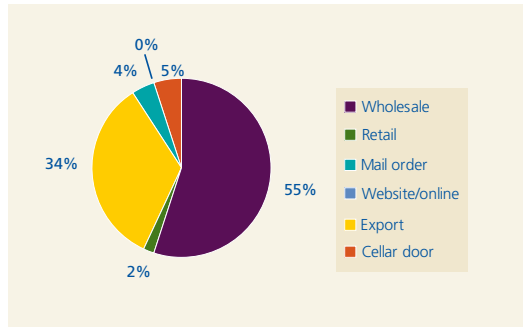
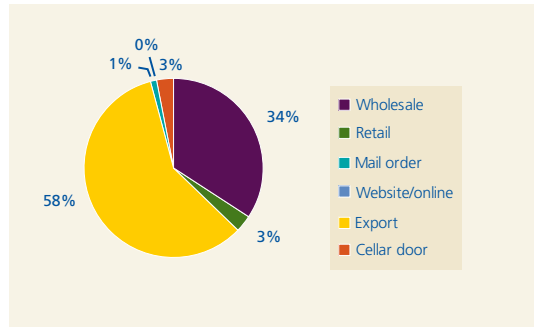


Chart 6: Sales channel (\$10 million - \$20 million)



The predominant sales channels for medium wine businesses are Wholesale and Exports; each channel is discussed in more detail below.

A. Agent/distributor (domestic)

Medium wine businesses are generally at a cost disadvantage with large wine businesses when selling to domestic or international supermarket chains. They typically utilise a distributor to sell their products both to the on-premise market and the off-premise tier below supermarkets, (such as convenience stores, independent liquor outlets and hotel or pub chains).

Management of the distributor and/or importer

The best performing medium wine businesses actively manage their distributors and importers.

This often involves monitoring the distributor's performance through regular depletions reports. The depletions reports indicate what wine is being sold by the distributor and can highlight brands or products which are ahead or behind expectations. Monitoring distributors' order patterns is not the best way to understand product or brand performance, as buying patterns may differ for each product or brand and/or from actual customer sales.

The exchange and review of such information facilitates the timely discussion of any concerns and allows corrective action by both the wine business and the distributor as soon as sales fall significantly behind expectation. This close working relationship also encourages additional efforts such as advertised in-store presentations.

When selling to a distributor, medium wine businesses can tend to treat the distributor as the customer rather than monitoring the actual price at which the wine is retailed. The retail price point is critical as a retailer may reduce the price of a particular wine to sell any slow-moving product. The availability of wine at a reduced price may discourage customers from purchasing the wine through other sales channels, or purchasing the wine in the future at the recommended retail price.

Distributor and retailer margins

The distributor and retail margins in the **Ready Reckoner** are outlined in Table 3 below, although the actual margin may depend on a number of individual considerations including the volume of product sold through the distributor or retailer.

The **Ready Reckoner** is built around the off-premise market. While it is accurate to expect sales through on-premise outlets might deliver a better return for wine businesses than distributor or agent sales, there are additional margins to consider such as a 50% – 70% on-premise mark-up when comparing on-premise prices vis-à-vis retail outlets. Direct sales will generally offer the best margins for wine businesses.

The effects of discounting

Medium wine businesses that sell their wine via a distributor to the retail trade will often be exposed to the provision of discounts, rebates and bonuses to sell their products.

This extends beyond the large supermarket chains to the smaller supermarkets, convenience stores and liquor outlets.

It is estimated that between 60% to 80% of high volume lower-priced wine is sold on promotion in the UK. Threshers, a UK chain of liquor outlets that sells a large portfolio of wines from medium sized Australian wine businesses, offers all wine as a 3 for 2 offer. That is, pay for two bottles and receive three.

The impact of selling on promotion is significant. It is crucial that wine companies planning to enter any export market understand the 'way wine is sold' at various price points. The initial pitch price to a distributor must take into account any promotional or discount patterns that are part of the normal trading environment in that market.

In most cases, a medium wine business selling wine on promotion will have to sell around 1.5 to 2 times as much wine to achieve the same dollar contribution.

The financial consequences of selling on promotion are significant, and the **Ready Reckoner** allows the winery to consider this impact on margins by altering price point and retail margin where applicable for comparison against original prices. A winery selling wine on promotion will have to sell between 50% and 100% more wine by volume to achieve the same dollar contribution to their gross margin.

The 'Guide for Large Wine businesses' discusses the challenges and opportunities of selling through major retail chains in greater detail, including discounts and rebates.

B. Export

Australia's rise in wine exports over the past 15 years has been phenomenal and, not surprisingly, as shown in Charts 6 and 7 on page 11, a large proportion of sales for Australia's medium wine businesses are through the export sales channel.

The best performing medium wine businesses have a presence in almost all significant international markets where Australian wine is sold, with an obvious concentration in the UK and US.

While export margins were generally strong through the 1990's, in recent years the margins in key export markets such as the UK have reduced.

This has obviously had a large impact on the profitability of wine businesses. In order to maintain sales, most medium wine businesses have been forced to reduce price and margin within already tight cost structures.

Increases in duties and taxes are generally passed on to wine businesses due to inelasticity of the retail price, further reducing wine business margins.

It is essential for wine businesses to carefully consider all costs associated with export opportunities and the impact on business profitability bearing in mind the increased taxes and margin squeeze of recent years.

Importer, distributor and retailer margins

The **Ready Reckoner** assumes the following margins based on benchmarking data and industry norms:

Table 3: Australian, United State and United Kingdom margins (assumed)

	Australia	United States	United Kingdom
Importer	Nil	33%	Nil
Distributor	30%	30%	33%
Retailer	30%	30%	33%

The three levels applicable for the US market add nearly 125% (33% x 30% x 30%) to the wine price.

Wine businesses need to understand the relevant taxes and duties for each country to which they intend to export. For example, the US has federal taxes as well as varying state-by-state taxes and wine sold above 14% alcohol volume in the US attracts USD 0.31 per bottle as compared to USD 0.21 for wines under 14% alcohol.

3.3 Sales and marketing support

The marketing strategies adopted by wine companies do not vary significantly when comparing different wine businesses. The major consideration for most companies will be managing the transition from a small company to a larger company. The sales and marketing plans often go from being developed, managed and executed by the proprietors of the business to being delegated to employees and contractors.

Based on the results from the 'Best Performers' in the **Wine Survey**, the **Ready Reckoner** assumes a sustainable level of sales and marketing expenses of 16% of sales revenue for medium wine businesses.

There will be an increased cost of sales during the time of brand development.

Sales and marketing strategy

Actual sales and marketing costs will vary depending on marketing strategies and the routes to market.

The Guide for Small Wine Businesses discusses the following sales and marketing activities in some detail. The structure and magnitude of these activities varies between small, medium and larger wine businesses:

- careful matching of the type of marketing spend to the wine price point;
- maximising local advertising opportunities;
- presentation of wines at wine shows;
- targeting wine writers with specific preferences aligned to their wine styles; and
- appropriate use of wine samples.

Advertising costs

Table 4: Advertising costs (**Wine Survey**)

Year	\$5-10 million	\$10-20 million
2003	1.40%	2.90%
2004	2.80%	4.80%
2005	4.10%	8.00%

The table above demonstrates the advertising costs for medium wine businesses have been growing year-on-year to counteract the increasing number of competitors and wine brands in the market. The number of Australian wine businesses has grown from 535 in 1990 to over 2,000 in 2006. The challenge to differentiate product offering is growing every year for Australian wine businesses.

3.4 Contract winemaking

Most wine businesses are built with growth in mind and the failure to achieve this growth or the scaling back of production due to cancellation of grape contracts can result in reduced utilisation of wine production assets. This could lead to a situation where contract processing opportunities must be considered.

Contract processing wine for others can be difficult if the wine business is not set up for such services. The true costs of production (including depreciation and other fixed costs) are often ignored and the fee for service is set too low, only covering variable costs.

The 'Guide for Small Wine businesses' provides an example of the costs of contract processing from a variable cost and full absorption cost perspective.

It is a difficult balancing act to match capital expenditure with forecast growth in wine sales. Excess capacity can have a significant negative impact on profitability and additional production requirements could be contracted out in the first instance prior to large scale expansion. Capital expenditure to grow production capacity should be based on a high level of confidence regarding sustainable sales volumes.

4. Cost of goods sold & inventory

The following section details the components of each case of wine as presented in the Gross Margin Ready Reckoner and provides insights into management of inventory levels.

4.1 Absorption costing

This guide is compiled on the basis of adopting full absorption costing. Full absorption costing requires all costs associated with the manufacture of inventory to be capitalised into the cost of inventory and not included as period costs in general and administration expenses.

Examples of the types of costs which are often expensed and not capitalised into inventory include:

- depreciation of plant and equipment;
- winemakers' salaries;
- other direct salaries;
- amortisation/depreciation of oak barrels;
- light and power for winery; and
- laboratory costs.

These are all costs of the manufacture of wine and should be included in the calculation of inventory and cost of goods sold.

It is important for a wine business to clearly differentiate between the accounting treatment for costs of production and the taxation treatment for these costs. The treatment may be quite different and can result in an inaccurate assessment of costs and an incorrect targeting of price points.

4.2 Cost of goods sold

A. Grapes

The results of the **Wine Survey** suggest that wine businesses with \$5-10 million of revenue pay external grape growers, on average, \$1,121 per tonne for grapes and those with \$10-20 million of revenue pay, on average, \$945 per tonne.

Most medium wine businesses have an average cost of growing their own grapes at between \$500 per tonnes and \$750 per tonne based on the survey results. This is substantially less than the average price paid to external growers which demonstrates the importance of developing a grape supply strategy targeted at sustainable grape prices based on anticipated volumes and price points for the wine in question.

i Management of grape supply contracts

It is critical that medium sized wine businesses understand the consequences of the formal and informal documentation of agreements with third party growers. This has been highlighted in recent years with excess grape supply which has seen the price paid per tonne decrease significantly since 2002.

In 2005, the continued oversupply of grapes enabled medium wine businesses to purchase their fruit requirements at prices, on average, nearly 20% less than the 2004 average prices.

Many medium wine businesses have reduced grape purchases from third party growers in recent years as no formal contract existed. Long term, fixed price, grape supply agreements in the 1990's were not documented in many circumstances. Tight profitability conditions for wine businesses in recent years has seen many informal grape supply contracts cancelled.

On the counter side, there is also evidence of agreements documented in letters to grape growers with fixed prices and no expiry terms. Such letters can be construed to be contracts.

Wine businesses should seek legal advice to understand the nature of their grape supply agreements.

The best performing medium wine businesses actively manage their grape supply agreements in accordance with their vintage plan including forecast future sales. Expiration dates for supply contracts are monitored and new contracts are signed for periods of three to five years or less.

ii Cost of grapes

The **Ready Reckoner** uses a basic assumption that increasing grape quality will be required for increasing retail price points and there is a corresponding increase in the cost of grapes for higher retail prices.

With many grape varieties currently in over-supply, grapes have been obtainable at prices as low as \$200 per tonne. The **Ready Reckoner** ignores such anomalies and provides a sustainable cost of grapes for each retail price point

Wine businesses choose the desired wine region and variety and the **Ready Reckoner** will source the estimated average price for that region

The **Ready Reckoner** firstly derives a grape cost per tonne based on the region and variety of grape selected (source: AWBC/Winefacts). This cost is subsequently weighted, based on the retail price point of the wine. Discounted grape costs are included for wines retailing under \$10 per bottle, average pricing is applied to \$15-\$20 wines and a premium is applied to \$25 plus wines. Grape costs in the model range from \$400 per tonne (retail price) to \$5,000 per tonne (retail price). These costs can also be manually adjusted.

Note that inputting an artificially low grape price due to oversupply will not be sustainable. For long term business analysis, realistic average (at least) grape prices should be used. It is expected that a similar **Ready Reckoner** for grape growing will be developed to more accurately analyse sustainable grape prices vis-à-vis costs of production.

iii Trends of external grape purchases

The table below shows the cost of external grape purchases by wine businesses with \$5-10 million of revenue has remained relatively stable over the last four years, in contrast to wine businesses with \$10-20 million of revenue where there has been a sharp decline.

Chart 7: External Grape Purchases – 2002 to 2005



The medium wine businesses with \$5-10 million of revenue tend to more closely resemble the small wine company business model, purchasing select parcels of premium fruit intended for branded product where the margin is sufficient to justify the prices paid for the grapes.

B. Extraction rates

The extraction rate for grapes depends on many factors including grape variety and intended price point. The **Ready Reckoner** assumes the extraction rate will progressively decrease at higher price points, and ranges from 725 litres per tonne to 500 litres per tonne. Variability for red versus white wine has also been allowed and the **Ready Reckoner** assumes extraction rates for red grape varieties will be, on average, 80% – 90% of that for white grape varieties.

Allowances for evaporation, ullage and other losses have been considered via the inclusion of a wastage factor. While 9.1 litres per tonne of wine per case is often used to allow for wastage in larger wineries, the **Ready Reckoner** uses an assumed 3% wastage factor (or between 9.3 and 9.4 litres per case) but allows for the winery to manually input their own expected wastage factor.

C. Processing costs

Processing costs should capture all wine related costs including labour, overheads and depreciation. Exclusion of depreciation (due to a fully depreciated wine business) and other capital costs provides an artificially low assessment that, for example, does not adequately allow for machinery replacement costs.

Many wines are not released in the first 12 months of production and Cost of Goods Sold should also reflect interest (or finance costs) – included as a separate section below.

Many small and medium wine companies do not correctly evaluate the true cost of wine production and do not appropriately allocate labour and overheads to wine products.

Processing costs in the **Ready Reckoner** for medium wine businesses (\$5 million to \$20 million of case sales revenue) have been set at \$1 per litre. This cost is based on the **Wine Survey** as well as observed industry standards and can be manually changed.

As mentioned earlier, this is double that of larger wine businesses (\$0.50 per litre) and four times that of Australia's major wine businesses (\$0.25 per litre), indicating a huge cost disadvantage when competing with larger wine businesses. These costs are indicative of full capacity processing and will increase in years of shorter grape supply.

Vintage costing

It is difficult to identify any computer software systems that adequately deal with vintage costing for wine businesses. Most, if not all, wine businesses use a spreadsheet based system to allocate their annual vintage costs to individual products.

The majority of vintage costing systems involve relatively simplistic allocation of labour and wine business overheads, typically on a volume basis. In reality, the actual costs of production of various wines are quite different.

The best performing wine businesses implement the following procedures in their vintage costing analysis to allocate production costs:

- separate oak costs and allocate specifically to oak fermented wine;
- attach freight inwards specifically to each associated parcel of grapes;
- apply a different weighting of overhead to red versus white grapes;
- categorise their wine on a scale of 1 to 5, depending on care and handling and apply a different weighting of labour and overhead to each category; and
- separate grapes processed to the juice level only and allocate a lower overhead rate.

D. Storage and handling costs

The significant costs associated with storing wine are often not separately identified by wine businesses.

The **Ready Reckoner** assumes a rate of 3 cents per month per litre for medium wine businesses. Wine that requires special care and handling may cost between 2 to 3 times this amount. However, higher priced wines requiring this level of care should generate sufficient margin to justify the additional costs.

E. Finance costs

Holding and maturing wine ties up working capital. While holding wine will generally aid maturation and thereby increase sales value, the interest cost must be recognised and has been separately included in the **Ready Reckoner**.

F. The cost of oak

The significant cost of oak barrels and associated depreciation is often not apportioned by wine businesses to the cost of goods sold.

The listed price for 300 litre Hogshead Barrels at the time of writing this guide was \$800 for American Oak and \$1,300 for French Oak. These levels have been used in the **Ready Reckoner** but users should be aware that Oak costs will vary based on quality and the buying power of the business. While a barrel may last 5-7 years, the majority of use for oak flavour occurs in the first 3 years.

Oak costs have been separated in the Ready Reckoner, based upon the expected number of months in barrel, to enable a more accurate portrayal of total costs. The separate holding costs also account for time in tanks or bottle before sale.

The financial effects of oak fermentation have been explained through a separate case study 'Costs of Wine Maturation'.

Import duty rebates

Wine businesses should also be aware that import duty rebates may be available for barrels imported from overseas suppliers under the 'Tradex' scheme. Tradex provides for duty and GST free importation of goods that will be exported, either unaltered or incorporated into other products. While accessing Tradex does not cost anything, the importer is required to export the goods within 12 months or another agreed timeframe. If for any reason the goods are not exported within the agreed timeframe (usually four years in regard to barrels), the duty which would have been paid if not for Tradex, becomes due and payable to AusIndustry within 28 days. Further information is available at <http://www.ausindustry.gov.au>

G. Packaging costs per case

The costs of bottling, labelling, cartons and other packaging supplies have been calculated in the **Ready Reckoner** according to the intended price point.

The **Ready Reckoner** uses a range of \$10 per case to \$24 per case for packaging. These estimates are based on the best performing wine businesses in the Wine Survey and are considered to be target packaging costs for each price point. Individual wine business costs will vary from these estimates and these costs can therefore also be manually entered.

H. The value of grapes from owned vineyards

Similar to small wine businesses, many medium operators account for the cost of grapes from their own vineyards at the cost of production. The alternative to using the costs of growing grapes for determining pricing and cost of inventory is to price grapes at district weighted averages or an estimated market price for the grapes. This is the method prescribed in the Australian Accounting Standards (Australian Equivalents to International Financial Reporting Standards, A-IFRS) and is mandatory for all wine businesses that are required to produce 'General Purpose Financial Statements'. Individual wine businesses should consult their accounting advisors.

The Standard has the effect of bringing the cost of grapes to account at market value, rather than actual costs incurred on operating the vineyard. The resulting profit or loss is recorded in the year the grapes were picked.

This isolates the vineyard profit and aligns the cost of fruit with wineries that do not own vineyards. All wine inventories incorporate grapes at market prices.

4.3 Inventory

A key challenge for medium and large wine businesses is the management of inventory levels and the constant need to match wine demand to the supply of grapes and wine.

Any inventory which cannot be sold as branded product is often sold as bulk wine or unbranded at a significant loss.

The 'Guide for Large Wine businesses' discusses the management of inventory in greater detail and provides insights of strategies adopted by the best performing wine businesses.

Inventory and working capital ratios

The following table shows the typical inventory and working capital ratios for medium wine businesses.

Table 5: Inventory and working capital ratios – best performers

Inventory and working capital	\$5-10 million 2005	\$10-20 million 2005
Inventory to COGS	1.40	1.60
Inventory turnover	0.77	0.80
Working capital to sales	1.02	1.00
Working capital to COGS	1.55	1.74
Non-current inventory %	21%	31%

Inventory ratios

The average proportion of non-current inventory held for the best performing for wine businesses between \$5 million and \$10 million of revenue is just over 20% of total inventory and slightly over 30% for best performing wine businesses between \$10 million and \$20 million of revenue.

The 'Inventory to COGS ratio' suggests that the best performing medium wine businesses have between 1.4 and 1.6 years of inventory on hand.

Working capital ratios

The working capital ratios are somewhat higher than the inventory ratios, highlighting that medium wine businesses may have significant trade receivables balances which should be actively managed.

For every \$1 increase in sales for medium wine businesses, an equivalent \$1 investment in working capital will be required. This can have a significant impact on cash flows when a business is growing.

This is a reduction to the ratios found in small wine businesses and reflects the much higher proportion of white wines produced by medium wine businesses when compared to small. This is also impacted by medium wine businesses growing their sales base through a higher proportion of lower price point wines which are released into the market at a much earlier date.

Similar to the position for a small wine business, an increase in working capital is a requirement to achieve sales growth. Additional working capital must be provided either through cash reserves or an increase in borrowings or equity.

There are challenges for a medium wine business that are not as evident in a small wine business through the requirement for a much higher quantum of working capital. For example, a \$15 million turnover business looking to increase sales by 20% will require additional working capital of approximately \$3 million. This is unlikely to be funded by equity and will require detailed cashflow modelling to enable the working capital increase to be financed through a range of measures. This could include matching creditor payments, such as payment for grape purchases, to cash inflows and flexible debt financing solutions. All of these measures would require early negotiation with creditors and financing advisors.

Similar to the small wine business, the precise amount and time of the funding of the working capital will depend on the selling pattern of the wine. A critical aspect to consider in seeking an increase in overall sales revenue is cash flow implications on the business during the process to build sales.

Key decisions for a medium company include:

- if targeting an increase in the average sale price of wine through extending the holding period and producing a higher quality product, is the incremental lift in the selling price greater than the costs of holding the wine?
- does the business have the financial capacity to fund the working capital required to hold wine for longer or increase sales volumes?
- as cashflow financing requires significant negotiation with financiers and is often only achieved through specialist finance companies rather than traditional bank lending, what are the options available for financiers in the market to supply this type of requirement? There are flexible financing options available that medium wine businesses can investigate beyond the more traditional banking institutions.

Consideration of working capital ratios demonstrates the need for a wine business that is planning substantial sales growth to consult their financial or accounting advisor to develop a detailed cash flow model that accurately depicts the cash needs corresponding to the targeted increase in sales. These cashflows then need to be discussed with the wine business's financiers or bankers to determine the best approach to financing the targeted growth. Wine businesses should investigate more flexible financing arrangements than traditional bank options if required.

5. General and administrative expenses

This category should include all overhead costs of operating the wine business which are not directly related to the production of wine.

Examples would include office costs, computer hardware and software expenses, postage and printing, salaries (excluding cellar, winemaking and sales and marketing salaries) and other general expenses.

Based on the **Wine Survey** and industry experience, many medium wine businesses do not use full absorption costing and include items as general and administrative costs that should have been applied to cost of goods.

Full absorption costing should be adopted to more clearly reflect the true costs of wine production and provide more accurate information on which to base sales decisions.

General and administrative expenses in the **Ready Reckoner** assumes a sustainable level of 11% of revenue for medium wine businesses.

The best performing wine businesses from the Wine Survey incurred general and administrative expenses of 14% (\$5 million – \$10 million of revenue) and 10% (\$10 million – \$20 million of revenue), which indicates that a target of 11% is achievable.

Careful cost management in this area can significantly improve profitability.

5.1 Foreign exchange

As discussed earlier in the report, a high proportion of sales of medium wine businesses are through the export sales channel. This often exposes large wine businesses to foreign exchange risk in relation to exports which are not denominated in Australian Dollars (AUD). In particular, the main exposure is to the United States Dollar (USD) and Great British Pound (GBP) as these are Australia's main export markets.

Historically, there have been significant fluctuations in the ratio of the AUD to the GBP and the USD.

Some medium wine businesses hedge their exposure by entering into Forward Exchange Contracts to lock-in a forward rate for sales made in foreign currency.

The 'Guide for Small Wine businesses' discusses the basics of hedges and the 'Guide for Large Wine businesses' discusses the accounting impacts of accounting for hedged transactions.

5.2 Taxation

Wine businesses operate in an environment of multiple and complex taxation regulations particularly when dealing with multiple export jurisdictions. Examples of taxes that a wine business is subject to and must actively manage are:

- i. Wine Equalisation Tax (WET);
- ii. Goods and Services Tax (GST);
- iii. stamp duty;
- iv. income tax;
- v. capital gains tax;
- vi. Fringe Benefits Tax (FBT);
- vii. payroll tax;
- viii. customs and import duties;
- ix. overseas taxes and duties for exporters; and
- x. employee superannuation.

This complexity of taxation issues requires the operators to develop a sound process to ensure that they are properly managing and optimising their taxation affairs across all taxation regimes.

The key issues for wine businesses to consider in relation to the management of taxation affairs are:

- ensure all financial records are filed in an orderly and logical manner;
- review all sales invoicing processes and ensure that an assessment is made of the taxation issues that are impacted by invoicing, such as WET and GST for domestic and overseas taxes and duties for export;
- review monthly and year to date financial information to regularly assess payroll tax thresholds;
- review asset records to ensure adequate information is available to assess capital gains tax implications of any sales of assets;
- review all payments for imported goods to ensure correct treatment of customs and import duties;
- whenever contemplating any transaction involving the sale or purchase of assets, businesses, goodwill etc, seek advice on the tax and duty implications such as GST, stamp duties and capital gains tax;
- regularly review all forms of returns to taxing authorities to ensure information is being properly compiled, and consider having those returns reviewed by your accountant. Returns include BAS, Income tax, payroll tax, superannuation, workers compensation and fringe benefits tax (among others!);
- compile a checklist list of all potential returns, including lodgement dates, and review monthly to ensure returns are lodged on time to avoid penalties; and
- regularly seek updates on any new or proposed taxes or changes to existing taxes.

There is an important message for all wine businesses, but particularly for medium wine businesses that are moving through the transition from being an owner/operator business to a larger business with many employees, operating across state borders and entering export markets. Taxation legislation is extremely complex and prolific; management of taxation affairs requires a high level of organisation and diligence and the penalties for non-compliance are financially significant and in some cases can result in serious court action by the taxing authorities. Diligent management of taxation affairs will save wine business operators substantial amounts of time and money by not overpaying on tax obligations, avoiding financial penalties for poor administration and not having to spend substantial amounts of time reconstructing records to satisfy tax administrators and auditors in the case of a tax audit.

6. Balance sheet structure

The way in which a wine business structures its business will affect its profitability and cash flows.

The table provided below provides one model of the Balance Sheet structure of a medium wine business. The basis of preparation of these balance sheets is set out in the assumptions at the bottom of the table. When comparing this 'working model' balance sheet, it is important to be aware of differences in business operations and structures that would explain variations from the model. This could include the amount of purchased fruit versus own estate fruit, contract processing, age of equipment and vineyards and key impacting items such as inventory turnover and fluctuations through the course of the year.

Table 8: Balance sheet

2005	\$7.5 million		\$17.5 million	
Assets				
Current assets	\$'000	%	\$'000	%
Cash	0	0.0	0	0.0
Receivables	1,530	20.4	2,870	16.4
Inventories	9,930	132.4	16,885	96.5
Other current assets	0	0.0	0	0.0
Total current assets	11,460	152.8	19,755	112.9
Non current assets				
Land	900	12.0	2,000	11.4
Vineyards	2,675	35.7	4,875	27.9
Buildings and improvements	300	4.0	500	2.9
Plant and equipment	2,580	34.4	3,980	22.7
Total net fixed assets	6,455	86.1	11,355	64.9
Total assets	17,915	238.9	31,110	177.8
Liabilities and equity				
Current liabilities				
Notes payable and bank debt	1,400	18.7	2,500	14.2
Provisions	100	1.2	150	0.9
Trade payables and accruals	1,355	18.1	2,620	15.0
Total current liabilities	2,855	38.0	5,270	30.1
Non current liabilities				
Long term debt	8,300	110.7	14,100	80.5
Non-current Provisions	75	1.0	100	0.6
Other long term liabilities	0	0.0	0	0.0
Total non current liabilities	8,375	111.7	14,200	81.1
Total liabilities	11,230	149.7	19,470	111.2
Equity	6,685	89.2	11,640	66.6
Total liabilities and equity	17,915	238.9	31,110	177.8
Return on Assets (ROA) after tax		4.4		5.5
Return on Equity (ROE) after tax		11.8		14.8
Debt/Equity		145.1		142.6
Working Capital/Sales		134.7		98.9

Note: % - represents figures indicated as a percentage of sales

Assets

Similar to small wine businesses, the most significant element of current assets is inventory although as a percentage it reduces with size as medium wine businesses tend to hold higher proportion of inventory for early release and sale.

While the **Wine Survey** requested wine businesses to record all inventory as current for comparative purposes, in reality, a large proportion of inventory will not be sold in the first 12 months after manufacture. This has a significant effect on cash flow as discussed in this report

The other very significant asset held by small wine businesses is fixed assets (wine businesses and vineyards). The section below explains how the benefits of these assets can be enjoyed, even if they are owned by a third party.

Liabilities and Equity

Long term debt makes up the majority of liabilities.

Medium wine businesses are funded 37% with equity as they have greater access to debt funding for expansion compared to small wine businesses with 52% equity.

Assumptions

The following assumptions have been used in building the model balance sheet:

- i. portfolio mix – cases of wine sold in each price segment are approximated as per the figures in charts 1 and 2;
- ii. sales channels are approximated as the percentages listed in charts 5 and 6;
- iii. debtor Days – 60;
- iv. creditors assumed to be basis for funding debtors thus cancelling the two figures;
- v. percentage of grapes from own estate – 55% for \$5 million – 10 million and 47% for \$10 million – 20 million;
- vi. inventory turnover – 26 months for \$5 million – 10 million and 24 months for \$10 million – 20 million;
- vii. debt levels are based on funding of assets such that 50% of inventory is funded by debt, 60% of vineyards is funded by debt and 90% of plant & equipment is funded by debt;
- viii. vineyards are valued at \$55,000 per hectare of developed vineyard, including land;
- ix. buildings, plant & equipment are assumed at a cost of \$1,600 per tonne capacity for \$5 million – 10 million and \$1,400 per tonne capacity for \$10 million – 20 million;
- x. operations are assumed to be at approximately full capacity;
- xi. there is no contract processing; and
- xii. there are minimal bulk wine sales.

Key aspects

The key aspects to consider when analysing the above Balance Sheet, and indeed individual enterprise Balance Sheets, are:

- the model shows for both wine business sizes a debt/equity ratio of approximately 1.4-1.5:1. This ratio provides a reasonable balance between return on equity being a relatively conservative 8-12% and the ability to withstand the pressure caused by vintage fluctuations on lending covenants imposed by banks;
- while the ratio of debt to equity might be similar to that of small businesses, as the wine business grows it is more likely to be dependant on equity within the business rather than some form of security over external assets. In the small model it was noted the impact of the proprietors providing equity through guarantees and charges over other assets. The impact of this in percentage terms decreases as the business grows;
- the equity level for a medium wine business assumes a significant level of retained profits. These profits will have usually been earned over time. Absence of retained profits will require equity from other sources to support the level of borrowings;
- the model also demonstrates the investment impact of carrying inventory for 24 plus months and the need for the wine businesses to be able to achieve a minimum gross margin of 50% on sales. The holding costs associated with this inventory structure are approximately 20-25% of the sale price of the wine;
- wine businesses are very 'Asset' intensive businesses. The model wine business structure has total assets representing approximately 240% of sales and 180% of sales for the \$5 million – \$10 million and \$10 million – \$20 million wine business respectively. By comparison, the definition of a large proprietary company in corporations law uses a ratio of total assets to sales of 50%. This is a key consideration when analysing balance sheet structure for wineries;
- the model clearly demonstrates the growth challenge for any wine business. To be able to support sustainable growth a wine business must be able to access debt or equity funding of approximately double the forecasted sales growth; and
- the need for more innovative funding solutions to generate growth in sales volumes are increased significant for medium wine businesses as a result in the growth of the quantum of funding required. The working capital section explains in more detail the funding challenges for medium wine businesses.

Following are some examples of key areas of the way in which the best performing medium wine businesses structure their business and minimise costs.

6.1 Sale and leaseback transactions

In recent years, we have seen evidence of many medium wine businesses following the example of large wine companies and divesting of infrastructure assets by way of sale and leaseback transactions.

Most of these sale and leaseback transactions have been structured such that the original operator receives the produce or output (such as grapes or wine processing in the case of a vineyard or wine business sale) of the asset and also maintains a strong level of quality control by having employees in place at the asset site (vineyard or wine business).

In relation to a sale and leaseback of a wine business, while ownership and the capital risk and benefits (being the potential increase or decrease in value of the wine business) transfers to the lessor, the lessee enters into a long-term contract to process their grapes at the wine business. The lessee can incorporate such clauses into the sale contract to require the lessor to employ the lessee's winemaking team at the wine business and any other factors considered necessary to maintain wine quality and ensure preference over other customers the new wine business owner may introduce to utilise capacity.

The financial benefit for the operator is to free up capital for business development and expansion.

6.2 Use of partnerships and joint ventures

Another opportunity is to enter a form of partnership or joint venture.

Such an arrangement may facilitate the expansion of a wine business or improve the under-utilisation of a wine business. An investor may be prepared to fund the creation of a wine business or wine business, whereby the vineyard owner and wine business operator may be different people.

7. Appendix A – Australian medium size wine business comparison

Wine portfolio mix change – revenue \$17.5 million (approximate case sale revenue)

	Wine business 1 (lower price, higher volume)		Wine business 2 (higher price, lower volume)		Variance	
	\$	%	\$	%	\$	%
Balance sheet						
Cash	0	0.00 %	0	0.00 %	0	0.00 %
Receivables	2,871,441	8.57 %	2,871,441	9.23 %	0	0.66 %
Inventory	16,744,753	50.00 %	16,883,056	54.27 %	138,303	4.27 %
Working capital [assets]	19,616,193	58.57 %	19,754,496	63.50 %	138,303	4.93 %
Vineyards	6,875,000	20.53 %	6,875,000	22.10 %	0	1.57 %
Plant & equipment	7,000,000	20.90 %	4,480,000	14.40 %	(2,520,000)	(6.50)%
Fixed assets	13,875,000	41.43 %	11,355,000	36.50 %	(2,520,000)	(4.93)%
Total assets	33,491,193	100.00 %	31,109,496	100.00 %	(2,381,697)	0.00 %
Payables	2,871,441	8.57 %	2,871,441	9.23 %	0	0.66 %
Debt	18,797,376	56.13 %	16,598,528	53.36 %	(2,198,849)	(2.77)%
Liabilities	21,668,817	64.70 %	19,469,969	62.59 %	(2,198,848)	(2.11)%
Equity	11,822,376	35.30 %	11,639,528	37.41 %	(182,849)	2.11 %
Return on equity (pre-tax)	(439,406)	(3.72)%	2,458,142	23.10 %	2,897,549	9.21 %
Profit & Loss						
Sales	17,467,932	100.00 %	17,467,932	100.00 %	0	0.00 %
Cost of sales						
Grapes						
Own	1,000,000	5.72 %	1,000,000	5.72 %	0	(0.00)%
Purchased	1,400,000	8.01 %	1,020,000	5.84 %	(380,000)	(2.18)%
Overhead	3,500,000	20.04 %	2,240,000	12.82 %	(1,260,000)	(7.21)%
Oak	795,083	4.55 %	1,321,953	7.57 %	526,870	3.02 %
Packaging	4,468,085	25.58 %	2,859,574	16.37 %	(1,608,511)	(9.21)%
Cost of sales	11,163,168	63.91 %	8,441,528	48.33 %	(2,721,641)	(15.58)%
Gross margin	6,304,763	36.09 %	9,026,404	51.67 %	2,721,641	15.58 %
Sales & marketing	3,493,586	20.00 %	3,493,586	20.00 %	0	0.00 %
Administration	1,746,793	10.00 %	1,746,793	10.00 %	0	0.00 %
EBIT	1,064,384	6.09 %	3,786,025	21.67 %	2,721,641	15.58 %
Interest	1,503,790	8.61 %	1,327,882	7.60 %	(175,908)	(1.01)%
EBT	(439,406)	(2.52)%	2,458,142	14.07 %	2,897,549	16.59 %

Wine portfolio mix change (continued)

Wine portfolio	Wine business 1 (lower price, higher volume)		Wine business 2 (higher price, lower volume)		Variance	
	Cases	%	Cases	%	Cases	%
Luxury	0	0.00 %	2,200	0.95 %	2,200	0.95 %
Ultra premium	0	0.00 %	26,000	11.17 %	26,000	11.17 %
Super premium	45,000	13.24 %	50,500	21.70 %	5,500	8.47 %
Premium	95,000	27.94 %	107,000	45.98 %	12,000	18.04 %
Popular premium and basic	200,000	58.82 %	47,000	20.20 %	(153,000)	(38.63)%
Total cases	340,000	100.00 %	232,700	100.00 %	(107,300)	0.00 %
	Litres		Litres		Litres	
Bulk – litres	304,000		52,620		(251,380)	
Other information						
Winery size – tonnes	5,000		3,200		(1,800)	
Extraction rate – litres per tonne	700		700		0	
Productive capacity – litres	3,500,000		2,240,000		(1,260,000)	
Litres per case	9.4		9.4		0	
Case capacity	372,340		238,298		(134,043)	
Winery construction costs – \$/tonne	1,400		1,400		0	
Winery cost – \$	7,000,000		4,480,000		(2,520,000)	
Vineyards – hectares	125		125		0	
Yield – tonnes/hectare	12		12		0	
Production – tonnes	1,500		1,500		0	
Developed cost – \$ per hectare	55,000		55,000		0	
Vineyard investment – \$	6,875,000		6,875,000		0	
Vineyard running costs – \$/hectare	8,000		8,000		0	
Average 3rd party grape price – \$/tonne	400		600		200	
Grapes purchased – tonnes	3,500		1,700		(1,800)	

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