Grape Growers of Ontario

Developing key measures to critically look at the grape and wine industry

March 2012
The Grape Growers of Ontario “GGO” is looking to develop a tool that can be utilized to assess the relative health and progress of the industry. Specifically, the tool is to be utilized to assess the impact of the Ontario government’s 2009 industry strategy and complementary programs to develop new strategies for the industry.

Due to the fact that the grape and wine industries are integrated industries in which all participants in the value chain are interdependent, the GGO would like to ensure that the tool captures the industry as a whole.

The GGO requires a tool that can be easily updated by the industry and transparent to all stakeholders in the industry.

For the purpose of this project, the scope was as follows:
- Only publicly available information sources was utilized.
- Input was sought by both grape and winery industry representatives.

Deloitte assisted the GGO in developing the scorecard that is outlined in this report. The premise of the scorecard is based on the four pillars of sustainability the GGO believe are critical for the industry. These are namely: **1) Quality 2) Market Performance 3) Financial Performance and 4) Investment and Innovation.**

The scorecard looks at key indicators of performance for each of these pillars for both grape and wine production.

Due to the limitations in currently available public information the tool is still a work in process. Outlined in the report are “Areas for Improvement” for the tool. These are areas where additional information could be acquired in order to make the tool have greater utility. Specifically obtaining the information for key performance indicators to provide more transparent points of reference for the industry’s performance is required.

The scorecard does provide for a consistent analysis on a number of critical factors, and should assist in critical discussion of the industry.
The grape growers being part of an integrated industry can only exert control over its part of the “wine value chain”, however is reliant on all parts of the industry to be successful for its growers to be successful. Based on the observations from the analysis the following are some of the key insights:

1) Over the last five years grape quality has remained strong, even as overall grape prices declined. The grape growers initiated a “plateau pricing” system which has allowed for different price points for grapes and has allowed for the sale of more cost effective grapes to the industry. Average BRIX levels in grapes have exceeded VQA standards by over 11% over the last five years. The average composite grape price has declined which provides flexible pricing for both International Canadian Blend (“ICB”) and VQA wineries.

2) Ontario based wines are gaining increased recognition in wine competitions which is a commentary on the quality of the product being produced.

3) With the 2010 change to the Wine Content and Labeling Act requiring 40% purchases of Ontario grapes by winery and 25% per bottle minimum, grape purchases have increased and imported blending material (wine, concentrate and juice) has decreased. International Canadian Blends (ICB) wines absorb a significant amount of grape demand. It is estimated that over 50% of grapes sold are used for this product channel.

4) The Wine Content and Labeling Act which requires use of domestic grapes in blended wine, but does not currently require the use of domestic grapes after March 31, 2014. The removal of this requirement could have a significant impact on domestic grape purchases.

5) VQA sales have shown strong performance over the last five years, which supports grape demand. The pace of growth has slowed in the past year, though it was still positive growth.

6) Though it is difficult to tie specific marketing funds with sales increases, over the last five years in which there has been government support for the VQA brand, VQA wine sales has outpaced the market.
Summary of Observations

7) There are potential questions regarding the equilibrium between grape supply and wine demand. There is insufficient information to conclude on the issue. Obtaining greater transparency regarding wine inventory levels is required to better assess the overall health of the integrated industry.

8) On a preliminary basis government support for vineyard and other viniculture improvement has been leveraged by grape producers.

The following page provides a very high level summary of the four quadrants of the scorecard.
## Summary Scorecard

### Quality

- Grape quality is strong
- Wine quality continues to improve

**Overall Performance**

### Market Performance

- VQA sales are outpacing the market
- Non VQA sales are growing at less than the overall growth of the market and at a lower rate than imports.
- Grape sales are increasing
- The amount of imported blending materials are trending lower
- There is a potential of increasing inventory levels of wine and a potential oversupply of grapes.

**Overall Performance**

### Financial

- Grape prices have had a downward trend for five years
- Average sale prices for VQA and non-VQA is increasing
- Non-VQA product is priced competitively against imports
- VQA products are priced in some cases above imports

**Overall Performance**

### Investment and Innovation

- More industry information is required for this pillar
- On select government programs there is positive correlation between government spend and private sector spend and or sales performance

**Overall Performance – limited data, however leverage of government funding was positive, concerns on innovation**

- Positive trend, increasing performance
- Mixed trend, some concern
- Negative trend, or area of concern
**Observations**

- Average BRIX level (a measure of sugar content) in grapes produced exceed VQA standards by over 11% over the last five years.
- This quality standard has not been isolated to a few grapes but across a number varietals.

**Improvement Areas**

- Though BRIX level is a key indicator as to quality, and is a measurement that is not subjective, one measurement reference is not ideal. As such the industry should begin to track more quality indicators.
- These indicators could range from vineyard characteristics such as crop yield and canopy area to other chemical composition measurements.
Quality – Wine

**Observations**
- Ontario wines are improving their performance in Canadian competitions.

**Improvement Areas**
- Wine quality is subjective by nature, and as such it is more critical in this area to provide multiple points of reference. The industry should look at conducting and measuring judging panel determinations, as well as formal consumer evaluations.

Source: Wine Access Magazine
Market performance – Grape

Observations

• The potential implications of the calculations of theoretical demand to the left, without knowing blend ratio and yield differences, shows a higher level of grape purchases than grape usage resulting in potential oversupply of grapes. Further information is required to understand the potential implication.

• The calculation is a hypothetical calculation and changes in the assumptions could lead to materially different results. Additionally differences in this type of calculation can also be explained by the healthy building of inventory levels as well as other normal business practices.

Improvement Areas

• The disclosure and tracking of industry inventory, from an organization like the AGCO, would assist significantly in the analysis of grape demand and supply and provide the industry and its participants with a supportable market analysis.

Estimated Usage of Grapes

VQA Usage 46%
ICB Usage 54%

Source: Grape Growers of Ontario Annual Reports, Deloitte calculations
Market performance – Grape

Blending Materials Analysis

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Imported Wine (litres)</td>
<td>36,406,730</td>
<td>25,178,128</td>
<td>15,361,137</td>
<td>25,504,088</td>
<td>23,930,798</td>
</tr>
<tr>
<td>Imported Concentrate (litres)</td>
<td>337,989</td>
<td>144,453</td>
<td>285,140</td>
<td>744,506</td>
<td>596,561</td>
</tr>
<tr>
<td>Imported Grape Juice (litres)</td>
<td>1,595,115</td>
<td>1,586,333</td>
<td>1,236,323</td>
<td>1,481,858</td>
<td>736,823</td>
</tr>
<tr>
<td>Total</td>
<td>38,339,834</td>
<td>26,908,913</td>
<td>16,882,599</td>
<td>27,730,452</td>
<td>25,264,181</td>
</tr>
</tbody>
</table>

Ontario VQA Sales (litres) | 9,834,332 | 19% | 10,946,596 | 20% | 12,301,036 | 22% | 14,137,845 | 25% | 14,409,913 | 25%
Ontario Non-VQA Sales (litres) | 42,813,809 | 81% | 43,589,780 | 80% | 43,399,584 | 78% | 42,550,913 | 75% | 43,115,367 | 75%
Total Ontario Sales | 52,648,140 | 54,536,376 | 55,700,619 | 56,688,758 | 57,525,280

| Imported blending materials as a % of Non-VQA Sales | 89.6% | 61.7% | 38.9% | 65.2% | 58.6% |

Observations

• Imported bulk blending material has decreased since 2007.
• If we use the assumption that non-VQA sales is representative of ICB production, there is also a declining trend of the percentage of materials used in this product.
• The rapid decrease in 2009 was not driven by any regulatory factor.

Sources: Imported data – Alcohol and Gaming Commission of Ontario
Ontario sales data - LCBO Scorecard and Monthly Reports (sales at LCBO, WRS, DD and Vintages)
Observations

- VQA sales growth in litres has exceeded the growth of other categories (imports and non-VQA) over the last five years. Additionally VQA sales is out pacing the total growth rate of the market. However VQA sales still only represent a small percentage of the total market.
- Import sales are tracking just above total market growth.
- Non-VQA sales have seen only nominal growth and is below the market. However the non-VQA product category is a significant category as it is more than twice the size of the VQA category.

Improvement Areas

- To assess the industry regarding the efficiency of its sales growth, an analysis of marketing spend per liter and marketing spend per dollar of revenue should be performed.
- Understanding the marketing spend of other jurisdictions in comparison to the Ontario industry would be a useful benchmark.
Financial – Grape

**Observations**

- The average price per tonne has decreased over the last five years.
- Part of this decrease is due to the “plateau pricing” concept that was developed by the Grape Growers. Growers switched growing and pricing strategies to address this initiative.
- Ontario average costs per tonne are below some comparable jurisdictions.

**Improvement Areas**

- More reliable cost surveys regarding grape production could be utilized to better understand the profitability of production.

**Price Competitiveness**

*Competitive set includes (Cal., Oregon, NY, Wash, BC)*

<table>
<thead>
<tr>
<th>Year</th>
<th>Composite Price Avg.</th>
<th>Difference as a %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>$1,768</td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>$1,671</td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>$1,601</td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>$1,711</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>$1,575</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>5 Year Average Composite Price - Ontario</th>
<th>5 Year Average Composite Price - Set</th>
<th>Difference as a %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>1,654</td>
<td>1,961</td>
<td>-15.6%</td>
</tr>
</tbody>
</table>

Sources:
- Ontario average price per tonne – Grape Growers of Ontario Annual Report
Financial – Wine

**Observation**
- Average VQA Price has increased on a per bottle basis.
- Non VQA wine prices have increased but to a lesser degree.
- Overall average sales price is increasing. This combined with lower grape input prices should support an increase in overall margins.
- The average retail list price (not weighted to sales) shows the Ontario prices are competitive on a price point basis.

**Improvement Areas**
- Getting greater detail around total cost of wine production via a cost survey would provide a better perspective related to the overall financial performance of the industry.
- Only LCBO data is utilized. However, having data for all distribution outlets would provide greater insight.
- Obtaining pricing trend analysis for imports as a comparison benchmark for Ontario products.

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*Source: Monthly LCBO Reports*

Note Average price is determined by total sales divided by total liters sold.

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*Source: LCBO Price List effective 10/10/2011*
The above chart includes only known investments and as such the total investment by the industry may be significantly higher.

### Observations

- **Significant leverage of public sector funding by known private investments occurred in the past five years. Over the last five years public sector funds have been leveraged up 227%, and this is based only on known investments.**
- **The significant increase in 2011 is mainly the result of the Ontario Vineyard Improvement Program (OVIP). The government provided funds of $2,615,000 to cover 35% of the project costs, the remainder of the project costs were covered by the industry participants.**
- **Agriculture & Agri-Food Canada provided $1,900,000 in 2011 to assist with the development of the innovative Agri-Products Initiative.**

### Improvement Areas

- **Develop the ability to track investments in the grape industry that are not captured within the programs.**

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**Key Investment Spending**

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Private Sector</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wind machines (estimated)</td>
<td>2,250,000</td>
<td>2,250,000</td>
<td>2,250,000</td>
<td>2,250,000</td>
<td>2,250,000</td>
</tr>
<tr>
<td>Industry funded research</td>
<td>53,865</td>
<td>49,406</td>
<td>89,807</td>
<td>55,660</td>
<td>122,661</td>
</tr>
<tr>
<td>OVIP - industry participants</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>4,856,429</td>
</tr>
<tr>
<td><strong>Private sector funds</strong></td>
<td>2,303,865</td>
<td>2,299,406</td>
<td>2,339,807</td>
<td>2,305,660</td>
<td>7,229,090</td>
</tr>
<tr>
<td><strong>Public sector</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Research and promotion</td>
<td>625,923</td>
<td>593,587</td>
<td>336,170</td>
<td>479,977</td>
<td>694,741</td>
</tr>
<tr>
<td>Agriculture &amp; Agri-Food Canada</td>
<td></td>
<td></td>
<td></td>
<td>1,900,000</td>
<td></td>
</tr>
<tr>
<td>OVIP - government portion</td>
<td></td>
<td></td>
<td></td>
<td>2,615,000</td>
<td></td>
</tr>
<tr>
<td><strong>Public sector funds</strong></td>
<td>625,923</td>
<td>593,587</td>
<td>336,170</td>
<td>479,977</td>
<td>5,209,741</td>
</tr>
<tr>
<td><strong>Total Investments</strong></td>
<td>2,929,788</td>
<td>2,892,993</td>
<td>2,675,977</td>
<td>2,785,637</td>
<td>12,438,831</td>
</tr>
</tbody>
</table>
Observations

- There has been an increase in total listings of domestic products which indicate new brands and products coming to the broader market.
- Though it is difficult to directly tie the VQA support program to sales as there are other factors contributing to the growth of VQA sales, there is a positive trend in VQA sales and thus a positive trend to the ratio of sales to support.
- According to a KPMG November 2011 report, the average economic impact per litre of VQA sold is $12.29. From 2008 to 2011, VQA sales have increased by approximately 3.5 million litres, in turn generating over $43 million of economic impact.

Improvement Areas

- Require greater analysis and information sources on innovation in the winery industry including analysis of new brands and products as well as investments made by wineries in R&D and capital investments.
- As noted previously, analysis of total marketing spend per liter or per revenue dollar is required.
- As noted previously, gaining greater transparency into total sales for all channels would provide better analysis.