

5 February 2016

Budget Policy Division
Department of the Treasury
Langton Crescent
PARKES ACT 2600

Via email: prebudgetsubs@treasury.gov.au

Pre-Budget Submission from the Winemakers' Federation of Australia for 2016-17

In our recent submission to the Department of Treasury for the separate WET Rebate Discussion Paper policy process (made jointly with Wine Grape Growers Australia), we raised a number of matters that are of direct relevance to the preparation of the 2016-17 Budget. These matters go to the heart of addressing fundamental structural reform for our industry and are the key to a return to profitability.

As such, we recommend consideration of these same matters as priorities for the Australian Government to help deliver a strong, sustainable wine industry in 2016-17 and beyond. Please find attached our submission to the WET Rebate Discussion Paper.

We commend the recommendations made in this recent submission and look forward to continuing our dialogue with the Australian Government towards the realisation of a more prosperous and sustainable Australian wine industry; characterised by growing demand and export growth, renewed innovation in strong brands that can command and sustain consumer loyalty here and overseas, and ongoing investment and employment growth in Australia's regions.

Yours sincerely,



Paul Evans
Chief Executive

Attachments:

1. WFA and WGGGA Joint Submission to the WET Rebate Discussion Paper, 11 September 2015; and
2. Submission Appendices A-F.



Submission to the WET Rebate Discussion Paper

11 September 2015



Winemakers'
Federation of
Australia



Wine Grape Growers Australia

Contents

1. **Introduction**
2. **The Recovery of the Australian Wine Industry and the Case for Increased Funding for Marketing and Growing Demand**
3. **Retaining the WET Rebate with Reforms**
4. **Summary of Recommendations and Budget Impacts**
5. **Background on the State of the Industry, Economic Contributions and Challenges**
6. **Conclusion**
7. **Responses to the 19 'Discussion Paper' questions**
8. **Appendix**
 - A. Letters of Support from State Wine Organisations
 - B. Snapshot of the industry
 - C. Actions for Industry Profitability 2014-2016
 - D. Legal Advice, "Returning WET Rebate to Fairness and Original Policy Intent" Finlaysons Lawyers
 - E. Economic Modelling, "Returning WET Rebate to Fairness and Original Policy Intent – Supporting Advice on the Impact to Government Revenue", PwC
 - F. WFA Vintage Report July 2015

1. Introduction

The Winemakers' Federation of Australia (WFA) and Wine Grape Growers Australia (WGGA) are pleased to make this joint submission to the Federal Government's discussion paper on the future of the Wine Equalisation Tax (WET) rebate. As the two national peak bodies representing winemakers and grape growers, we are proposing that the WET rebate be retained and that certain reforms are undertaken to restore its integrity and deliver its original policy intent.

Our proposals detailed in this submission have been developed over 2 years and are backed by extensive analysis, industry-wide consultation, independent modelling, expert legal advice and consensus decision-making. We believe they have majority support in the industry as evidenced by the backing from the memberships of the two national peak wine organisations and the letters of support for this submission from all state wine organisations which are attached.

The WET rebate remains an important revenue source for wine producers in both the fine wine and commercial segments which are struggling with a decline in export sales and intense competition in the domestic market. Similarly, it is important for some grape growing businesses who, due to the loss of supply contracts, have chosen to make wine. It is clear that a significant number of grape and wine businesses would be severely impacted financially without access to the rebate. Whether originally intended or not, the rebate has been factored into business models and pricing strategies at all points in the supply chain.

There are also widespread concerns that the WET rebate has evolved beyond its original intent of supporting local employment and tourism in wine regions, and is being compromised on three fronts:

- 1) The ability of brokers, intermediaries and uncommercial arrangements to access the entitlement;
- 2) The role of the rebate in delaying the correction to the supply/demand imbalance by underpinning the conversion of uncommercial grapes into bulk wine and ultimately low-equity cleanskins and home brands; and
- 3) The ability of New Zealand entities to access the entitlement on unfair and preferential terms.

WFA and WGGA, with the support of all state wine industry associations, are backing reforms to the rebate. The proposals outlined in this submission will better align the rebate's originally intended purpose and benefits with the future sustainability of the wine industry. In summary, we believe that the Government should;

- Stop the WET rebate going to unintended recipients and shut down the schemes;
- Keep the WET rebate within the original policy intent of delivering long-term benefits to industry and tourism in regional Australia;
- Phase out the WET rebate on bulk and unbranded wine over four years because we need strong brands to command margin and loyalty from consumers and retailers and to generate the profits that can be reinvested back into regional Australia;
- Abolish the separate New Zealand rebate scheme and its preferential treatment of NZ producers and replace with a 'level playing field' for all rebate claimants regardless of nationality;

- Encourage consolidation by introducing transitional rebate measures to allow the second rebate on a merger of two businesses entitled to the rebate to remain with the new entity but be phased out at 25% per year over 4 years.

The details of each of these reform measures and what the Government must do to deliver them are in this submission. Each can be introduced and implemented quickly and we request the Government make these changes urgently at MYEFO 2015.

Once implemented, WFA and WGGA will, in consultation with industry, analyse the impact of reform and continue to assess the WET rebate and whether further policy reforms are required including those options raised in the Discussion Paper. Our shared focus remains on facilitating a return to sustainable profitability for the industry and any further reform measures that emerge in the future to help deliver this outcome will be considered closely. Improving the level of data and analysis on WET rebate claimants by the ATO, and sharing this with industry, will also play a critical role in enabling informed policy development.

In proposing our reforms to the WET rebate, global accounting firm PwC have conservatively estimated \$278million over four years in potential savings to the Commonwealth. We are seeking \$44m of these savings to be returned by the Government to the industry's statutory authority – the *Australian Grape and Wine Authority* (AGWA) – to supplement their marketing budget for the promotion of Australian wine in key overseas markets. The timing for this measure is now, given the growth opportunities afforded by an improvement in the AUD/US exchange rate and early signs of strengthening consumer interest in the prized North American market.

Boosting the promotional activities of AGWA as outlined in this submission will also maximise the potential export opportunities created by the Government's signing of recent Asian Free Trade Agreements that are critical to the cost competitiveness of Australian wine. This would serve as an important demonstration of the Government and industry working hand-in-glove for the global success of an iconic, regionally-based and globally competitive Australian industry.

Companies have always assumed a prominent role in promoting Australian wine overseas. Their contribution to raising the perception of Australian wine as a category, through their own example, has been weakened by low profitability. Boosting contributions to, and making eligibility for the Government's Export Market Development Grants more flexible, will also help kick-start company promotions and activity in overseas markets.

Notwithstanding the importance of a demand-led recovery, continued adjustment in supply will also contribute to improved market prospects of Australian wine by accelerating the transition and improving the supply-demand balance.

Moreover, WFA and WGGA recognise that some support will be required for grape and wine businesses that will be adversely impacted by the reform measures proposed in this submission.

Provisionally, the support may include transition programs when WET rebate access is removed or adjustment programs that facilitate uptake of more suitable business models, initiatives to address barriers to vineyards exits, to facilitate quicker turn-over in vineyards, capability building among

vineyard operators, improving market operations that hasten market forces to bring about adjustment or innovation in vineyard management.

WFA and WGGA will develop such proposals further in consultation with AGWA and the Government.

WFA has undertaken over two years of industry-wide consultation and detailed analysis in preparing the proposals outlined in this submission. They are supported by the two national peak wine industry associations because they will help deliver an uplift in demand and adjustment in the supply-demand imbalance. The resulting improvement in prices, wine company and grape grower margins, and investment in regional winegrowing communities will be timely and urgent given the lengthy downturn the industry has already endured.

We look forward to working closely with the Government on the recovery of the wine sector and on delivering the outcomes of the Discussion Paper at MYEFO 2015.



Paul Evans
Chief Executive Officer
Winemakers' Federation of Australia



Lawrie Stanford
Executive Director
Wine Grape Growers Australia

2. The Recovery of the Australian Wine Industry and the Case for Increased Funding for Marketing and Growing Demand

The Winemakers' Federation of Australia (WFA) has developed a comprehensive plan to restore profitability to our wine businesses and secure the futures of those regional communities and jobs that depend on their success. This blueprint for recovery entitled "*Actions for Industry Profitability 2014-2016*" (referred to as the 'Actions') was developed following extensive industry consultation and has the majority support of the Australian wine industry. It was publicly released in December 2013 and incorporated the findings of an independent expert review on the profitability and dynamics of the Australian wine industry, completed in August 2013.

While implementing the WFA Actions for the industry's recovery continues to be led and predominantly financed by industry, it also requires Government support to:

1. Provide finite funding of \$43.4m¹ over four years to the Australian Grape and Wine Authority (AGWA) to grow the demand opportunity for our wine and multiply the benefits of recent FTAs; and
2. Retain the rebate but make limited legislative changes to the eligibility for the Wine Equalisation Tax (WET) producer rebate to restore integrity and return the rebate to its original policy intent and to ensure it is financially sustainable.

These two initiatives stand on their own and should both be progressed by the Government. As a package they will also enable Government to:

3. Use the significant savings from WET rebate reform to fully offset the \$43.4m in proposed new spending to AGWA and to deliver a conservatively estimated net savings to the Commonwealth of at least \$234m over the Forward Estimates.

WFA's proposals are underpinned by detailed legal advice on what specific reforms are needed and the basis for those changes. Our recommended saving measures are fully costed with supporting economic modelling provided by PwC..

1. Provide finite funding of \$43.4m over four years to AGWA to grow the demand opportunity for our wine

Background

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.

However, from 2007 a confluence of events confronted the sector with a number of challenges that are on-going:

- The global financial crisis hit world markets starting in August 2007 and accelerated through 2008—coinciding with a significant fall in Australian wine exports. Export volumes recovered

¹ In WFA's Pre-Budget Submission, the figure of \$25million was proposed. Subsequent further consultation with AGWA has confirmed the need for an increase to this figure, in large part owing to the poor performance of Australian wines in the North American market in spite of the recent turn around in the AUD/US exchange rate and to maximise the export opportunities created by the recent Asian FTAs.

through 2009, only to fall again in 2010 and 2011 including a fall in demand for Australian wine in key markets, especially the US, UK and Canada, from 2007 to 2012.

- From 2004 the Australian dollar rose steadily to almost parity in July 2008. A sharp fall to 62 cents in August 2008 preceded a steady climb to parity in November 2010 and beyond.
- Domestic retail consolidation which has resulted in approximately 77% of all off-premise wine sales now being controlled by the two national grocery chains.
- Flat domestic demand growth and an increase in imports.
- A supply-demand imbalance resulting from excess planting and wine making capacity given the 'unexpected' fall in export demand and rise in the Australian dollar.

The priority Actions for the sector's recovery are those aimed at rebuilding global demand for Australian wine by boosting the marketing and promotion of our offering. Australian wine at all price points continues to be a globally competitive product and our Actions focus on securing the necessary funding required by AGWA to market and promote our wine to the world.

The need to secure \$43.4m of government funding over four years for AGWA is urgent and has strong backing from industry. The recent decline in the Australian dollar and some early signs of strengthening consumer demand (particularly in the key U.S. market) opens a limited window of opportunity for Australian wine to recapture the attention of our traditional markets. The recent signing of important FTA's in key Asian markets also provides an opportunity to multiply the benefits generated by the reduction in tariffs with in-market promotional campaigns. The newly appointed Board of AGWA has developed its 5-Year Plan in response to these developments and the time to provide additional funding is now.

If adequate resources are not secured to seize the potential created by this positive confluence of events, Australia will continue to struggle to remain competitive against lower cost New World wine producers and Old World wine producers who enjoy substantial government subsidies². In comparison since 2005/06 the industry-sourced annual revenue base of the Wine Australia Corporation (now AGWA) has been steadily eroded by around \$4m, reducing both core operating capability (including staffing and offices in key overseas markets) and the reach and impact of our promotional activities aimed at influencing wine buyers. Total AGWA expenditure on marketing activities is estimated to decline to \$5.6m in 2014/15. This decline in the capacity to spend on marketing Australian wine has led to the Australian category losing support among some traditional distributors and importers and potentially we are not well placed to capture the full opportunity presented by the 'Asian Century' and emerging markets such as China.

Following consultations with AGWA and the broader industry, we recommend a minimum of an additional \$2m per annum is required over the next three years to supplement AGWA's current operating budget. This short-term assistance will provide AGWA with the means to restore our core global marketing capabilities and an appropriate level of global representation. To enable AGWA to also undertake the specific in-market activities we believe are required, a further \$10.9m in Year One, \$12m in Year Two and \$10m in Year Three and \$4.5m in Year Four will also be needed. While this support will see the annual budget for AGWA exceeding previous levels, we believe this investment, along with the implementation of the other Actions by industry, will deliver uplift in performance and profitability. In turn, this will restore levels of industry contributions and enable the sector to once again meet its own marketing needs by the end of the Forward Estimates. That is why all the proposed spending proposals in this submission are short-term or one-offs.

By making this investment, WFA and WGGA believe we can increase the market share, support regional economies and employment and grow the tourism spend. In time, this will enable the level of industry contributions to AGWA to recover.

² Under the Common Agriculture Policy, the EU spent approximately €143 million in 2012, and another €228 million in 2013, on promoting the wine exports of countries such as France, Italy and Spain

Recommended Measures

AGWA should be adequately funded to rebuild its core operational capability.

As noted above, AGWA has faced declining levy-based budgets and increasing fixed costs, and therefore has significantly reduced operating costs, restructured its operations and made difficult decisions about where to focus limited resources. Indeed, additional cuts will be required if alternate revenue sources cannot be found, including further reductions to in-market representation and the withdrawal from some markets altogether. It is estimated that to reach the desired level of operating capability, AGWA will require an additional \$2m per annum over the next three years.

Recommendation 1.1

Measure: Government to assist in rebuilding AGWA's core operating budget

Budget Implication: \$2m from 2015/16 for three years.

	Year 1	Year 2	Year 3	Year 4
1.1 Government to assist in rebuilding AGWA's core operating budget	(\$2m)	(\$2m)	(\$2m)	

Global Marketing Activities

In recognising the critical importance of category-level marketing to growing demand for Australian wine and shaping appreciation for our diversity and quality, we believe there are a number of existing and potential AGWA programmes that will re-engage international and domestic consumers 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.

WFA believes we need to reposition Australia's best wines as being second to none, and also promote the quality, diversity and value of the wider Australian branded category. 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. The specific programme initiatives are:

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.

2. Implementing the Food and Wine Strategy

Under its MOU with AGWA, 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.

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 AGWA'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 AGWA 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.

4. *Visitors Program*

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.

5. *Domestic wine tourism, social media and regionally-based initiatives*

WFA also supports increased investment in domestic marketplace initiatives and the development with the trade of 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. Such programs could potentially link with other industries, including food and tourism and take full advantage of the recent decline in the Australian dollar against the currencies of importing countries.

We are also seeking support for AGWA to develop and execute two new industry wide initiatives:

- A social media-based platform to promote Australian wine: While many cellar door operators already have successful web-based sales formats, research on the potential of social media and web-based sales platforms can provide AGWA with a better understanding of the opportunity for the sector and how best to leverage the category offering online.
- Regional promotions: In partnership with progressive regions, AGWA with the support of the Australian Government to undertake 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.

6. *Savour Australia 2016*

The benefits of government support for staging key events has been evidenced by the success of the Savour Australia 2013 event which has already had a significant impact on demand for Australian wine internationally. The event was a major success that leveraged a government grant for the benefit of the industry and the country as a whole.

Savour galvanised the Australian wine industry and restored some much needed confidence. The industry has fed off the excitement generated by the event and is continuing to maintain the momentum. The industry's focus over the next 12 months will be to build on the Savour momentum and growing that positive sentiment to get more quality Australian wines on the world's retail shelves and wine lists.

AGWA is building on the overwhelmingly positive feedback from Savour Australia 2013 through a global program of industry-funded educational initiatives, tastings, masterclasses, trade and consumer events and retail promotions in all our markets over the coming months.

These include the Australia Day tasting in the UK, ProWein in Germany, Aussie Wine Month in Australia, the China National Food, Wine and Spirits Fair, the AGWA Trade Roadshow in the US and the in-store tastings with various liquor boards in Canada.

Delegate feedback suggests the Australian wine industry and the global wine trade generally see great value in Savour and would like it to become a regular event on the world's wine calendar with a strong link to Australian food also benefiting the broader agricultural industry.

Recommendation 1.2

Measure:

AGWA to be funded to:

- Increase our presence at international trade shows - \$1m in Year Two and Year Three
- Enhance the partnership opportunities with Tourism Australia - \$2.5m in Year Two and Year Three
- Invest in education programmes in key markets - \$0.5m in Year Two and Year Three
- Expand the Visitors Program - \$0.5m in Year Two and Year Three
- Support domestic wine tourism, social media and regionally-based initiatives - \$1m in Year Two and Year Three
- Host Savour Australia in May 2016 - \$2m in Year One

Budget Implication:

	Year 1	Year 2	Year 3	Year 4
1.2 AGWA to be funded to undertake various promotional and marketing activities	(\$2m)	(\$5.5m)	(\$5.5m)	

Re-launching Australian Wine in the U.S.A.

WFA is aware that AGWA has written to the Australian government seeking funding to support Savour Australia in 2016 and a significant marketing campaign in the United States. In the *Actions for Industry Profitability 2014-16 Report*, WFA identified the key importance of the United States market and rebuilding the image of Australian wine in that market.

The United States is the world's biggest wine market with sales of 3 billion litres valued at US\$40 billion in 2013. It has also been Australia's second biggest export market in volume behind the United Kingdom for the last 15 years and number one in value for the last five years.

In 2013-14, 6.5 million cases of wines (domestic and imported) were sold in the US off-trade at over US\$15 per bottle, up 7% on the previous year. However, Australia is significantly under-represented in this segment.

Research undertaken by Wine Intelligence suggests that Australia is losing its reach in the US with the number of Australian wine drinkers falling from 42% of the wine drinking population in 2008 to 27% in 2013. Furthermore, the quality perception of Australian wines among consumers is the lowest among the seven key imported wine suppliers to the market and has not changed since 2010. This is mainly due to the fact that 93% of Australia's sales in the US are at under US\$8 per bottle while only 62% of the market is in this segment. Feedback from US distributors suggests that the best opportunity for Australia lies at \$US15-\$25 segment. Unlocking this opportunity is paramount and requires significant investment.

Feedback also suggests that there are also opportunities at the higher value end of the market. In 2014, Australian wine exports to the US at above A\$67.50 per case were valued at A\$51million compared to A\$210 million in 2007 and a peak of A\$303 million in 2003. Restoring Australia's premium wine exports in the US to the level of seven years ago would return A\$159 million per annum to the Australian wine sector.

To realise these benefits, it is important to boost Australian wine's efforts in the USA. This would in turn continue to expand the impact of Savour Australia as a global event.

The proposed AGWA campaign is supported by WFA and WGGA and is directionally consistent with the recommendations of the WFA 'Actions' document. Key initiatives include:

- A multi-targeted program to engage gatekeepers large and small, including a focused distributor outreach effort via trade-only, business events and media partnerships in trade-only beverage business publications.
- An engaging outreach campaign to target retailers and restaurateurs across the US, with long 'Savour' lunches and compelling Australian visits.
- For consumers, a guerrilla PR campaign across 10-12 US cities, complete with a tour-vehicle 'pop-up' themed wine truck. A media-partnership with Food & Wine Magazine and Events to layer in lead sponsorship of their top five large-scale consumer (and VIP trade) events of the year.
- Two comprehensive Visitor Programs (VP): one for distributors and national accounts – with strong business and logistics focus sessions and engaging trend spotting activities; the other for media, independent retail and the restaurant community focused more on engaging, inspiring education and perception shifting activities.
- Throughout all programs, AGWA will overlay the Restaurant Australia themes, through Tourism Australia's campaign, as well as regional/premium messaging.

Since WFA lodged its Pre-Budget Submission with the Government, Australian wine has continued to struggle against its competitors in the prized North American market. As such, WFA has worked with AGWA to identify what additional programmes are required to support a demand-led recovery in this key market. These programs are as follows:

1. *USA Roadshow*

The purpose of this program is to expand the opportunity for North American wine trade across all offerings – entry level, premium and luxury. The USA Roadshow would take the major in-country markets centred around the cities of Los Angeles (California), Chicago (Illinois), New York (NY), Austin (Texas) and Miami (Florida).

2. Restaurant Australia USA Roadshow

This program is about expanding the perception of Australian food and wine across North America, with Tourism Australia as a driving partner. This program is focussed on an Australian premium message on food and wine.

3. G'DAY USA

This would involve sponsorship of G'Day Australia in the USA and the promotion of Australian wine being aligned with all G'Day Australia fashion and key media activity. This program allows expansion of messaging to both trade media and to consumers in the USA to change the perception of Australian wine and amplify the "premium" Australia message.

4. USA Ambassador Investment

Australian celebrities with a positive profile in the USA have the potential to influence and change the perception of Australian wine among North American consumers. Messaging will promote wine's "fashion status".

Recommendation 1.3

Measure: Re-launching Australian Wine in the USA

Budget Implication: \$12.6m over four years

	Year 1	Year 2	Year 3	Year 4
1.3 Re-launching Australian Wine in the USA <ul style="list-style-type: none">•USA Roadshows•Restaurant Australia USA Roadshow•G'Day USA•Ambassador Investment	(\$6m)	(3.4)	(1.6)	(1.6)

Maximising the Asian Free Trade Agreements

Since WFA submitted its Pre-Budget Submission it has held further discussions with AGWA on how to grow the demand for Australian wine in Asia and specifically how to maximise the export growth benefits that can be realised from the signing of the Free Trade Agreements (FTAs) with China, Japan and Korea. An additional \$11.8million over four years is sought to support the development and delivery of the following activities:

1. Roadshows across China, Korea and Japan

The roadshow program is about expanding the trade opportunities for Australian wine in China, Korea and Japan to help grow the momentum in all markets, following the Free Trade Agreements. Regional ambassadors would play a role in leading master classes and debates on Australian wine styles and perceptions. One focus would be to target opportunities for 'new-to-market' wineries to enable these wineries to develop in-country contacts.

2. China Wine Showcase

This program would capitalise on the growing momentum in China for the Australian category and support the anticipated Free Trade Agreement with China. The aim is to increase the penetration of Australian wine across the China market, developing market entry opportunities and reinforcing existing distributors and importers in the market. As part of the program, five to six major cities would be toured by a minimum of 50 Australian wineries up to a maximum of 100. Ambassadors would be leveraged to help sell the story of Australian wine.

3. Japan Wine Showcase

Investment in this program would increase opportunities for 'new-to-market' wineries as well support for current importers and distributors. A series of masterclasses and branded wine dinners would form part of the activities and wine ambassadors would help to tell the story of Australian wine's history, evolution and revolution.

4. Market Entry Programmes (China)

Increased investment into Market Entry opportunities to place Australian wineries with new distribution.

5. Ambassador Investment

This program is about developing a network of industry key influencers (on paid retainers) who can change the perception of Australia wine in their key home markets. This will enable Wine Australia to expand critical messaging, tastings and media development on a significant scale.

Recommendation 1.4

Measure: Maximise Asian FTAs

Budget Implication: \$11.8 over four years

	Year 1	Year 2	Year 3	Year 4
1.4 Maximise Asian FTAs <ul style="list-style-type: none">•China, Japan and Korea Roadshows•China Wine Showcase•Japan Wine Showcase•Market Entry Programmes (China)•Ambassador Investment	(\$2.9m)	(3.1)	(2.9)	(2.9)

3. Retaining the WET Rebate with Reforms

Retain the Rebate

It is important to restate that WFA recognises that the WET rebate continues to play a critical role in supporting many grape and wine businesses during a prolonged period of difficult trading conditions. It is clear that without the rebate a significant number of grape and 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 rebate also indirectly benefits many regional communities reliant on winemaking and wine grape growing. Reforms are required, however, to ensure the WET rebate continues to deliver these outcomes in a manner that is in keeping with the rebate's original policy intent and without unintended consequences.

Support on-going Compliance Activities

The industry is concerned that in recent years the number of uncommercial claims on the rebate has increased as speculators and other intermediaries with no long-term interest in the sector enter into business arrangements with the sole purpose of accessing the rebate. The Discussion Paper outlines many of the arrangements. WFA strongly supports the compliance and policing actions of the ATO to stamp these practices out and notes that in 2013/14 some \$47m was recovered by the ATO in fines and adjustments to WET payments.

In relation to compliance and enforcement, WFA and WGGGA will continue to work with the ATO to identify changes that can be made to the interpretation and application of the existing provisions so that eligibility remains in line with the original intent. For example, we believe WFA can assist the ATO in identifying and assessing claim accessibility for uncommercial arrangements. This may occur, for instance, when the ATO forms the view that claimants have split their activities or have colluded in the establishment of business activities with the substantial purpose of claiming multiple rebates. Similarly, there may be occasions where schemes have been established with the sole or dominant purpose of accessing the rebate contrary to the anti-avoidance provisions.

Recommendation 2.1

Measure:	On-going support for ATO and Treasury to continue work with WFA on identifying any changes that can be made to the interpretation and application of the existing WET Rebate provisions so that eligibility is consistent with the original intent of supporting local wine businesses and wine regions.
-----------------	--

Budget Implication:	The ATO has stated that its compliance activities into WET rebate claims have already recovered over \$47m in penalties and adjustments in 2013/14. For the purposes of this submission, we have conservatively estimated no ongoing savings to the Commonwealth from on-going compliance activity but it is likely to be substantial.
----------------------------	--

	Year 1	Year 2	Year 3	Year 4
2.1 On-going support for ATO and Treasury to continue work with WFA on identifying any changes that can be made to the interpretation and application of the existing WET Rebate provisions so that eligibility is consistent with the original intent of supporting local wine businesses and wine regions.	Nil			

Reform Rebate Eligibility

WFA has identified certain legislative changes that are required to further ensure the WET rebate continues to deliver its original policy intent, namely to support local grape and wine businesses and wine regions. The consequences of our proposals will be to restrict future rebate eligibility to those grape and wine businesses (regardless of nationality) with an investment in regional Australia and who have a long-term commitment to the industry in supporting branded wine product. This approach will ensure the rebate continues to support rural and regional Australia.

In regards to the specific legislative changes required to ensure the WET rebate continues to deliver the original policy intent, WFA believes the Government should restrict future rebate eligibility to producers who:

- have business premises in Australia (potentially, in a designated wine region in Australia); and
- hold a licence, issued by the Government of a state or territory in Australia, to sell liquor in that state or territory; and
- are self-employed or engage one or more employees (including associates of the winemaker) to perform work for the winemaker; and
- sell their wine either:
 - by retail sale, or under quotation, from the business premises referred to above; or
 - by internet or mail order sales (in which case the sales would be deemed to take place at the above premises).

These changes will ensure that all future recipients of the rebate have an investment in regional Australia and must continue to reinvest in local communities. These changes, in concert with the recommendation below to abolish the separate New Zealand producers' WET rebate arrangement, have the additional benefit of creating a level playing field for all claimants regardless of nationality. Wine businesses producing branded product will not need physical production assets to claim the rebate.

Recommendation 2.2

Measure:

Government to retain the WET rebate but undertake legislative reform as soon as possible so it is claimed in accordance with its original policy intent to support local wine businesses and regional communities. The legislative changes sought from Government would see the WET rebate only available to wine businesses that:

- manufacture and sell wine in a form fit for retail sale, where the finished product is identifiably theirs; and
- have business premises in Australia (potentially, in a designated wine region in Australia); and
- hold a licence to sell liquor in an Australian state or territory; and
- are self-employed or engage one or more employees; and
- sell their wine either: (i) by retail sale, or under quotation, from the business premises referred to above; or (ii) by internet or mail order sales.

Budget Implication:

While there are no savings estimated for this measure, it should be noted that introducing the proposed eligibility criteria outlined above will ensure future claims are reduced from potential claimants, regardless of nationality, who do not have investments in regional Australia. This will ensure the WET rebate continues to deliver its original policy intent and that it is returned to a more sustainable fiscal base. Combined with the abolition of the separate New Zealand rebate arrangement as proposed below, it will also ensure that all future claimants are on a level playing field in regards to the cost of compliance.

	Year 1	Year 2	Year 3	Year 4
2.2 Government to retain the WET rebate but undertake legislative reform as soon as possible so it is claimed in accordance with its original policy intent to support regional communities. The legislative changes sought from Government would see the WET rebate only available to wine businesses that: <ul style="list-style-type: none">• manufacture and sell wine in a form fit for retail sale, where the finished product is identifiably theirs; and• have business premises in Australia (potentially, in a designated wine region in Australia); and• hold a licence to sell liquor in an Australian state or territory; and• are self-employed or engage one or more employees; and• sell their wine either: (i) by retail sale, or under quotation, from the business premises referred to above; or (ii) by internet or mail order sales.	Nil	Nil	Nil	Nil

WFA and WGGA believe that bulk, unpackaged, unbranded wine that is only facilitated by artificially low on-sell prices and topped up by WET rebate receipts both impoverishes winegrape growers and diminishes the ability of winemakers to build brand equity and margins with retailers and consumers. Therefore, the Commonwealth should phase out WET rebate eligibility for bulk and unbranded wine at 25% per year starting at 75% of the rebate rate from implementation.

This can be achieved by changing the legislative definition of rebatable wine for the WET rebate to:

*'rebatable wine means *grape wine, *grape wine products, *fruit or vegetable wine, *cider or perry, *mead or *sake, that is packaged in a single container with a capacity not exceeding 5 litres at the time of the dealing, and which is labelled with a brand on the primary packaging that is wholly owned by, or licensed exclusively to, the producer of the wine.'*

This proposal would continue to support the industry consistent with the original intent of the rebate discussed above. By way of example, it would enable the following activities to continue to claim the rebate:

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

These legislative changes are expected to deliver significant budget savings as summarised below.

Recognising an impact of this reform on bulk and unbranded wine traders, WFA and WGGA proposes to phase out the WET rebate on bulk and unbranded wine at the rate of 25% per annum, starting at 75%. These reforms will encourage the re-emergence of 'brand power' and equity which is critical to capturing above inflation retail price increases, increased margin share with retailers, higher grape prices and reinvestment back into rural communities.

'Cleanskins' and unbranded wine work against these objectives and therefore do not play a long-term role in encouraging sustained regional investment or development. They crowd the domestic market with low equity offerings sourced from contract-made wine made from grapes which are uncommercial and sold at prices below market value due to the ability of the producer to claim the rebate and defer the WET liability to the retailer utilising the quoting provisions available within the WET arrangements. This includes the supply of bulk wine for the home brands of wine retailers. This not only pulls down the pricing for both grapes and wine, it also delays the correction to the supply-demand imbalance.

Recommendation 2.3

Measure: Government to retain the WET rebate but undertake legislative reform as soon as possible so it is claimed in accordance with its original policy intent to support local wine businesses and regional communities. The specific legislative changes sought from Government are:

1. Remove eligibility from bulk, unpackaged and unbranded wine to be phased out at 25% over 4 years (costings exclude New Zealand wine).

Budget Implication: Significant savings estimated for the Commonwealth.

	Year 1	Year 2	Year 3	Year 4
2.3.1 Remove eligibility from bulk, unpackaged and unbranded wine to be phased out at 25% over 4 years (excluding New Zealand)	\$29m	\$43m	\$57m	\$73m

To further ensure the WET rebate continues to deliver its original policy intent of supporting local grape and wine businesses and wine regions, WFA and WGGA also recommend that the amendments to the *WET Act* in 2005, which established the New Zealand WET rebate system on preferential terms that are unfair to local claimants, be repealed. To be clear, WFA and WGGA are not seeking to exclude New Zealand producers from claiming the rebate. We are instead seeking to ensure all claimants have access to the rebate under the same conditions irrespective of nationality.

Currently, the separate New Zealand rebate scheme provides New Zealand producers with an unfair commercial advantage over local and other foreign claimants as they are not required to be registered for Australian GST and are not subject to compliance costs associated with lodging an Australian income tax return. As outlined in the attached legal advice...

...foreign winemakers who receive the WET rebate are: (1) treated as having derived Australian income; and (2) therefore required to lodge Australian income tax returns.

However, NZ winemakers are not required to lodge Australian income tax returns, as the WET producer rebate is considered to be assessable in NZ and not Australia.

In addition, NZ winemakers are not required to be registered for Australian GST purposes and hold a state or territory liquor license, unlike Australian wine producers and other foreign wine producers.

NZ winemakers are therefore not subject to the compliance costs associated with lodging Australian income tax returns, Business Activity Statements (BAS), or with ongoing state or territory liquor licensing requirements.

Further, the ATO allows the NZ Inland Revenue to administer the WET rebate for NZ winemakers. The ability for NZ winemakers to deal with their local revenue authority is not available to other foreign wine producers.

These preferential conditions make it easier and cheaper for NZ winemakers to access to the WET rebate, than for other foreign wine producers.

The following table summarises the requirements to claim the producer rebate, and the benefits afforded to NZ wine producers that are not available to other foreign wine producers.

<i>Claim requirements under the current WET producer rebate schemes</i>			
	<i>Australian wine producers</i>	<i>New Zealand participants</i>	<i>Other foreign wine producers</i>
<i>GST registration required</i>	✓	✗	✓
<i>Wine tax must be paid</i>	✗	✓	✗
<i>Australian income tax obligations</i>	✓	✗	✓
<i>In-country administrative assistance provided</i>	✓	✓	✗
<i>Entity required to be exporter of wine</i>	N/A	✗	✓
<i>Required to hold a State/Territory Liquor License</i>	✓	✗	✓

While some \$25m per annum is currently rebated to New Zealand producers, the abolition of the separate New Zealand scheme plus the proposed changes to future rebate eligibility including the requirement to hold local liquor licences and business premises and the removal of the rebate from bulk and unbranded wine from New Zealand will deliver a net savings to the Commonwealth of \$44.9m over four years.

Applying the proposed changes would look like:

<i>Claim requirements under the recommended reforms to create a level playing field for all claimants</i>			
	<i>Australian wine producers</i>	<i>New Zealand participants</i>	<i>Other foreign wine producers</i>
<i>GST registration required</i>	✓	✓	✓
<i>Wine tax must be paid</i>	✗	✗	✗
<i>Australian income tax obligations</i>	✓	✓	✓
<i>In-country administrative assistance provided</i>	✓	✓	✗
<i>Entity required to be exporter of wine</i>	N/A	✓	✓
<i>Required to hold a State/Territory Liquor License</i>	✓	✓	✓

There is a compelling case to immediately abolish this separate New Zealand entitlement and WFA has supporting legal advice on how this can be achieved in a manner without impacting Australia's trading obligations and bilateral commitments. This advice is attached.

This recommendation has widespread industry support. Some \$25m per annum is currently rebated to New Zealand wine producers and the abolition of the separate New Zealand rebate scheme along with the other reforms to rebate eligibility proposed above will see a net saving of almost \$15m per annum to the Commonwealth and a level playing field created for all future

claimants regardless of nationality (meaning New Zealand producers could continue to claim the WET rebate but on the *same terms* as Australian and other foreign country claimants). This approach is consistent with Australia's bilateral and multi-lateral trading commitments.

Recommendation 2.3

Measure: Government to retain the WET rebate but undertake legislative reform as soon as possible so it is claimed in accordance with its original policy intent to support local wine businesses and regional communities. The specific legislative changes sought from the Government are:

- 2a. Abolition of the separate New Zealand producers' WET rebate scheme.
- 2b. Create a level playing field for all WET rebate claimants regardless of nationality to ensure the rebate continues to support local wine businesses and wine regions (see 2.2) and phase out of rebate for New Zealand bulk and unbranded wine (see 2.3.1).

Budget Implication: Significant savings estimated for the Commonwealth

	Year 1	Year 2	Year 3	Year 4
2.3.2a. Abolition of the separate New Zealand producers' WET rebate scheme	\$7.9m	\$10.1m	\$12.3m	\$14.6m
2.3.2b. Create a level playing field for all WET rebate claimants regardless of nationality to ensure the rebate continues to support local wine businesses and wine regions (see 2.2) and removal of rebate from NZ bulk and unbranded wine (see 2.3.1).				

WFA and WGGA also believe 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. Grape and wine businesses that believe their future lies in consolidation should not be stymied by the unintended consequence of a tax measure. Government should 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.

Recommendation 2.4

Measure: Introduce transitional rebate measures so that, following a merger of two businesses which are both entitled to the rebate, the merged entity can continue to claim the second rebate 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.

Budget Implication: Significant savings estimated for the Commonwealth.

	Year 1	Year 2	Year 3	Year 4
2.4 Introduce transitional rebate measures so that, following a merger of two businesses which are both entitled to the rebate, the merged entity can continue to claim the second rebate but be phased out at 25% per year over 4 years.	\$3m	\$6m	\$9m	\$13m

WFA and WGGA recognise that some support will be required for grape and wine businesses that will be adversely impacted by the reform measures proposed in this submission.

Provisionally, the support may include transition programs when WET rebate access is removed or adjustment programs that facilitate uptake of more suitable business models, initiatives to address barriers to vineyards exits, to facilitate quicker turn-over in vineyards, capability building among vineyard operators, improving market operations that hasten market forces to bring about adjustment or innovation in vineyard management.

WFA and WGGA will develop such proposals further in consultation with AGWA and Government.

Recommendation 2.5

Measure: WFA and WGGA in consultation with Government will develop industry assistance for grape and wine businesses impacted by WET rebate reform

Budget Implication: To be developed and costed

	Year 1	Year 2	Year 3	Year 4
2.5 WFA and WGGA in consultation with Government will develop industry assistance for grape and wine businesses impacted by WET rebate reform	To be advised	To be advised	To be advised	To be advised

**Please note that all the estimates used in this submission used for the proposed savings measures outlined above are detailed in the economic modelling advice from PwC found attached. In all cases the most conservative costings as advised by PwC have been used.*

4. Summary of Recommendations and Budget Impacts

The \$43.4m of new Commonwealth spending over four years proposed for AGWA's marketing activities can be fully offset by the significant savings generated by the WET rebate reforms proposed in this submission of some \$278m. These savings will also continue beyond the Forward Estimates. There is no better plan to secure additional funding for our global marketing efforts and to improve the export performance and profitability of Australian winemakers and grape growers.

	Year 1	Year 2	Year 3	Year 4	Total
Recommended Spending Measures	(\$12.9m)	(\$14m)	(\$12m)	(\$4.5)	(\$43.4)
Recommended Savings Measures	\$39.9m	\$59.1m	\$78.3m	\$100.6m	\$277.9m

An explicit commitment to the Australian wine industry made by Government, WGGGA and WFA as a condition for the merger of the two statutory authorities to create AGWA, was to quarantine R&D levies and the supporting co-contributions from the Government for R&D projects. This was reflected in the enabling legislation for the merger. It is unlikely therefore that industry would support a redistribution of levy funding into the marketing activities outlined in this submission. Any change would require significant industry consultation and legislative reform as required under the Act. WFA and the majority of industry strongly believe the shortfall for marketing of our wine would be better and more expeditiously met over the Forward Estimates by the savings generated by reform to the WET rebate. However, industry acknowledges that once the proposed finite Commonwealth funding commitment ends industry will need to have sourced alternate funding from within the sector.

WFA and WGGGA do not believe the funding shortfall for AGWA's marketing activities can be met by increasing existing compulsory industry levies given the low levels of wine business profitability. Even if there was capacity within the industry to increase levies, the potential sums are insufficient to support the marketing capability and projects we believe are necessary and as detailed in this submission. Doubling of the mandatory export charge, for example, would only increase AGWA funding by \$2.2m per annum.

WFA and WGGGA strongly recommends the Government supports the sector as proposed above at MYEFO 2015.

Commonwealth Spending (\$m)

Recommended Measure	Year 1	Year 2	Year 3	Year 4	Total
1. Grow the demand Opportunity					
1.1 Government to assist in rebuilding AGWA's core operating budget.	(2)	(2)	(2)		(6)
1.2 AGWA to be funded to: <ul style="list-style-type: none"> • Increase our presence at international trade shows • Enhance the partnership opportunities with Tourism Australia • Invest in education programmes in key markets • Expand the Visitors Program • Support domestic wine tourism, social media and regionally-based initiatives • Host Savour Australia in 2016 • 	(2)	(5.5)	(5.5)		(13)
1.3 Re-launching Australian Wine in USA <ul style="list-style-type: none"> • USA Roadshows • Restaurant Australia USA Roadshow • G'Day USA • Ambassador Investment 	(6)	(3.4)	(1.6)	(1.6)	(12.6)
1.4 Maximise Asian FTAs <ul style="list-style-type: none"> • China, Japan and Korea Roadshows • China Wine Showcase • Japan Wine Showcase • Market Entry Programmes (China) • Ambassador Investment 	(2.9)	(3.1)	(2.9)	(2.9)	(11.8)
Industry Assistance 2.5 WFA and WGGGA in consultation with Government will develop industry assistance for grape and wine businesses impacted by WET rebate reform	tba	tba	tba	tba	
Total	(12.9)	(14)	(12)	(4.5)	(43.4)

Commonwealth Savings (\$m)

Please note that all the estimates used in this submission for the proposed savings measures are detailed in the economic modelling advice from PwC. In all cases the most conservative costings as advised by PwC have been used.

Recommended Measure	Year 1	Year 2	Year 3	Year 4	Total
2. Retain with changes to the WET Rebate					
2.1 On-going support for ATO and Treasury to continue work with WFA on identifying any changes that can be made to the interpretation and application of the existing WET Rebate provisions so that eligibility is consistent with the original intent of supporting wine regions.	Nil				Nil
2.2 Introduce a requirement in the legislation that the WET rebate would be only available to producers who: <ul style="list-style-type: none"> • have business premises in Australia (potentially, in a designated wine region in Australia); and • hold a licence, issued by the Government of a state or territory in Australia, to sell liquor in that state or territory; and • are self-employed or engage one or more employees (including associates of the winemaker) to perform work for the winemaker; and • sell their wine either by retail sale, or under quotation, from the business premises referred to above; or by internet or mail order sales (in which case the sales would be deemed to take place at the above premises 	Nil				Nil
2.3.1 Remove eligibility from bulk, unpackaged and unbranded wine to be phased out at 25% over 4 years (excluding New Zealand).	29	43	57	73	202
2.3.2a Abolition of the separate New Zealand producers' WET rebate scheme.	7.9	10.1	12.3	14.6	44.9
2.3.2b Create a level playing field for all WET rebate claimants regardless of nationality to ensure the rebate continues to support local wine businesses and wine regions (see 2.2) and phase out rebate eligibility for NZ bulk and unbranded wine (see 2.3.1).					
2.4 Introduce transitional rebate measures so that, following a merger of two businesses which are both entitled to the rebate, the merged entity can continue to claim the second rebate but be phased out at 25% per year over 4 years.	3	6	9	13	31
Total	39.9	59.1	78.3	100.6	277.9

5. Background on the State of the Industry, Economic Contributions and Challenges

- The Australian wine industry continues to experience low levels of profitability and tough trading conditions.
- Australian wine producers play a critical role in the socio-economic fabric of regional communities, particularly in regards to tourism and regional employment.
- The wine industry is the least consolidated sector within alcohol manufacturing which reduces its ability to leverage economies of scale and command margin from a highly consolidated wine retail sector.

In recent years a range of factors have challenged the Australian wine industry. An independent expert review of the industry dynamics commissioned by WFA in 2013, which can be found in Appendix 2, concluded:

1. The Australian wine industry has a structural mismatch of supply and demand. As a consequence, seasonal improvements such as the Australian dollar depreciation will not address this imbalance in the long-run. If the industry does not undertake structural reforms, the mismatch of supply and demand will persist.
2. The Australian wine industry tripled in size from less than 400 million litres to 1.2 billion litres and achieved total revenues of \$5 billion in 2007, and was very successful at building export markets.
3. Since 2007 the profitability of the Australian wine industry has declined significantly:
 - The global financial crisis hit world markets starting in August 2007 and accelerated through 2008—coinciding with a significant fall in Australian wine exports.
 - From 2004 the Australian dollar rose steadily to almost parity in July 2008. A sharp fall to 62 cents in August 2008 preceded a steady climb back to parity in November 2010 and beyond.
 - Domestic demand growth during the same period has been flat and there has been an increase in wine imports.
 - A supply-demand imbalance has ensued resulting from excess planting and wine making capacity given the 'unexpected' fall in export demand and rise in the Australian dollar.
4. This decline in profitability has intensified:
 - Export returns have declined sharply. Export volumes recovered through 2009, only to fall again in 2010 and 2011 including a fall in demand for Australian wine in key markets, especially the US, UK and Canada, from 2007 to 2012. From 2012 to 2013, export volume decreased by 6%, while export value decreased by 5%.
 - Total industry gross margin has 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. In 2013, using 13 representative companies, average profit margin in the sector was 1.6% compared to -1.4% in 2012.

- Domestic margins have been squeezed by retailers, low demand growth, and increased imports. Domestic retail consolidation which has resulted in approximately 77% of all off-premise wine sales now being controlled by the two national grocery chains.
 - The decline and shift in export demand has created an “oversupply/under-demand” of grapes and wine in certain quality segments. It is estimated that up to 70% of total 2012 wine grape production may be uneconomic with the most significant profitability issues concentrated in lower grade grapes. For 2014, the estimated unprofitable production is 84% of total production assuming cost of production has increased by 3%.
5. Efforts to improve profitability have, in many cases, only reduced the extent of the decline.
 6. There are foreseeable circumstances that would put further pressure on profitability.
 7. The other side of this ‘perfect storm’ is that no single lever will ‘fix’ the problem.
 - Australian Grape and Wine Authority’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.
 8. The industry is not being impacted equally—some players/segments are more affected than others; there are a number of success models.

Since these findings of the expert review were released in 2013, industry fundamentals have not changed. The 2015 Vintage Report found an average crush of 1.67 million tonne, marginally lower than the “average” and while average grape prices have strengthened, this is off a low base.

Below is an extract from the 2015 WFA Vintage Report, see Appendix F for full report.

The 2012 Expert Review analysis on production profitability has been further expanded to include 2015 data. Increasing 2012 cost of production by 1.5%, profitable production across 15 representative regions decreased from 7% in 2014 to 6% this reporting period. Low profitability and breakeven during this time were unchanged, while unprofitable production increased to 85%.

Favourable changes in seasonal market conditions and the macro-economic environment will not be enough to restore the Australian wine sector’s lost share and margin. We need to take pro-active steps with the support of government to boost demand and our resourcing of promotional activities.

The 2016 vintage will continue to present challenges to the industry since we have not seen significant structural shifts.

Contribution to the national economy

The wine industry contributes to the national economy in the following ways:

- The wine industry contributed around \$1.77 billion to the national economy in 2013-14 and this is expected to increase at an annualised rate of 4.3% (vs. annualised GDP growth of 2.5%)
- The wine industry directly employs 16,122 in 1,867 businesses

Wine tourism³

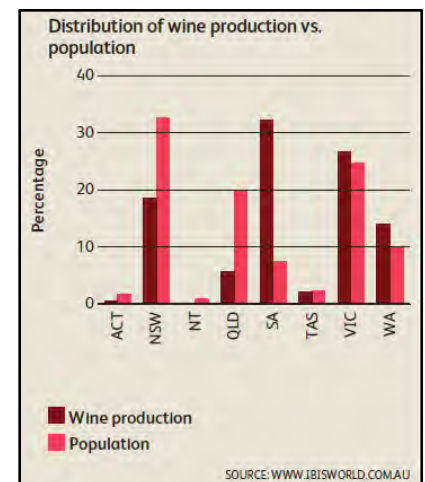
- International wine visitors (for the year ending September 2014):
 - Account for 696,602 visitors to Australia or 11% of the total visitors to Australia
 - Number of wine visitors increased by 1% from last year
 - Winery visitors account for 40 million nights within Australia or 18% of the market. This represents an average annual growth of 1% since the year ending September 2009
 - Contribute \$4.9 billion to the overall visitor expenditure to Australia
- Domestic Overnight Wine Visitors⁴
 - Account for 3.1 million trips, a 7% increase
 - Contribute 15.7 million visitor nights (5.2% of total)
 - Contribute \$3.3 billion in visitor expenditure to the domestic market

Regional benefits and challenges

The wine industry contributes the highest value to regional economies by generating employment and economic activity. The Productivity Commission's report in April 2014 on Geographic Labour Mobility highlighted the challenges facing regional growth, and agricultural manufacturing sectors such as wine grape production and winemaking play a vital role in the socio-economic fabric of many non-metropolitan regions. While the industry's proximity to vineyards limits transport costs to source raw materials, the long distances from vineyards to metropolitan areas and distribution centres results in significantly higher transport costs to markets and end-consumers.

The geographic spread of wine production is closely correlated with the distribution of wine grape production.

Wine production facilities are often located at or near vineyards to limit transport costs and ensure the freshest grapes are crushed. Of those employed in the industry, just 29% work in metropolitan areas, with nearly 62% in inland regional areas. This reflects the location of grape growing and wine production facilities.



Wine industry business locations

The competitive disadvantages of wine manufacturing

Despite this impressive economic contribution to the Australian economy and to regional Australia in particular, there are several commercial and structural factors unique to the winemaking industry which make it distinctive in the alcohol sector.

Profitability

Of the alcohol manufacturing sectors, wine has the highest cost structures and highest level of revenue volatility, making its profit margins smallest.

- Profits in the wine industry are only 5.3% of total revenue

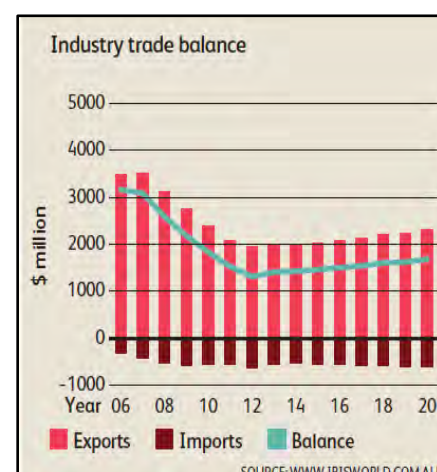
³ Figures for year ending September 2014, Tourism Australia

⁴ Overnight trips In the NVS, overnight trips are defined as trips involving a stay away from home for at least one night, at a place at least 40 kilometres from home. Only those trips where the respondent is away from home for less than 12 months are in scope. The trip is the basic collection unit used in the NVS to obtain information about overnight travel undertaken by Australians.

- Profits in the spirit industry are 11.8% of total revenue
 - Profits in the beer industry are 16.1% of total revenue and known to be one of the most profitable manufacturing industries in the world
- Wine industry purchases accounted for an estimated 62.8% of revenue, while labour costs account for an estimated 17.2% of revenue. Depreciation is about 4.5% of revenue.
 - Purchases costs include containers and other packaging materials; wine for blending, fortification or distillation; grape juice and grape spirit; sugar; and other purchases. Grapes, the most important production input, are predominantly grown and harvested specifically by wineries and grape growers for the purpose of wine production and is subject to significant seasonal volatility in both pricing and supply.
 - Wages in the wine sector are expected to have grown as a proportion of total revenue in 2013-14. This growth was mostly due to falling revenue, but also because of the labour intensiveness of various functions in wine production, such as the upkeep and maintenance of vineyards and manufacturing processes. Analysts believe that wages are expected to fall as a proportion of revenue over the next five years due to increasing investment in modern technologies, thereby making the industry's production process more highly capital intensive.
 - Depreciation in the wine sector remains at about 4.5% of revenue. This is a little higher than other beverage industries such as beer, mainly due to greater costs involved in wine maturation equipment and storage.
- The wine industry has the highest revenue volatility. Production and prices are affected by the supply of grapes, which is affected by weather and soil conditions, disease and plagues.
 - Earnings fluctuate due to changing input prices, changes in supply of grapes and restructuring costs.
 - Strong competition within a highly consolidated wine retail market continues to place significant downward pressure on wholesale pricing and margins. The retail price increases of wine has lagged CPI for over five years unlike the above-CPI price rises experienced by beer and spirits.
 - Unpredictable fluctuations in exchange rates also disproportionately impact the wine sector's exposure to imports in comparison to beer and spirits products.
- The spirit and beer industries exhibit far lower levels of revenue volatility. Due to higher profit margins, volatile prices for commodity inputs such as packaging, ethanol, aluminium and barley have only a moderate effect on beer and spirit pricing and revenue.

Industry trade balance

- The wine industry is a net exporter and therefore more vulnerable to global market issues such as exchange rate fluctuations and global supply/demand imbalance compared to other alcohol manufacturing industries.
- Export revenues for the wine industry are \$2 billion p.a.
- Wine exports have fallen sharply over the past 5 years, declining at an annualised rate of 6.5% to account for a 34.5% share of revenue.



Wine Industry trade balance

- Increased competition in the global wine market and global economic downturn have weighed down industry exports and intensified competition between winemakers on the domestic market.
- Wine producing countries such as Chile and South Africa have emerged to challenge Australian wine in its key export markets especially in the commercial wine segment.

Competitive landscape

The wine industry is the least consolidated sector within alcohol manufacturing which reduces its ability to leverage economies of scale and command margin from a highly consolidated wine retail sector.

- The four largest Australian wine producers account for 40.8% of industry revenue.
- The top four players in the spirits industry are estimated to account for about 65% of industry revenue.
- The market share of top two major beer manufacturers is 82.7% of industry revenue

Retailer margins

Retailers generate greater margins on wine sales than sales from beer and spirits. Wine sales provide two to three times more margin than beer. The ability of retailers to extract greater margins from wine can be seen as a reflection of the highly fragmented industry structure and ease of transferring costs to wine producers.

Compulsory levies

There are currently three levies/charges on wine/grapes. The grape research levy; the wine export charge; and the wine grapes levy. These industry levies/charges fund marketing, research and development and plant health programs for the grape and wine industry. As of 2012/13, the total levy receipts from the grape research levy, wine grapes levy and wine export charge amounted to \$17.12 million.

Capital intensity

Wine is very capital intensive (more than beer in most stages in the supply chain):

- Wine's fermentation equipment/machinery are used two to six cycles a year while beer's fermentation equipment is used 50 cycles a year in a commercial brewery.
- Wine's maturation stage can range from 2.6 months to 16 months while storage of beer can be from one to six weeks (commercially produced typically one to two weeks).
- Between bottling and selling, wine needs to be stored before it gets ready for sale from one to three years in a cool storage, while beer is sold after bottling.
- Wine's supply chain is also less flexible than beer since it only has a once-a-year production that needs to be crushed in six to eight weeks. On the other hand, barley can be stored and converted to malt throughout the year as needed and only takes one week to process.

Nature of capital⁵

A typical Australian wine producer is likely to have more difficulty accessing capital due to the small scale of operations, lack of diversity and level of risk associated with fluctuating industry earnings from season to season. In general, capital requirements for the wine industry are widely described as being greater, relative to the beer and spirit industries, due to vertically-integrated wine producers requiring the use of vineyards and winemaking facilities. Furthermore, the industry has a longer stockholding period than the beer industry, increasing requirements for working capital. Returns for winemakers on capital have been declining over the past four years, due to the lower levels of profitability and higher levels of capital required.

Access to capital

Access to capital for any business is impacted by a wide range of factors such as:

- a) the scale and diversity of the business (geography and product range)
- b) age and maturity of the business
- c) strength of the brand
- d) market share and position
- e) distribution channels to market
- f) current level of interest bearing debt
- g) variability/consistency of return, and
- h) management strength and capability.

The scale of a business' operation is a critical factor to the accessibility of debt or equity capital. Larger businesses with a high degree of product and geographic diversification may find accessing capital easier.

Access to capital is a significant challenge for winemakers in Australia as they tend to be small in scale and lack diversity relative to global beer and spirit operations. Smaller, privately held companies may typically source equity capital from private investors (e.g. friends and family)

⁵ This section on the comparative analysis of the nature of capital in the beer and spirits was provided by PwC.

and may source debt financing in the form of small trade loans from banks and financing lease arrangements for plant and machinery.

Wine businesses in the early stage of the lifecycle are likely to be purely equity funded with only the more established businesses able to attract a limited amount of bank debt. This debt would tend to be short term in nature with annually renewable debt most likely, although funding of up to three years is possible for the stronger, more established businesses. This contrasts with a beer and spirits multinational that could potentially access long-dated debt (i.e. 7-10 years). For an Australian winemaker, equity would typically come from private investors and be limited in volume.

Small businesses within the wine industry do not typically lend themselves to being operated as public corporations (which enable easier access to equity capital), and are mainly run as small scale, privately owned businesses for the following reasons:

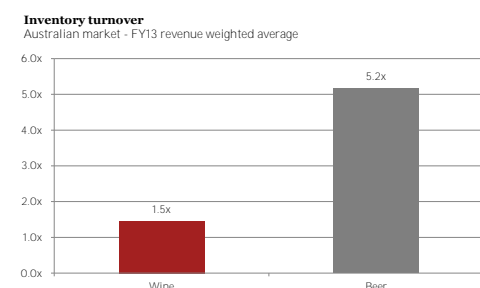
- a) the high capital intensity of the industry
- b) the high level of agricultural risk
- c) wine producers only have one production opportunity per year which increases risk
- d) wine producers have a high inventory holding requirement which requires capital, and
- e) the industry has historically generated low returns on invested capital.⁶

Capital requirements

Capital requirements for the wine industry are widely described as being greater, relative to the beer and spirit industries. In general, wine producers are vertically integrated and therefore require the use of vineyards and winemaking facilities.

Furthermore, given the longer holding period of inventory in the wine industry relative to beer and other beverage producers, a higher level of working capital is required. As set out in the chart below, the wine industry in Australia has an inventory turnover of approximately 1.5 times (implying that on average, a business holds enough inventory to satisfy 65% of total sales for the year), whereas the Australian beer industry has an inventory turnover of approximately 5 times (implying on average, 20% of total annual sales could be satisfied with inventory on hand).

Fig. 1. Chart of weighted average inventory turnover across the Australian wine and beer industries



Note:

1. Inventory turnover is calculated using the formula: cost of goods sold/inventory

2. Based on the average of inventory turnover from financial year 2011 (FY11) to FY13

3. The weighted averages have been calculated based on the FY13 revenue of each company

4. Based on the analysis of 16 Australian wine companies (3 public and 13 private) and 3 Australian beer companies (2 public and 1 private)

Source: S&P Capital IQ, ASIC, IBIS World, PwC analysis

⁶ John Angove, the Managing Director of Angove Family Winemakers, L. Lockshin, Future opportunities and challenges for the South Australian wine industry: An interview with John Angove, Wine Economics and Policy 2 (2013) 50-54, 5 May 2013

The demerger of Treasury Wine Estates (TWE) from the Foster's Group Limited in 2011, also highlights the different (and higher) requirements for capital in the wine industry relative to the beer industry. The key benefits from the demerger were stated to:

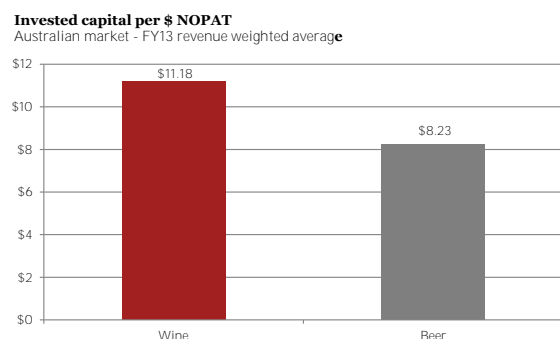
- a) "allow the beer business to pursue growth opportunities and invest...without the potential constraints of competing capital demands of the wine business"
- b) "allow the beer and wine businesses to establish a more appropriate capital structure... TWE would require a more conservative capital structure than Fosters, given agricultural and cyclical risks and its high asset intensity"

A more conservative capital structure would be a consequence of less predictable cash flows⁷ and more risky returns, thereby increasing the cost of capital.

More uncertain and higher risk cash flows reduce the amount of debt that could be serviced in the capital structure of the original Foster's Group. As such, following the demerger, Fosters was able to sustain a higher level of gearing, relative to the wine business, given the more stable, more predictable cash flows of the beer business.⁸ Fosters was expected to have a pro-forma leverage ratio of 2.0x (net borrowings divided by earnings before interest, tax, depreciation and amortisation (EBITDA)) and TWE a lower leverage ratio of 0.5x post demerger.⁹

Based on available financial data for respective wine and beer companies in Australia, at a high level, the amount of invested capital required to generate a dollar of net operating profit after tax (NOPAT, or profit) appears to be higher in the Australian wine industry than in the Australian beer industry. Over the last three years, the average level of invested capital required to generate a dollar of profit is approximately \$11 in the wine industry, whereas the amount of invested capital required to generate a dollar of profit in the beer industry is approximately \$8. Given a considerable portion of the smaller brewers across the Australian beer industry are privately held, there is a limited amount of financial information that can be used to draw conclusions. Conclusions and figures presented here should therefore be considered in light of this limitation.

Fig. 2. Chart of weighted average invested capital per profit across the Australian wine and beer industries



Source: S&P Capital IQ, ASIC, IBIS World, PwC analysis

Note:

1. Invested capital per \$ NOPAT is calculated using the formula: Invested capital/NOPAT
2. Invested capital = Long term debt + Equity (Book value of equity for private companies and market capitalisation at the end of each financial year for public companies)
3. NOPAT = EBIT*(1 - Tax). Tax is assumed to be 30%, in line with the Australian statutory company tax rate
4. Based on the average invested capital per NOPAT from FY11 to FY13
5. The weighted averages have been calculated based on the FY13 revenue of each company
6. Companies with negative NOPAT are assumed to have zero invested capital per \$ NOPAT
7. Based on the analysis of 16 Australian wine companies (3 public and 13 private) and 3 Australian beer companies (2 public and 1 private)

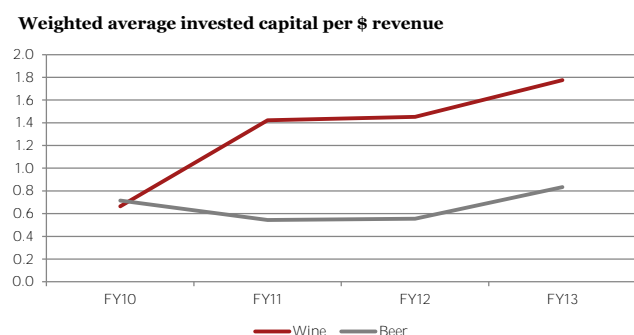
⁷ Grant Samuel Independent Expert Report, page 135

⁸ Proposed Demerger of Treasury Wine Estates Limited from Foster's Group Limited, Concise Independent Expert's Report, Grant Samuel, 17 March 2011

⁹ Ibid

The level of capital used in the Australian wine industry has increased over the past four years and by a higher amount than the beer industry. The charts below illustrate the average level of invested capital that was required to generate one dollar of revenue, gross profit and net income respectively. Each chart illustrates the increasing level of required capital to generate a dollar of each metric.

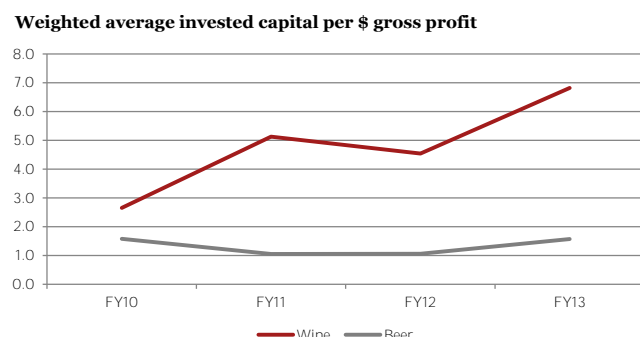
Fig. 3 Weighted average level of invested capital per dollar of revenue generated from FY10 through to FY13, based on a small sample of 14 Australian wine businesses and 3 Australian beer businesses



Source: S&P Capital IQ, ASIC, IBIS World, PwC analysis

This chart illustrates that on average, capital invested in Australian wine businesses to generate a dollar of revenue has increased over the past four years from \$0.66 in FY10 to \$1.78 in FY13 compared to the average beer business, which has increased from \$0.72 to \$0.83 over the same period.

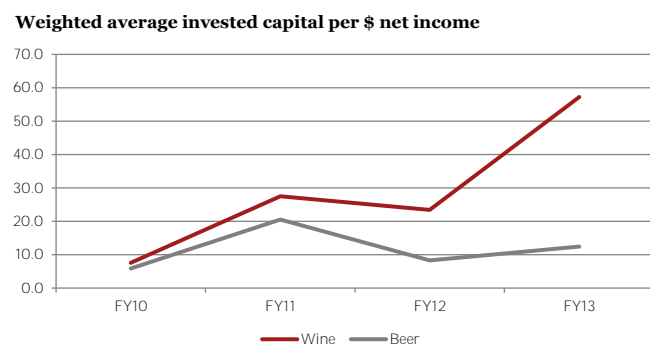
Fig. 4. Weighted average level of invested capital per dollar of gross profit generated from FY10 through to FY13, based on a small sample of 14 Australian wine businesses and 3 Australian beer businesses



Source: S&P Capital IQ, ASIC, IBIS World, PwC analysis

On average, the level of capital invested in Australian wine businesses required to generate a dollar of gross profit has increased over the past four years from \$2.66 in FY10 to \$6.81 in FY13, relative to beer which has remained broadly flat over same time period.

Fig. 5 Weighted average level of invested capital per dollar of net income generated from FY10 through to FY13, based on a small sample of 14 Australian wine businesses and 3 Australian beer businesses



Source: S&P Capital IQ, ASIC, IBIS World, PwC analysis

Over the last four years, the amount of capital invested to generate a dollar of net income for a wine business has increased from \$7.56 in FY10 to \$57.19 in FY13, relative to a beer business which has increased from \$5.88 in FY10 to \$12.43 in FY13.

Note:

1. Companies with negative net income are assumed to have zero invested capital per \$ net income for the purpose of this analysis

Return on capital

The ability for a business to generate the appropriate level of return (relative to the level of risk) is influenced by specific industry dynamics such as the:

- a) level of competition within the market (e.g. level of fragmentation or consolidation)
- b) level of supply and demand for the product
- c) bargaining power of buyers
- d) level of capital intensity.

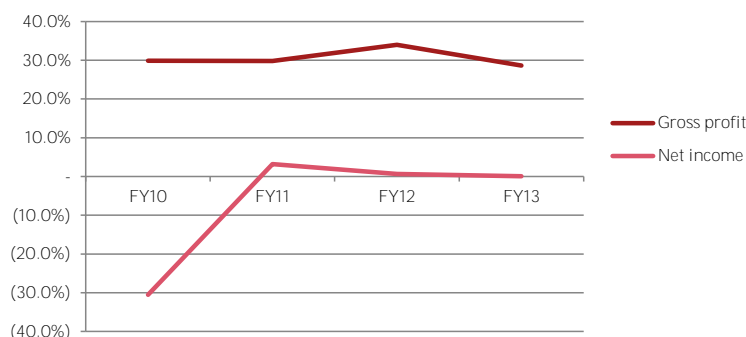
Each of these factors is likely to contribute to the low level of returns observed in the wine industry today.

As set out in the chart below, profit margins have been falling over the past three years in the Australian wine industry.

Fig. 6. Weighted average profit margins (gross margin and net income margin) from FY10 through to FY13, based on a small sample of 14 Australian wine businesses

Weighted average margins: FY10 to FY13

Australian wine industry



Source: S&P Capital IQ, ASIC, PwC analysis

Declining profit margins are in part driven by the domestic oversupply of wine and heavy discounting throughout the supply chain. In addition the profitability of wine producers has been negatively impacted by:

- a) the increasing dominance and bargaining power of supermarket retailers
- b) the high Australian dollar, reducing the competitiveness of Australian wine in foreign markets¹⁰
- c) fragmentation of the industry leading to difficulties in pricing growth.¹¹

Profit margins across the Australian wine industry are expected to be approximately 5.4% in 2014-15, being significantly lower than the average profit margin of the beer and the spirit manufacturing industry of 16.0% and 13% respectively.¹²

In comparison, as set out in the chart below, the average level of capital employed (long-term debt financing, plus equity) has increased over the comparable period.

¹⁰ Wine Production in Australia, IBISWorld Industry Report, August 2014

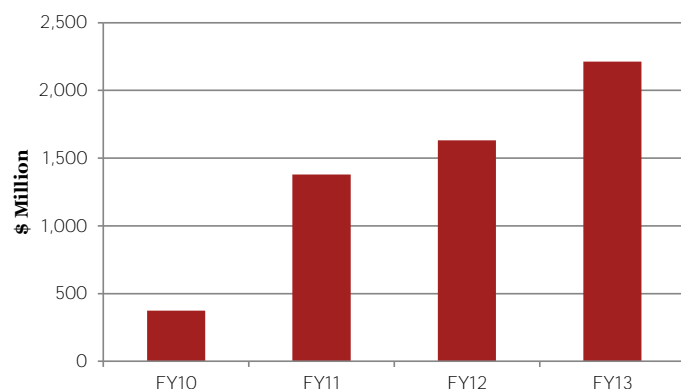
¹¹ Treasury Wine Estates Limited, UBS Broker Report, 25 June 2014

¹² Wine Production in Australia, IBISWorld Industry Report, August 2014

Fig. 7. Weighted average level of invested capital from FY10 through to FY13, based on a small sample of 14 Australian wine businesses

Weighted average invested capital: FY10 to FY13

Australian wine industry



The average amount of capital invested (debt and equity) in a wine business (based on a small sample of businesses in the wine industry) has increased from \$375 million in FY10 to \$2,214 million in FY13. However, this chart does not take into consideration the level of productivity or output generated by the increase in invested capital.

Source: S&P Capital IQ, ASIC, PwC analysis

Given these trends, the declining profit margins and increasing levels of invested capital, returns on capital for the wine industry have been reducing over the past 5 years.

Risk rating¹³

Risk component	Wine	Spirit	Beer
Structural risk (25%)	6.48	4.48	3.25
Growth risk (25%)	5.88	5.37	5.54
Sensitivity risk (50%)	6.37	6.4	6.7
Overall risk	6.27	5.66	5.55

The wine industry has the highest overall risk among alcohol producers at 6.27 (out of 9) which is due to high levels of structural and sensitivity risks. The wine industry's risk rating is higher than the average risk score for all Australian industries and the manufacturing sector. The main structural risk factors for the industry include high level of competition, decreasing exports and a high level of revenue volatility due to changes in grape supply and prices, in addition to the influence of intra-industry competition. Both spirit and beer industries have low volatility risks due to the ability to mitigate effects of market fluctuations, a steady consumer base and high profit margins.

¹³ To calculate the overall risk score, IBISWorld assesses the risks pertaining to industry structure (structural risk), expected future performance (growth risk) and economic forces (sensitivity risk). Risk scores are based on a scale of 1 to 9, where 1 represents the lowest risk and 9 the highest. The three types of risk are scored separately, then weighted and combined to derive the overall risk score.

6. Conclusion

WFA and WGGGA with the support of all state wine organisations agree that the WET rebate should be retained but reformed. Why and how this can be done are outlined in detail in this submission as is the case for returning \$44m in savings back to the sector's global marketing efforts to help build export demand for our wine.

We now ask government to act with urgency. Our proposals represent the consensus majority view within industry and will play a significant supporting role in the recovery of the sector, an uplift in profitability and achieving a better supply-demand balance.

Australia continues to produce wine products that are among the world's best across all price points. With industry working together with government, we can help individual wine businesses succeed and take our product to the domestic and global consumer at prices that better reflect its intrinsic worth.

The time to act is now. The confluence of positive macro-economic developments in our industry's favour that have occurred recently will be cyclical and do provide an opportunity within the highly competitive global market to make the structural changes required for sustainable profitability into the future, whatever it may hold.

We look forward to your consideration of our submission and working with industry on recovery and growth.

7. Response to the 19 ‘Discussion Paper’ questions

Q1. Is the WET rebate delivering benefits to the wine industry and/or contributing to distortions in the wine industry? How?

The WET rebate continues to deliver important support to wine producers as was its original policy intent. However, it is also contributing to distortions in the industry which are inconsistent with the aim of achieving sustainable profitability.

The rebate was originally intended to assist 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.”

The rebate remains an important revenue source for wine producers in both the fine wine and commercial segments which are struggling with a decline in export sales and intense competition in the domestic market. It is clear that without the rebate a significant number of wine producers 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 rebate is particularly important for the cash flow of grape and wine businesses and in dealing with on-going tough trading conditions and low levels of profitability.

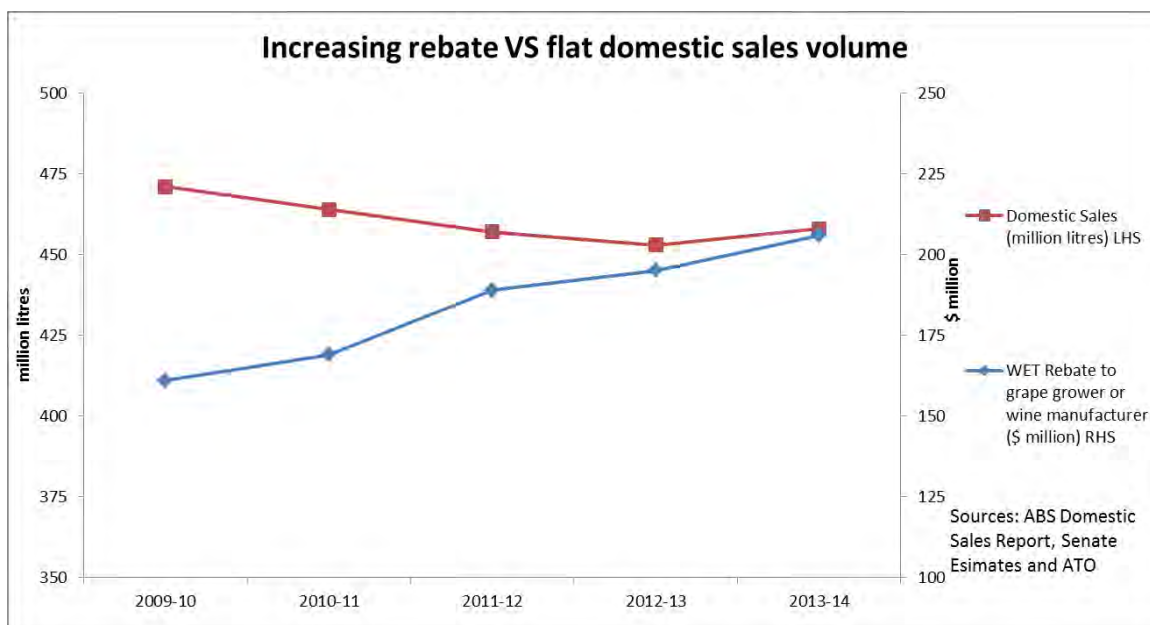
While the rebate continues to play an important role in supporting regionally-based producers and the communities they operate in, it has evolved and changed over time, and it has introduced a number of distortions to the market.

Specifically, there are widespread industry concerns that the WET rebate has evolved beyond its original intent of supporting local employment and tourism in wine regions, and is being compromised as follows:

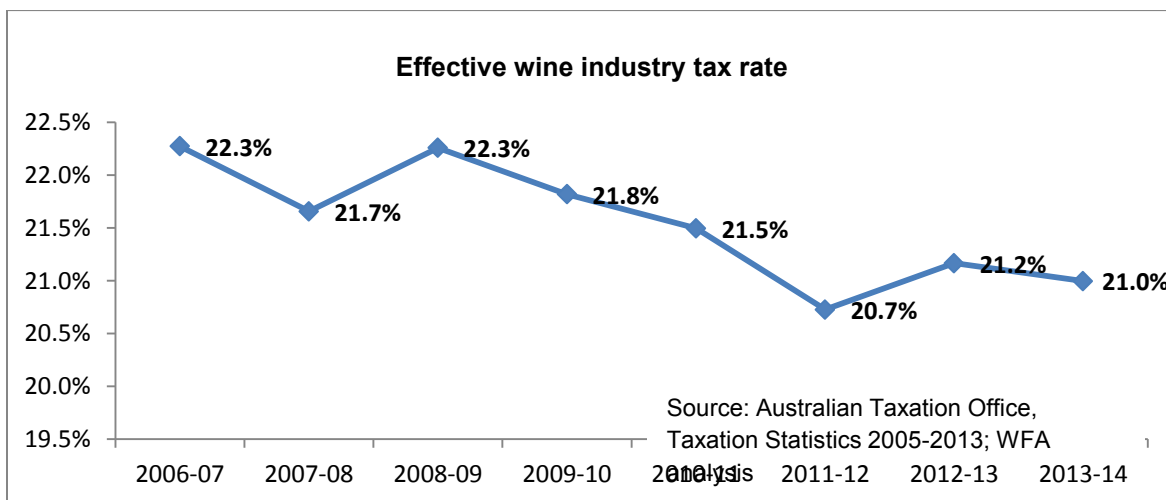
- 1) The ability of brokers, intermediaries and uncommercial arrangements to access the entitlement; and
- 2) The role of the rebate in delaying the correction to the supply/demand imbalance by underpinning the conversion of uncommercial grapes into bulk wine and ultimately low equity cleanskins and home brands; and

Unintended Recipients

These concerns have been fueled by an increase in the amount of claimants on the rebate and the amount being claimed at a time when the industry has not grown.



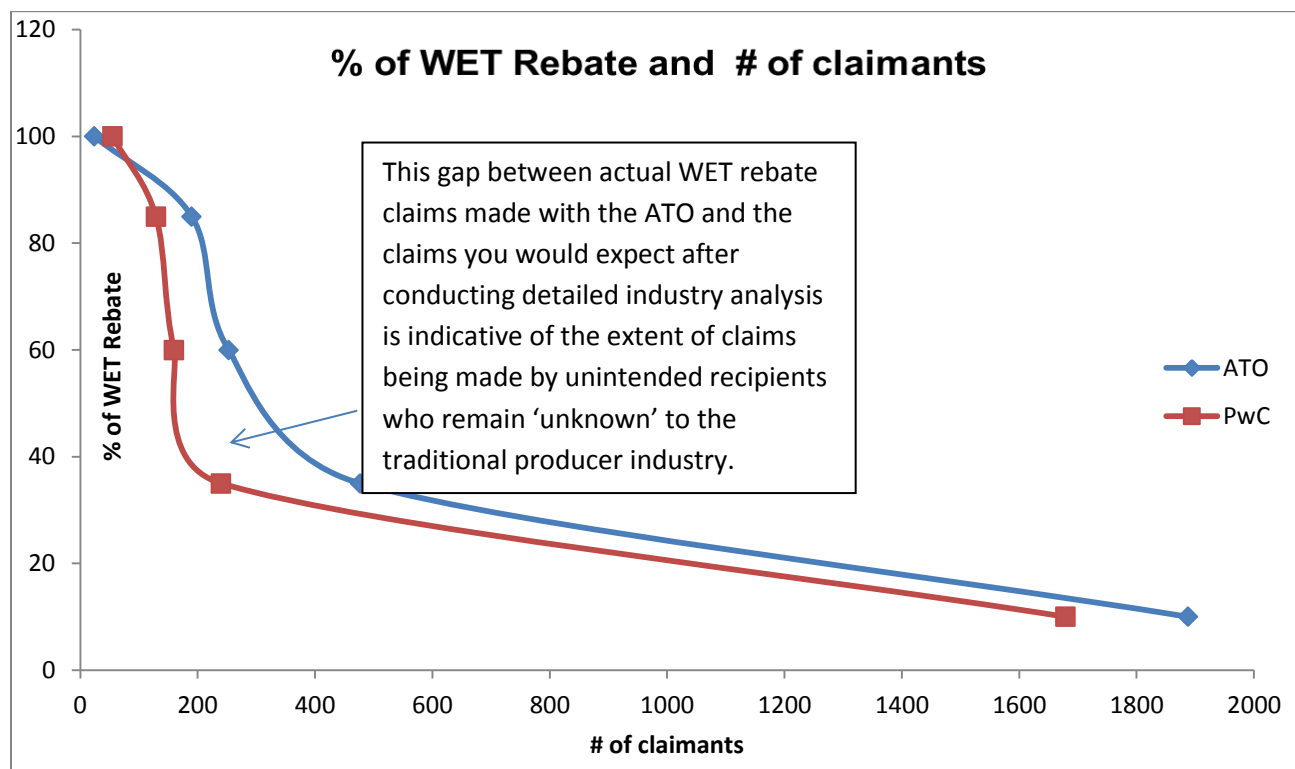
The total WET rebate to the industry has been in an upward trend since 2006-07, with an average annual increase of 12%. WET rebate for Australian producers (reflected in WET refundable – BAS 1D) started at \$134 million in 2005-06, but have since increased to \$308 million in 2013-14.¹⁴ It is estimated that the Total WET Rebate and Refunds will increase to \$333 million in 2013-14 and \$340 million in 2014-15.¹⁵ When we compare the trend of the WET Rebate to the Total WET over the last 7 years, the evidence of an unsustainable financial platform underpinning current WET Rebate arrangements is even more apparent and threatens the future of the rebate for all claimants. Further evidence of this is the faster growth of total WET rebate compared to WET payable, has delivered a decrease in the effective wine industry tax rate.



As further evidence, analysis undertaken by PwC - which compares data from the ATO on the profile of rebate claims against what could be expected - shows a clear distortion in producer claims and a number of claimants near the rebate cap that are 'unknown' to the traditional wine producer industry. This work can be found in the attached PwC report.

¹⁴ ATO correspondence

¹⁵ Based on ATO correspondence; The Treasury, 2013. TAX EXPENDITURES STATEMENT, s.l.: The Treasury .



The severity of the situation has been further highlighted by the Australian Taxation Office with the Tax Commissioner rating the compliance risk associated with its administration of WET as 'high'. The ATO has issued a series of Tax Alerts to Industry on rebate compliance issues.¹⁶ In addition, the Financial Review published an article in June 2014 titled "Tax office goes after wine rorts in \$32m WET hit" with the following extract:

"The tax office is auditing people it believes may have claimed multiple rebates against the wine equalisation tax (WET). The amount includes \$18.5 million in extra tax bills and penalties of more than \$13 million, illustrating the size of the problem."

The tax office has been increasingly concerned about rorting of the system. There have been hundreds of artificial transactions between related corporate entities which claim to be blending or finishing off the winemaking process before the wine is sold. Companies have been set up for the purpose of claiming rebates. In some cases, there have been up to 10 claims each for \$500,000 on the same wine."

WFA and WGGA strongly support the work of the ATO to improve compliance and restrict the ability of these uneconomic arrangements to access the rebate. Addressing this growing list of unintended rebate recipients and consequences has widespread industry support. Maintaining the integrity of the rebate system is important to safeguard its retention for those who are entitled to claim it.

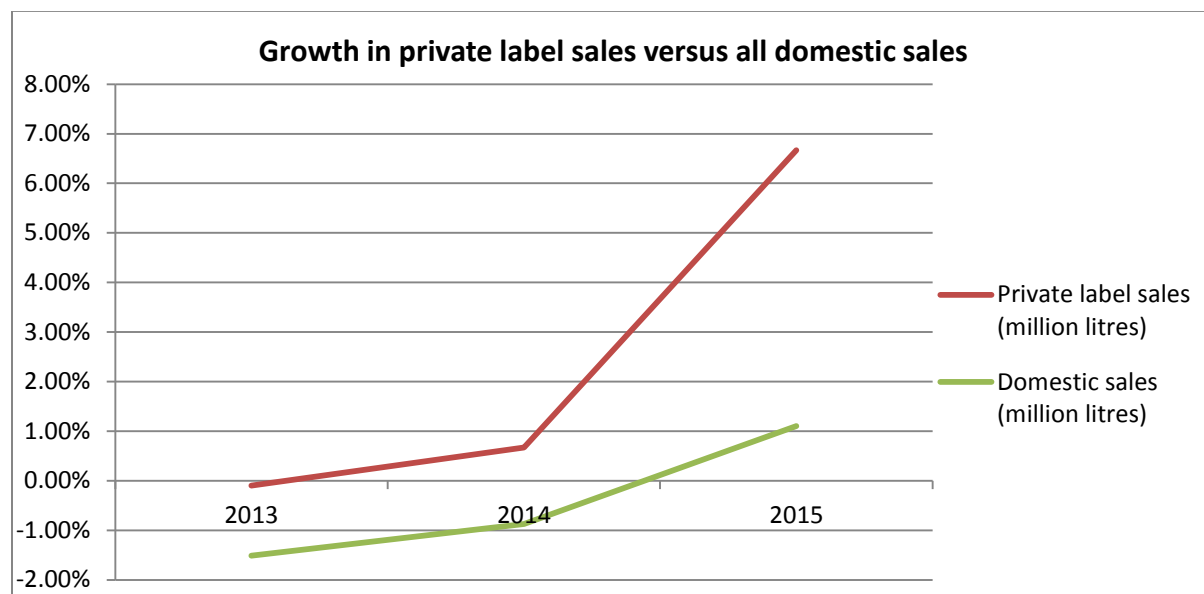
The rebate's role in supporting 'sticky supply' and low grape and wine prices

The rebate also underpins grape production that would otherwise be unprofitable and hence it delays the correction in the supply-demand imbalance and places downward pressure on grape and wine prices. This dynamic has helped drive the production of low equity brands and 'clean skins' and has seen many out-of-contract grape producers converting their grapes to finished wine (via contract winemaking) and this wine is highly likely to attract the WET rebate, with the

¹⁶ <http://law.ato.gov.au/atolaw/view.htm?DocID=TPA/TA20132/NAT/ATO/00001>

deferral of the WET liability to the retailer (utilising 'quoting' provisions available within the WET arrangements). The lack of security of sale of wine grapes during the current difficult trading conditions is therefore increasing the number of WET rebate claims.

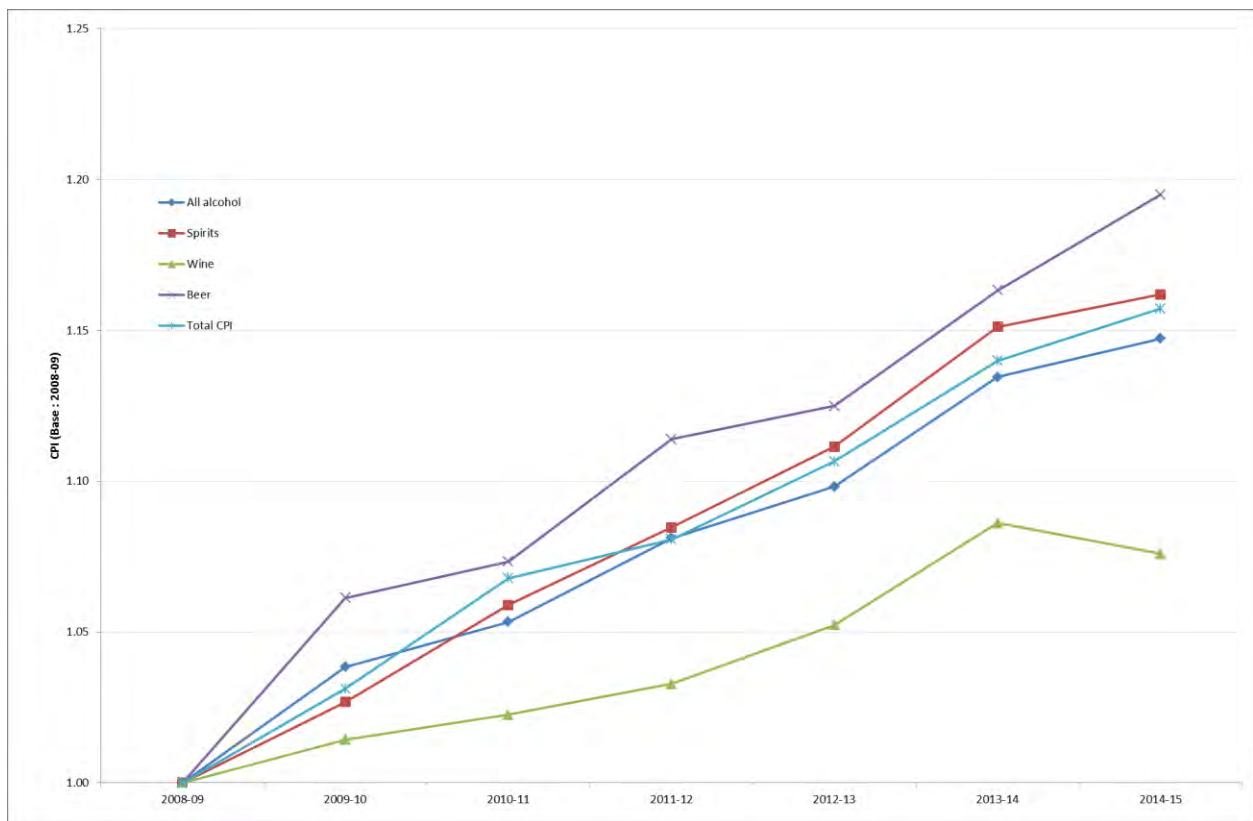
The availability of the rebate to growers and winemakers to convert unprofitable grapes into bulk wine has helped drive the proliferation of low equity brands in recent years which has in turn put downward pressure on the margins and profitability of traditional brand owners.



Source: ABS Domestic Sales and Wine Australia.

The ability of private label (home brand) sales (red line) to grow by 7% between 2013 and 2015 in a difficult economic environment compared to near flat growth in volume for ALL domestic sales (green line) is telling. This is attributable to the retailer's vertically integrated business models and the leverage the WET rebate gives them when negotiating the purchasing price for bulk wine for their home brands. The retailer as the purchaser is effectively able to access the rebate as many times as they have supplier agreements for bulk wine destined for their home brands.

The ability of suppliers of bulk and unbranded wine to claim the rebate and to underwrite the production of otherwise uncommercial grapes has the flow on impact of effectively setting a retail 'floor price' on all wine and a retail culture of endless 'discounting' in a crowded and oversupplied domestic market. Combined with the impacts of retail consolidation, this translates into poorer margins for all branded winemakers and grape producers. Retail pricing growth for wine has remained flat for many years compared to both CPI and other alcohol categories and is not sustainable. (See graph overleaf.)



Source: ABS Catalogue 6401.0 - Consumer Price Index, Australia, June 2015

Q2. Is the future sustainability of the Australian wine industry linked to the production of high quality wine? How?

Given we already produce high quality wine, the future sustainability of the industry is linked to growing demand for our wines at all price points profitably.

Australia continues to produce wine at a globally competitive standard but more must be done to expose global wine consumers to its diversity, value and consistency. This applies in both the fine wine and commercial wine segments.

A significant component of achieving this will be to grow our reputation as a producer of excellent wines by boosting the marketing funds of AGWA to promote our wine in a fiercely competitive marketplace. AGWA has a 5-Year Plan in place to develop the equity of the Australian category based on this approach with the aim of increasing demand for all Australian wine.

This submission provides a fully costed account of what finding and programmes are required to lift demand for Australian wine and cement our reputation as a producer of excellent wines.

Q3. Is there a policy case to be made for the WET rebate continuing to operate in its current form?

The WET rebate continues to deliver important support to regional wine businesses as was its original policy intent. However, it is also contributing to distortions in the industry which are inconsistent with the aim of achieving sustainable profitability. Reforms are required to ensure the future integrity of the rebate.

The rebate was originally intended to assist 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.”

The rebate remains an important revenue source for small and medium wine producers in both the fine wine and commercial segments which are struggling with a decline in export sales and intense competition in the domestic market. 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 rebate is particularly important for the cash flow of small and medium winemakers and in dealing with on-going tough trading conditions and low levels of profitability.

However, reforms are need to the rebate to ensure it delivers upon its original policy intent. WFA and WGGGA, with the support of all the state wine industry associations, are backing the reforms outlined in this submission that will better align the rebate’s originally intended purpose and benefits with the future sustainability of the wine industry. In summary, we believe that the Government should;

1. Stop the WET rebate going to unintended recipients and shut down the schemes.
2. Keep the WET rebate within the original policy intent of delivering long term benefits to industry and tourism in regional Australia.
3. Phase out the WET rebate on bulk and unbranded wine over four years because we need strong brands to command margin and loyalty from consumers and retailers and to generate the profits that can be reinvested back into regional Australia.
4. Abolish the separate New Zealand rebate scheme and its preferential treatment of NZ producers and replace with a ‘level playing field’ for all rebate claimants regardless of nationality.
5. Encourage consolidation by introducing 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 four years.
6. Work with WFA and WGGGA to develop industry assistance for grape and wine businesses impacted by reform.

The details of each of these reform measures and what the Government must do are in this submission. Each can be introduced and implemented quickly and we request the Government to make these changes urgently at MYEFO 2015.

Once implemented, WFA and WGGA will in consultation with industry analyse the impact of reform and continue to assess the WET rebate and whether further policy reform is required including those options raised in the Discussion Paper that fall outside our proposals.

Q4. How could WET rebate be redesigned to better support the wine industry?

WFA have a comprehensive fully costed plan to reform the WET rebate which we believe has the majority industry support.

Following over two years of analysis, extensive industry consultation and consensus decision-making, WFA has proposed a package of limited reforms to the WET rebate to restore its integrity, place it on a sustainable financial footing and to ensure it continues to deliver its original policy intent. These are outlined in detail in our submission.

Keep and Return the WET Rebate to Fairness and the Original Policy Intent

In regards to legislative changes required to ensure the WET rebate continues to deliver the original policy intent, WFA believes the Government should restrict future rebate eligibility to producers who:

- have business premises in Australia (potentially, in a designated wine region in Australia); and
- hold a licence, issued by the Government of a state or territory in Australia, to sell liquor in that state or territory; and
- are self-employed or engage one or more employees (including associates of the winemaker) to perform work for the winemaker; and
- sell their wine either:
 - by retail sale, or under quotation, from the business premises referred to above; or
 - by internet or mail order sales (in which case the sales would be deemed to take place at the above premises).

These changes will ensure that all future recipients of the rebate have an investment in regional Australia and must continue to reinvest in local communities. These changes, in concert with the recommendation below to abolish the separate New Zealand producers' WET rebate arrangements, have the additional benefit of creating a level playing field for all claimants regardless of nationality. Grape and wine businesses producing branded product will not need physical production assets to claim the rebate.

WFA does not believe that bulk, unpackaged and unbranded wine should be eligible for the rebate as, over the long-term, they do not support the building of brand equity and margins with retailers and consumers. Therefore, the Commonwealth should phase out WET rebate eligibility for bulk and unbranded wine at 25% per year starting at 75% of the rebate rate from implementation.

This can be achieved by changing the legislative definition of rebatable wine for the WET rebate to:

*'rebatable wine means *grape wine, *grape wine products, *fruit or vegetable wine, *cider or perry, *mead or *sake, that is packaged in a single container with a capacity not exceeding 5 litres at the time of the dealing, and which is labelled with a brand on the primary packaging that is wholly owned by, or licensed exclusively to, the producer of the wine.'*

This proposal would continue to support the industry consistent with the original intent of the rebate discussed above. By way of example, it would enable the following activities to continue to claim the rebate:

1. Winemaking and grape growing businesses that produce their own branded and packaged wine;

2. Winemakers and grape growers who lease their production assets or contract out the making of their wine and produce their own branded and packaged wine; and
3. Businesses that purchase grapes or leases vineyards and produce their own branded and packaged wine.

WFA also 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. Government should 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 four years. These transitional arrangements will be made available to the industry for up to five years from the date of implementation.

Abolition of the separate New Zealand producers' WET rebate scheme and replacing it with a level playing field for all claimants

While all foreign entities are currently eligible to access the rebate, it is New Zealand winemakers that have particularly benefited from the rebate. In recent years, we have seen New Zealand imports increase from 21 million litres in 2007 to over 52 million litres in 2014 resulting in a 30% of the total value of the leading 20 SKUs sold in Australia.

The separate New Zealand producers' rebate scheme provides New Zealand producers a commercial advantage over other local and foreign claimants as outlined in the supporting legal advice (attached to this submission);

...foreign winemakers who receive the WET rebate are: (1) treated as having derived Australian income; and (2) therefore required to lodge Australian income tax returns.

However, NZ winemakers are not required to lodge Australian income tax returns, as the WET producer rebate is considered to be assessable in NZ and not Australia.

In addition, NZ winemakers are not required to be registered for Australian GST purposes and hold a state or territory liquor license, unlike Australian wine producers and other foreign wine producers.

NZ winemakers are therefore not subject to the compliance costs associated with lodging Australian income tax returns, Business Activity Statements (BAS), or with ongoing state or territory liquor licensing requirements.

Further, the ATO allows the NZ Inland Revenue to administer the WET rebate for NZ winemakers. The ability for NZ winemakers to deal with their local revenue authority is not available to other foreign wine producers.

These preferential conditions make it easier and cheaper for NZ winemakers to access to the WET rebate, than for other foreign wine producers.

The following table summarises the requirements to claim the producer rebate, and the benefits afforded to NZ wine producers that are not available to other foreign wine producers.

<i>Claim requirements under the current WET producer rebate schemes</i>			
	<i>Australian wine producers</i>	<i>New Zealand participants</i>	<i>Other foreign wine producers</i>
<i>GST registration required</i>	✓	✗	✓
<i>Wine tax must be paid</i>	✗	✓	✗
<i>Australian income tax obligations</i>	✓	✗	✓
<i>In-country administrative assistance provided</i>	✓	✓	✗
<i>Entity required to be exporter of wine</i>	N/A	✗	✓
<i>Required to hold a State/Territory Liquor License</i>	✓	✗	✓

The supporting legal advice attached to this document outlines what changes are required and how they can be implemented without compromising our bilateral or international trading obligations.

These legislative changes are expected to deliver significant budget savings as outlined in this submission. The requirements for claimants under our proposals are summarised below:

<i>Claim requirements under the proposed changes for accessing the WET producer rebate</i>			
	<i>Australian wine producers</i>	<i>New Zealand participants</i>	<i>Other foreign wine producers</i>
<i>GST registration required</i>	✓	✓	✓
<i>Wine tax must be paid</i>	✗	✗	✗
<i>Australian income tax obligations</i>	✓	✓	✓
<i>In-country administrative assistance provided</i>	✓	✓	✗
<i>Entity required to be exporter of wine</i>	N/A	✓	✓
<i>Required to hold a State/Territory Liquor License</i>	✓	✓	✓

While some \$25m per annum is currently rebated to New Zealand producers, the abolition of the separate New Zealand arrangements together with the proposed changes to future rebate eligibility including the requirement to hold local liquor licences and business premises and the removal of the rebate from bulk and unbranded wine from New Zealand, will deliver a net savings to the Commonwealth of \$44.9m over four years.

Ongoing review

WFA and WGA will continue to monitor the implementation and impacts of any reforms introduced by government and remain open-minded regarding the need for further reform to the rebate and what specific changes may be required. Our shared focus remains on facilitating a return to sustainable profitability for the industry and any further reform measures that emerge in the future that can help deliver this outcome will be considered closely.

Q5. Should the purpose of the WET rebate be to support rural and regional winemakers only? How could this be achieved?

The original policy intent of the WET rebate, to support regional wine producers and the communities they support by helping deliver sustainable profits, should remain its primary policy focus.

In our response to the previous question, we have identified a number of reforms that are about ensuring the rebate is returned to its original intent of supporting winemakers and grape growers in regional Australia. Please refer to our response to Question 4 for further details.

Taxation arrangements for the Australian wine industry play a critical role in shaping industry structure, performance and competitiveness. The Wine Equalisation Tax (WET) has been in place for well over a decade but has undergone a number of changes particularly in regards to the WET rebate.

The WET at a rate of 29% of the last wholesale sale price came into being in the context of the broader GST changes made in 2000 to replace wholesale sales taxes. In order to obtain the support of the Australian Democrats for its GST reform package in 2000, the Government *'undertook to ensure that arrangements were established which provided a tax exemption for cellar door and mail order sales up to a wholesale value of \$300,000 per annum'*.¹⁷

This rebate was intended to assist small and medium sized winemakers and to promote tourism in regional areas.¹⁸ 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."*

The WET arrangements were given statutory force by the Indirect Tax Legislation Amendment Act 2000, which in turn amended the A New Tax System (Wine Equalisation Tax) Act 1999 (WET Act). The *Indirect Tax Legislation Amendment Act* provided a 14% WET rebate from 1 July 2000 on cellar door and mail order sales (and applications to own use) up to a maximum of \$300,000 of sales per annum.¹⁹ The rebate tapered down to zero for sales between \$300,000 and \$580,000 per annum.²⁰ The WET rebate applied in conjunction with the applicable 15% State Government cellar door subsidy. The combination of the 14% WET rebate and the 15% State subsidy meant that cellar door and mail order sales up to \$300,000 per annum were effectively WET-free.²¹ It should be noted that the majority of these state government-based cellar door rebate schemes have now been abolished.

To be eligible to claim the WET rebate, the producer was required to hold a licence issued under a State law to make retail sales of wine from particular premises as a wine producer or a vigneron (i.e. a producer's license under State liquor licensing laws).²² Hence, the WET rebate was limited to wine and did not include other products captured under the WET Act such as cider, perry and sake.

¹⁷ Supplementary Explanatory Memorandum, Indirect Tax Legislation Amendment Bill 2000, [2.27]

¹⁸ Supplementary Explanatory Memorandum, Indirect Tax Legislation Amendment Bill 2000, [2.38-2.39].

¹⁹ Ibid [2.29];[2.46]

²⁰ Ibid

²¹ Ibid[2.29]

²² See sections 19-10 and 33-1 of the WET Act, as inserted by the Indirect Tax Legislation Amendment Act 2000.

The WET rebate was introduced to primarily provide assistance to winemakers and to promote tourism in regional areas through increased incentives to open cellar doors.²³

WFA and WGGA and the majority of the industry believes the WET rebate should be reformed to be better aligned with the original policy intent of supporting regional businesses.

²³ Supplementary Explanatory Memorandum, Indirect Tax Legislation Amendment Bill 2000, [2.38-2.39].

Q6. What other policy goals should the WET rebate pursue? Why?

WFA and WGGA support the WET rebate being better aligned with its original intent and for reform measures to specifically support the following policy goals:

WFA and WGGA, with the support of all the state wine industry associations, are backing the reforms outlined in this submission that will better align the rebate's originally intended purpose and benefits with the future sustainability of the wine industry. In summary, we believe that the Government should:

1. Stop the WET rebate going to unintended recipients and shut down the schemes.
2. Keep the WET rebate within the original policy intent of delivering long term benefits to industry and tourism in regional Australia.
3. Phase out the WET rebate on bulk and unbranded wine over four years because we need strong brands to command margin and loyalty from consumers and retailers and to generate the profits that can be reinvested back into regional Australia.
4. Abolish the separate New Zealand rebate scheme and its preferential treatment of NZ producers and replace with a 'level playing field' for all rebate claimants regardless of nationality.
5. Encourage consolidation by introducing 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.
6. Work with WFA and WGGA to develop industry assistance for grape and wine businesses impacted by reform.

The details of each of these reform measures and what government must do are in the submission. Each can be introduced and implemented quickly and we request government make these changes urgently at MYEFO 2015. If reform is not expedited and delayed beyond 2015, it may be that the proposed phase-in periods for the recommended measures are shortened by industry to help deliver change in a timely manner.

Once implemented, WFA and WGGA will in consultation with industry analyse the impact of reform and continue to assess the WET rebate and whether further policy reform is required including those options raised in the Discussion Paper that fall outside our proposals.

Q7. Should the WET rebate be abolished? Why?

The WET rebate should not be abolished, because it is providing benefits to the very industry participants it was designed to encourage. It is supporting employment and tourism in regional Australia. In this way, the WET rebate is fulfilling its original intent.

The WET Rebate is providing an important benefit to wine and grape businesses and the regions in which they operate. The benefits the WET rebate delivers can best be expressed by the comments of industry as follows:

“O’Leary Walker Wines are small South Australian winemakers, sourcing grapes from vineyards in the Adelaide Hills, Clare Valley to produce premium cool-climate wines, spanning 12 varietals for export and domestic sale. Our cellar door in Clare Valley has been an important development in our 15 year history, helping to grow our brand and expand our customer base. This decision was taken in a tough trading environment but was seen as critical to growing our market share in a fiercely competitive environment. Our cellar door is also helping to grow regional tourism, attracting approximately 5200 visitors per year since it opened in 2001. When we started our business our commitment was to make great wines. The W.E.T. rebate was a great benefit in the startup of our business as the costs were significant. It gave us the confidence to take our wines into the international markets and employ more people within our business. On inception we had one employee, now we are employing over 12 staff. This would not have been possible without WET assistance. More recently the WET rebate has helped sustain our operations through the tough trading period of the last few years.”

- David O’Leary, Winemaker and Co-Owner, O’Leary Walker Wines

“Wirra Wirra is a small to medium-sized winery operating out of McLaren Vale, employing in excess of 45 full-time, part-time and casual staff and crushing around 2500 tonnes of fruit each year. Our cellar door is one of the most popular in the region, attracting thousands of visitors on an annual basis as we have become a key regional player in the wine tourism market. Over the past decade, we have seen very challenging times for the Australian wine industry. The growth of the domestic retail duopoly, the high AUD and the decline in demand for Australian wine in export markets have seen continual erosion of margin for wine producers. Wirra Wirra has managed to remain a sound, competitive business by continuing to invest in our brand and people during this difficult period. That investment can be firmly attributed to the WET rebate, without which we and many others would struggle to retain our relevance and position on the domestic and international stage.”

- Andrew Kay, Managing Director and CEO, Wirra Wirra

“Ballandean Estate Wines is a family business situated in the emerging wine growing area of the Granite Belt in Queensland. Over four generations the Puglisi family has created wines that truly reflect the unique essence of the region and shared them with our customers. As with the majority of wineries in the region (over 40) our cellar door has been our main market, with approximately 75% of our wine sales being attributed here and in the order of 40,000 visitors to the winery each year.

The WET rebate has contributed to our growth over the years by allowing us to complete improvements to our cellar door including an award winning restaurant and a Food Gallery. With this growth we have contributed to the growth of tourism generally in our region and as a result employ 18 local people. Tourism is one of the largest industries in the Granite Belt and is therefore hugely significant for the sustainability of this region and the employment of the local population. With over 40 employers in the wine industry, the WET rebate is a significant benefit to regional Queensland. A healthy wine tourism industry attracts and benefits numerous other industries resulting in more visitors and more jobs.

Ballandean Estate has recently been named Queensland Winery & Cellar Door of the year and without the WET rebate and our continued development, these accolades would have been more difficult to achieve.

- Angelo Puglisi, Owner, Ballandean Estate Wines

“Snake + Herring” is a small winemaker brand that selects unique parcels of fruit from the South West of Western Australia. These niche fruit parcels provide strong returns to the growers we purchase from across Margaret River, Blackwood Valley, Pemberton and Great Southern regions. We contract process the majority of our fruit in Margaret River, with some small parcels still being processed in the Great Southern region. These wineries need us to keep their operating cost per tonne down. We also own our own tanks, fermenters and barrels with an investment of \$1.5m in stock since 2011.

We sell 80% nationally through restaurants and export 5%. We will grow exports organically (re-investing profits slowly into export development). Considering our cost of goods are high and we have to send the goods across the Nullabor, without the WET rebate we wouldn't be competitive. I doubt we would have a business that could sustain the infrastructure (wages and lease commitments).

We recently secured a restaurant site in the Margaret River region (Dunsborough) and by March 2016 will have financed \$2m to see this into a reality. It will employ 20 locals and a payroll estimated to be \$700,000. A wine tourism business is extremely expensive to run in the country (costs are higher) and the WET rebate significantly contributes to regional development and jobs.”

- Redmond Sweeney CA, Director, Snake & Herring

“Crittenden Estate has been a family-owned and run small winemaking business on Victoria's Mornington Peninsula for over thirty years. Our business enterprise includes vineyards as well as on-site winemaking with a capacity of 300 tonnes throughput [approximately 20,000 cases]. Our recently built and nationally acclaimed second generation or new concept “Crittenden Wine Centre” has contributed significantly to the growth of local tourism for the Mornington Peninsula, attracting around 7,500 visitors each year. Across our vineyard, winery and sales operations we directly employ the equivalent of 12 full time staff. Most of these staff are local to the region and see themselves as part of a farming business with strong ties to the land, tourism and our local community. In the absence of the WET rebate scheme I expect our business would cease to operate. Unsustainable lack of profitability but also trends showing flat

or declining sales have many in our industry worried about the future of winemaking in this country.”

- **Garry Crittenden, Founder and Director, Crittenden Wines**

“Oliver’s Taranga Vineyard has been growing wine grapes since 1841 in South Australia’s McLaren Vale. Now into its sixth generation of family ownership, our business has diversified from being traditional grape growers into winemaking, producing our first Oliver’s Taranga branded wine in 1994. The introduction of the WET rebate in 2000 importantly helped underpin the development of our wine diversity and wine tourism offering. We have gone from producing one wine to now having a range of around ten wines, including fortifieds. Without the certainty of being able to fully-offset our WET liability, as a small wine business, we could not have taken the risk of growing our branded wine offering. We are proud employers of 10-15 locals, and our connection with our region extends beyond the boundaries of our 110 hectare vineyards through our sponsorships of the local McLaren Vale netball and football teams, and personal contributions to our region and industry on numerous levels over many years.”

- **Corrina Wright, Winemaker & Director, Oliver’s Taranga Vineyards**

“Campbells has been producing wines for over 145 years from our vineyards in Rutherglen, Victoria. A small, family-owned business, we are now in our fifth generation and directly employ 45 people from our region. The WET rebate has enabled us to stay in business and where possible, to expand our infrastructure, keep innovating and to employ more staff. Maintaining investment in infrastructure is particularly challenging for small wine businesses like ours, especially through difficult trading years as we have experienced over the last ten years. We run one of the oldest cellar door operations in the country and over 50% of our sales are direct to the consumer. The WET rebate has enabled us and the wineries in our region to be sustainable and in turn bring tourism and employment, providing a major boost to our region and indeed to the many country towns across the nation that have been built around wine and tourism. I was party to the negotiations that gave rise to the WET rebate. The WET rebate was provided to wineries by Peter Costello to correct the anomaly at the time of the introduction of the GST; with the proviso that it would help generate regional tourism and employment. That policy objective has seen our region survive and contribute to regional tourism and employment. It remains just as relevant today as it was in 1999 and should guide policy decision-making as we work together to secure a strong future for Australian wine.”

- **Colin Campbell, Joint Owner and Director, Senior Winemaker, Campbells of Rutherglen**

“Voyager Estate is a family-owned winery located in Stevens Valley, Margaret River. For nearly 40 years we have been both growers and producers of premium and ultra-premium wines, focusing on Chardonnay, Cabernet Sauvignon, Shiraz, Semillon, Sauvignon Blanc, and Chenin Blanc. We sell domestically and in export, and have a substantial cellar door and direct business that accounts for over 25% of our total revenue. Our commitment to excellence in wine quality and in our cellar door and restaurant experiences requires us to have a high number of staff relative to our size of wine production. To make this all happen, we proudly offer direct employment to between 45 and 60 locals depending on the season. We also

indirectly employ up to 30 additional locals throughout the year through labour-hire companies and other contractors.

The WET rebate enables our business to keep up with investment requirements in our vineyard and winery infrastructure, which are inherently capital-intensive. Its inclusion in our business planning also allows us to develop enhanced visitor and wine experiences that act as drawcards for regional tourism. (Anecdotally, Voyager Estate is among the top three most visited wineries in Margaret River, and Margaret River has among the highest visitation of any region in Western Australia.)

- Alexandra Burt, Managing Director, Voyager Estate

“Angove Family Winemakers is a 5th generation, family owned winery in South Australia producing single vineyard, super premium and commercial wines for the domestic and global markets. As a medium size wine business with a typical annual crush of 18,000 tonnes, we directly employ 155 staff. Our staff are predominantly local to the regions we operate in, being McLaren Vale and Renmark and additionally located around Australia in sales positions. The last 10 years have been particularly tough for our industry and maintaining our full diversity of wines, two cellar door operations (McLaren Vale and Renmark) and winemaking facilities has been incredibly challenging. During this extended, difficult period, the WET rebate has supported our investment in our brand, our assets, our people and our regions.”

- Victoria Angove, Executive Director, Angove Family Wines

“Yalumba is a member of the WFA’s medium sized producers group. Similar to many other producers, we have been impacted significantly in recent years by profitability challenges and low returns on capital employed. The WET rebate has allowed us to maintain our investment in growing our brands and by default premium “Brand Australia” in over 50 export markets as well as domestically. This ongoing commitment and investment has enabled us to continue to require fruit supply from the regions we produce brands being: The Barossa, Coonawarra, King Valley, Tasmania, Adelaide Hills, and the South Australian Riverland. Of our total grape requirements 70% is from family growers in these regions and therefore the WET rebate received by Yalumba has had direct benefits to communities in the aforementioned regions.”

- Nick Waterman, Managing Director, Yalumba

“Tyrrells Vineyards has been growing grapes and making wine from our base in the Hunter Valley since 1858. Today we are the equal second oldest continuous family winemakers in Australia. Our winery receives in advance of 200,000 visitors per annum. We employ 68 full time staff in three locations. As the retail sector falls away cellar door remains our best marketing resource as it is here that we tie the consumer to our brands and it also forms the heart of the ever growing wine tourism sector. However Wine Tourism comes at the cost of sampling and weekend staff rates. The original Winemakers Exemption was created to assist that cost as it saved wineries paying the state licence fees. In NSW we have lost the state cellar door rebate which replaced the Winemakers Exemption - an annual cost of \$3 million to the Hunter valley and over \$500,000 to Tyrrells. The WET rebate is significant for medium-sized family companies. If the WET rebate were removed the combined financial impact on Tyrrells would

be difficult to absorb and would require a major reconstruction of the business. It would also require replacement of these funds used in marketing and that would have to come from government as our pockets are not bottomless.”

- **Bruce Tyrrell AM, Managing Director, Tyrrell’s Wines**

“Henschke is a 6th generation, family owned winery based in Eden Valley producing single vineyard, varietal, super and ultra-premium wines from family owned vineyards in the Eden Valley, Barossa Valley and the Adelaide Hills for the our domestic and export customers. We are a small-medium size wine business with an artisanal focus of producing exceptional wines from outstanding vineyards. Our average annual crush is 800 tonnes and for that we directly employ around 50 staff, most of whom are local to the Barossa and Adelaide Hills. We have faced industry challenges in the last decade due to the GFC, recession in Europe, volatile exchange rates, and market retail domination from corporate supermarkets in Australia. Without the WET rebate we could not run a sustainable business to support our loyal local growers and employees.”

- **Stephen Henschke, Managing Director/Winemaker, Henschke Cellars Pty Ltd**

“Taylors are a family-owned business that have been making wine for four decades, across three generations. Based in South Australia’s Clare Valley, the Taylors portfolio boasts five ranges, from commercial to fine wines, across 15 different varietals. The WET rebate has helped to make possible our ongoing investment in vineyards, winemaking, bottling, cellar door and our 188 staff, all in our regional area of Auburn in the Clare Valley. We are the highest taxed wine producing country in the world so the WET rebate helps us offset this massive tax burden on the Australian wine industry.”

- **Mitchell Taylor, Managing Director and Winemaker (Founding Director of Australia’s First Families of Wines)**

Q8. If the WET rebate was removed, what would be the likely effects for the wine industry?

We are proposing that the WET rebate be retained but with reforms. WFA and WGGA, with the support of all the state wine industry associations, are backing reforms that will better align the rebate's originally intended purpose and benefits with the future sustainability of the wine industry.

WFA has not undertaken any modelling on the impact of removing the WET rebate altogether and does not endorse any third party modelling on this policy option. WFA and WGGA do not support the removal of the WET rebate for intended recipients as per the rebate's original policy intent.

As covered in the response to Questions 1 and 7, the rebate continues to play a critical role in supporting many wine businesses in both the fine and commercial wine segments. Its removal will likely have a significant impact on these businesses and the regional communities they support.

WFA and WGGA will in consultation with industry continue to analyse the impact of reform and continue to assess the WET rebate and whether further policy reform is required including those options raised in the Discussion Paper that fall outside our proposals. Please see our response to Questions 1 and 7 for further detail.

Q9. Should the WET rebate be replaced with a grant scheme that would phase out over a defined period of time? Why/not?

Q10. Over what period of time should the grant phase out? What transitional arrangements should apply?

WFA and WGGA will continue to monitor the implementation and impacts of any reforms introduced by the Government and remain open-minded regarding the need for further reform to the rebate and what specific changes may be required.

Our shared focus remains on facilitating a return to sustainable profitability for the industry and any further reform measures that emerge in the future that can help deliver this outcome will be supported. Improving the level of data and analysis on WET rebate claimants by the ATO and sharing this with industry will also play a critical role in enabling informed policy development.

In regards to the proposal to replace the rebate with a grants scheme, if the details of such a scheme clearly demonstrated that it met the criteria of delivering the original policy intent of the rebate and led to sustainable profitability and was easier to administer, then WFA and WGGA would consider it closely.

At this point in time we are not aware of any such detailed proposal and in the absence of sufficient data, WFA and WGGA do not support policy options that fall outside our detailed recommendations as presented in this submission. However, we will analyse the impact of the reform measures outlined in this submission, continue the analysis of the WET rebate 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 review of rebate policy arrangements three 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 the Expert Review had in establishing a clear view on the impact of the WET rebate on industry dynamics due to lack of data, WFA will, in collaboration with WGGA, 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.

Q11. Are there other ways that the wine industry could be supported to restructure? What are they?

In 2013, WFA finalised 43 Actions to restore profitability in the wine sector. This document remains a blueprint for industry recovery and growth in both domestic and export markets and can be found attached.

The Actions relevant to restructuring the industry that are outside our recommendations included in this submission (on WET rebate reform and growing the demand for our wine with additional funding to AGWA) are below. Further details on each can be found in the attachments to this submission. (Refer to Actions document in the Appendix.)

Grow the Demand Opportunity

With AGWA 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

WFA will work with AGWA 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.

Extend Export Market Development Grants

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

Improve Market Access

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

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.

Supply Side Activities and Hastening Supply Correction

Programs to support continued adjustment in supply will also contribute to improved market prospects of Australian wine by accelerating the transition to supply-and-demand balance.

WFA with WGGA will hasten the correction to the supply base to improve margins throughout the value chain. The outcome will help reduce the grape oversupply and the depressed prices it creates throughout the industry.

In addition, WFA and WGGA recognise that some support will be required for grape and wine businesses that will be adversely impacted by the reform measure of removing WET rebate eligibility of bulk and unbranded wine trade.

As examples, supply-side programs may include the following. Beyond these suggestions, WFA and WGGA undertake to provide more detail and costings as the policy responses to the Discussion Paper submissions evolve.

Transition programs when WET rebate access is removed

Growers or winemakers who have legitimately remodelled their businesses under the current WET rebate provisions, in order to secure alternative routes to market from that of wine company brands (when demand for these cannot accommodate their fruit) should be assisted through transitional arrangements when their eligibility is removed.

Programs that facilitate uptake of more suitable grape growing business models

For example

- mentoring for business remodelling
- promotion of initiatives such as collaborative farming
- programs to separate land asset ownership from business operations on that land.

Initiatives to address barriers to vineyard exits and ‘sticky supply’

Research is needed to identify and quantify the drivers of apparent barriers to exit of unsustainable vineyards – and then to address them. Prime candidates in this endeavour include understanding and addressing the role of stranded assets in preventing vineyard exits and the roles of off-farm income and diverse agriculture portfolios in sustaining underperforming vineyards.

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

Facilitating more rapid turn-over in vineyards in times of downturn or trend change

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

- lowering the cost of vineyard turnover and removal to facilitate greater responsiveness of vineyards to structural imbalances, economic cycles and changes in consumer preferences;
- vineyard flexibility to ascertain where there is excess supply and the technical priorities to support improvements in vineyard quality;
- alternate uses/markets for grape oversupply.

Capability of vineyard operators

- Business mentoring

- Programs to identify and promulgate good vineyard practice.
- Incentivising vineyard consolidation.
- Social support mechanisms for distressed, isolated farm operators.

Improving market operations that enable market forces to bring about supply adjustment

- Code of Conduct. WFA and WGGA will continue to support the Code of Conduct between winemakers and growers.
- Vineyard profitability. 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.
- WGGA and WFA, through their Joint Policy Forum, will discuss further market-based mechanisms to hasten the supply-side adjustments.

Vine buyback

- A vine buyback is not supported.

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

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

Code of Conduct

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

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

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

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

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

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

Q12. Should eligibility to the WET rebate be restricted by excluding bulk, unpackaged and unbranded wine?

To support regional communities over the long-term, WFA proposes to phase out the WET rebate on bulk and unbranded wine at the rate of 25% per annum over four years, starting at 75%.

The development of 'brand power' is critical to capturing above inflation retail price increases, increased margin share with retailers and reinvestment back into rural communities. 'Cleanskins', and unbranded wine work against these objectives and therefore do not play a long term role in encouraging sustained regional investment or development.

This measure will impact some grape and wine businesses in the short term who without the prospect of selling grapes into wine company owned brands, have changed their business models to produce finished wine and claim the rebate. WFA and WGGA believe that structural reform is required to return all parts of the wine supply chain to long-term profitability and that industry's future lies in strong branded product that can command loyalty and margin growth from retailers and consumers. WGGA is of the strong view that a proportion of this wine volume will still have the capability to find its way into alternate profitable routes to market

WFA does not believe that bulk, unpackaged and unbranded wine should be eligible for the rebate as, over the long-term, they do not support the building of brand equity and margins with retailers and consumers. WGGA is concerned about the strong potential for this trade to depress winegrape prices. Therefore, the Commonwealth should phase out WET rebate eligibility for bulk and unbranded wine at 25% per year starting at 75% of the rebate rate from implementation.

This can be achieved by changing the legislative definition of rebatable wine for the WET rebate to:

*'rebatable wine means *grape wine, *grape wine products, *fruit or vegetable wine, *cider or perry, *mead or *sake, that is packaged in a single container with a capacity not exceeding 5 litres at the time of the dealing, and which is labelled with a brand on the primary packaging that is wholly owned by, or licensed exclusively to, the producer of the wine.'*

Branded product, which would remain eligible for the rebate under this proposal, is defined as that product which bears the proprietary brand of the claimant and includes brands that may be exclusively ranged in specific outlets.

This proposal would continue to support the industry consistent with the original intent of the rebate discussed above. By way of example, it would enable the following activities to continue to claim the rebate:

- Winemaking and grape growing businesses that produce their own branded and packaged wine;
- Winemakers and grape growers 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 leases vineyards and produce their own branded and packaged wine.

WFA also 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. Government should 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 four years. These transitional arrangements will be made available to the industry for up to five years from the date of implementation. Accessing this arrangement would be limited to a 'once-only' or finite entitlement.

These legislative changes are expected to deliver significant budget savings as detailed in this submission.

Further insight into industry thinking on the proposal to remove rebate eligibility for bulk and unbranded wine is as follows:

“Riverland Wine strongly supports the WFA proposal to phase-out the WET rebate on bulk, unbranded and unpackaged wines. The current arrangement provides a rebate where no tax is payable. This leads to a distortion in market-pricing, putting the great majority of growers at a disadvantage relative to those enterprises producing wine with a rebate. There is clear evidence that the availability of the WET rebate on bulk, unbranded and unpackaged wine is being used as leverage to negotiate below market prices for the purchase of grapes. This is a distortion the industry cannot afford.”

- **Chris Byrne, Executive Officer, Riverland Wine**

(the Riverland is Australia's largest wine producing region accounting for more than half South Australia's production and more than 20 per cent of the national crush. Riverland Wine represents the diverse interests of over 1000 grape growers and 16 wineries spanning large and small boutique operations.)

“The WET rebate on bulk wine is having unintended outcomes in the market that result in lower grape prices. This must be fixed to allow industry recovery to start.”

- **Brett Proud, Riverland grape grower**

“The WET rebate issue needs resolving. It is reducing the ability for us to sell fruit, and also has a negative impact on the value of bulk wine”

- **Sheridan Alm, Director, Yatco Viticulture**

“Australian Vintage Limited is a leading Australian wine company and a fully-integrated wine business that includes vineyards, boutique and bulk wine production, packaging, marketing and distribution. AVL crushes around 8% of Australia's total production. AVL supports the WFA proposal to phase-out the rebate on bulk, unbranded and unpackaged wines. This is because we fundamentally believe this particular use of the WET rebate is artificially depressing grape prices and is preventing a correction to the industry's oversupply problem. Addressing this situation is critical to the sustainability of the industry.”

- **Neil McGuigan, CEO, Australian Vintage Limited**

Q13. Should the definition of 'producer of wine' be amended to restrict claims for the rebate?

WFA and WGGGA believe that the priority reform is to amend the definition of 'rebateable wine' in the Act rather than change the definition of 'producer'.

WFA looked closely at this question and it formed part of the industry consultations held in 2013. With the benefit of this consultation, together with expert legal opinion, it became clear that approaching this matter by trying to define "producer", and covering all intended consequences and avoiding all unintended consequences, would prove more complex than focussing on the "product". To focus on "producer" would likely require a lengthy, convoluted definition. Simplicity is highly desirable as one of the biggest issues with the current law is that it cannot be understood by the average winemaker or grape grower.

Further, the issue of who is a "genuine producer" is a highly subjective and emotive one. Focussing on the 'activity' or 'product' is simpler. It is also important to note that the liquor licensing of producers is governed by State law, so there already exists different definitions of 'producer' throughout the country. Another national definition, which would be different again, would add further confusion.

It was also felt that determining rebate eligibility by reference to the definition of "producer" would encourage people to adopt a particular business model for the wrong reason. From an economic benefit perspective, Australian businesses should be encouraged to select the most efficient model for their businesses and to be innovative in that regard.

Focussing on the definition of "producer" would not necessarily prevent a wine from being the subject of multiple rebates, as it could pass through the chain to multiple entities all within the definition. On the other hand, 'rebateable wine', as defined and proposed here in this submission, can only be subject to one rebate when dealt with by its producer.

Finally, relying on the definition of "producer" could also give rise to WTO/CER problems, if it impacts on the ability of foreign producers to claim the rebate. For all these reasons, the consensus was that focussing on the definition of what constitutes 'rebateable wine', was preferable for its simplicity and clarity.

WFA does not believe that bulk, unpackaged and unbranded wine should be eligible for the rebate as, over the long-term, they do not support the building of build brand equity and margins with retailers and consumers. Therefore, the Commonwealth should phase out WET rebate eligibility for bulk and unbranded wine at 25% per year starting at 75% of the rebate rate from implementation.

This can be achieved by changing the legislative definition of rebateable wine for the WET rebate to:

*'rebateable wine means *grape wine, *grape wine products, *fruit or vegetable wine, *cider or perry, *mead or *sake, that is packaged in a single container with a capacity not exceeding 5 litres at the time of the dealing, and which is labelled with a brand on the primary packaging that is wholly owned by, or licensed exclusively to, the producer of the wine.'*

This proposal would continue to support the industry consistent with the original intent of the rebate. By way of example, it would enable the following activities to continue to claim the rebate:

- Winemaking and grape growing businesses that produce their own branded and packaged wine;
- Winemakers and grape growers 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 leases vineyards and produce their own branded and packaged wine.

It should also be noted that our proposals would also require all rebate claimants to hold a relevant domestic liquor licence.

Q14. Should the WET rebate only be allowed for wine on which WET has been paid? Why?

WFA and WGGA will continue to monitor the implementation and impacts of any reforms introduced by government and remain open-minded regarding the need for further reform to the rebate and what specific changes may be required.

Our shared focus remains on facilitating a return to sustainable profitability for the industry and any further reform measures that emerge in the future that can help deliver this outcome will be supported. Improving the level of data and analysis on WET rebate claimants by the ATO and sharing this with industry will also play a critical role in enabling informed policy development.

In regards to the proposal to allow the rebate to be paid only on wine where the WET has been paid, if the details of such a proposal clearly demonstrated that it met the criteria of delivering the original policy intent of the rebate and led to sustainable profitability and was easier to administer, then WFA and WGGA would consider it closely.

At this point in time we are not aware of any such detailed proposal and in the absence of sufficient data, WFA and WGGA do not support policy options that fall outside our detailed recommendations as presented in this submission. However, we will analyse the impact of the reform measures outlined in this submission, continue the analysis of the WET rebate 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 review of rebate policy arrangements three 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 the Expert Review had in establishing a clear view on the impact of the WET rebate on industry dynamics due to lack of data, WFA will, in collaboration with WGGA, 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.

Q15. If the cap was reduced, what should the maximum WET rebate be?

Q16. If the rebate was only available for a proportion of the WET, what should that proportion be?

WFA and WGGA will continue to monitor the implementation and impacts of any reforms introduced by government and remain open-minded regarding the need for further reform to the rebate and what specific changes may be required.

Our shared focus remains on facilitating a return to sustainable profitability for the industry and any further reform measures that emerge in the future that can help deliver this outcome will be supported. Improving the level of data and analysis on WET rebate claimants by the ATO and sharing this with industry will also play a critical role in enabling informed policy development.

In regards to proposals to reduce the rebate cap or make it only available on a portion of the WET paid, if the details of such a proposal clearly demonstrated that it met the criteria of delivering the original policy intent of the rebate and led to sustainable profitability and was easier to administer, then WFA and WGGA would consider it closely.

At this point in time we are not aware of any such detailed proposal and in the absence of sufficient data, WFA and WGGA do not support policy options that fall outside our detailed recommendations as presented in this submission. However, we will analyse the impact of the reform measures outlined in this submission, continue the analysis of the WET rebate 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 review of rebate policy arrangements three 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 the Expert Review had in establishing a clear view on the impact of the WET rebate on industry dynamics due to lack of data, WFA will, in collaboration with WGGA, 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.

Q17. Should New Zealand producers' access to the rebate be changed? If so, how?

WFA and WGGA are not seeking to exclude New Zealand claimants from rebate eligibility. We are seeking a level playing field for all claimants regardless of nationality and this will require abolition of the separate New Zealand producers' rebate arrangements and its preferential terms.

To further ensure the WET rebate continues to deliver its original policy intent of supporting local wine businesses and wine regions, WFA recommends that the amendments to the WET Act in 2005, which established the New Zealand WET rebate system, be repealed. The ability of New Zealand wine producers to access the rebate on unfairly favourable terms has directly harmed Australian producers and has added to the oversupply of wine in the domestic market. The separate New Zealand rebate arrangements provides New Zealand producers with an unfair commercial advantage over local and other foreign claimants as they are not required to be registered for Australian GST and are not subject to compliance costs associated with lodging an Australian income tax return. There is a compelling case to immediately abolish this separate entitlement, and instead enable New Zealand producers to continue to claim the rebate, but on identical terms of access as currently applied to Australian and other foreign country claimants. WFA has supporting legal advice on how this can be done in a manner without impacting Australia's broader trading obligations and bilateral commitments.

This recommendation has widespread industry support. Some \$25m per annum is currently rebated to New Zealand wine producers and the abolition of the separate New Zealand rebate arrangements along with the other reforms to rebate eligibility proposed above will see a net saving of almost \$15m per annum to the Commonwealth (by 2018/19) and a level playing field created for all future claimants regardless of origin. This approach is consistent with Australia's bilateral and multi-lateral trading commitments.

While all foreign entities are currently eligible to access the rebate, it is New Zealand winemakers that have particularly benefited from the rebate. In recent years, we have seen New Zealand imports increase from 21 million litres in 2007 to over 52 million litres in 2014 resulting in a 30% of the total value of the leading 20 SKUs sold in Australia. This loss of market share, in large part underpinned by the rebate, has directly harmed Australian producers, and consequently regional communities. The supporting legal advice at attached to this submission outlines what changes are required and how they can be implemented without compromising our bilateral or international trading obligations.

The separate New Zealand producers' rebate scheme provides New Zealand producers a commercial advantage over other local and foreign claimants as outlined in the supporting legal advice (see attachment):

...foreign winemakers who receive the WET rebate are: (1) treated as having derived Australian income; and (2) therefore required to lodge Australian income tax returns.

However, NZ winemakers are not required to lodge Australian income tax returns, as the WET producer rebate is considered to be assessable in NZ and not Australia.

In addition, NZ winemakers are not required to be registered for Australian GST purposes and hold a state or territory liquor license, unlike Australian wine producers and other foreign wine producers.

NZ winemakers are therefore not subject to the compliance costs associated with lodging Australian income tax returns, Business Activity Statements (BAS), or with ongoing state or territory liquor licensing requirements.

Further, the ATO allows the NZ Inland Revenue to administer the WET rebate for NZ winemakers. The ability for NZ winemakers to deal with their local revenue authority is not available to other foreign wine producers.

These preferential conditions make it easier and cheaper for NZ winemakers to access to the WET rebate, than for other foreign wine producers.

The following table summarises the requirements to claim the producer rebate, and the benefits afforded to NZ wine producers that are not available to other foreign wine producers.

Claim requirements under the current WET producer rebate schemes			
	<i>Australian wine producers</i>	<i>New Zealand participants</i>	<i>Other foreign wine producers</i>
<i>GST registration required</i>	✓	✗	✓
<i>Wine tax must be paid</i>	✗	✓	✗
<i>Australian income tax obligations</i>	✓	✗	✓
<i>In-country administrative assistance provided</i>	✓	✓	✗
<i>Entity required to be exporter of wine</i>	N/A	✗	✓
<i>Required to hold a State/Territory Liquor License</i>	✓	✗	✓

While some \$25m per annum is currently rebated to New Zealand producers, the abolition of the separate New Zealand arrangements plus the proposed changes to future rebate eligibility including the requirement to hold local liquor licences and business premises and the removal of the rebate from bulk and unbranded wine from New Zealand will deliver a net savings to the Commonwealth of \$44.9m over four years.

These legislative changes are expected to deliver significant budget savings detailed in our submission. The requirements for claimants under our proposals are summarised below:

Claim requirements under the proposed changes for accessing the WET producer rebate			
	<i>Australian wine producers</i>	<i>New Zealand participants</i>	<i>Other foreign wine producers</i>
<i>GST registration required</i>	✓	✓	✓
<i>Wine tax must be paid</i>	✗	✗	✗
<i>Australian income tax obligations</i>	✓	✓	✓
<i>In-country administrative assistance provided</i>	✓	✓	✗
<i>Entity required to be exporter of wine</i>	N/A	✓	✓
<i>Required to hold a State/Territory Liquor License</i>	✓	✓	✓

Q18. Should the WET rebate be replaced by a small rebate for independent Australian alcohol producers such as wineries, distilleries and breweries?

WFA and WGGA will continue to monitor the implementation and impacts of any reforms introduced by government and remain open-minded regarding the need for further reform to the rebate and what specific changes may be required.

Our shared focus remains on facilitating a return to sustainable profitability for the industry and any further reform measures that emerge in the future that can help deliver this outcome will be supported. Improving the level of data and analysis on WET rebate claimants by the ATO and sharing this with industry will also play a critical role in enabling informed policy development.

In regards to proposals to replace the rebate, if the details of such a proposal clearly demonstrated that it met the criteria of delivering the original policy intent of the rebate and led to sustainable profitability and was easier to administer, then WFA and WGGA would consider it closely.

At this point in time we are not aware of any such detailed proposal and in the absence of sufficient data, WFA and WGGA do not support policy options that fall outside our detailed recommendations as presented in this submission. However, we will analyse the impact of the reform measures outlined in this submission, continue the analysis of the WET rebate 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 review of rebate policy arrangements three 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 the Expert Review had in establishing a clear view on the impact of the WET rebate on industry dynamics due to lack of data, WFA will, in collaboration with WGGA, 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.

Q19. Would any significant changes to the WET rebate require transitional arrangements to help the wine industry restructure? How should transitional arrangements be designed?

WFA and WGGA recommend a number of transitional arrangements for the proposed reforms:

1. A four year phasing out of rebate eligibility for bulk and unbranded
WFA does not believe that bulk, unpackaged and unbranded wine should be eligible for the rebate as, over the long-term, they do not support the building of brand equity and margins with retailers and consumers. Therefore, the Commonwealth should phase out WET rebate eligibility for bulk and unbranded wine at 25% per year starting at 75% of the rebate rate from implementation.
2. Government to work with WFA and WGGA to develop industry assistance for grape and wine businesses impacted by reform.
3. Encourage consolidation by introducing 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 four years.
4. On-going analysis by WFA and WGGA in consultation with industry on further reform

WFA will analyse the impact of the reform measures outlined above and continue the analysis of the WET rebate 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 review of rebate policy arrangements three 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 the Expert Review had in establishing a clear view on the impact of the WET rebate on industry dynamics due to lack of data, WFA will, in collaboration with WGGA, 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.

8. Appendix

- A. Supporting Letters from State Wine Associations
- B. Snapshot of the industry
- C. Actions for Industry Profitability 2014-2016
- D. Legal Advice, "Returning WET Rebate to Fairness and Original Policy Intent" Finlaysons Lawyers
- E. Economic Modelling, "Returning WET Rebate to Fairness and Original Policy Intent – Supporting Advice on the Impact to Government Revenue", PwC
- F. WFA Vintage Report July 2015



9 September 2015

Mr Paul Evans
Chief Executive
Winemakers Federation of Australia
National Wine Centre
Botanic Road
ADELAIDE SA 5000

Dear Paul

WFA TAX REFORM AGENDA

Following Executive consideration of the WFA/WGGA joint submission the NSWIA advises that it supports the following core elements of the push for tax reform as follows:

1. Supports reform of access to the WET rebate by overseas entities to abolish preferential treatments where these occur in order to create a 'level playing field' for all rebate claimants regardless of nationality.
2. Supports the removal of WET rebate from bulk wine
3. That savings achieved from 1 and 2 above be reinvested towards industry re-structuring and the promotion of wine at the local, regional, national and international levels.
4. That WFA takes a lead role in the harmonisation of WET rebate eligibility across all States to removed current discrepancies in treatment.

The NSWIA Executive Members also notes that WFA is the advocate for this reform and NSWIA will refer all requests for public comment to WFA.

Yours sincerely

A blue ink signature of Tom Ward, written in a cursive style.

Tom Ward
President



9 September 2015

To Whom It May Concern

Re WET REBATE DISCUSSION

The Queensland Wine Industry Association supports the joint submission of the Winemakers Federation of Australia and Wine Grape Growers of Australia to the WET Rebate Discussion.

The industry in Queensland is made up of a number of small producers selling the greatest percentage of wine produced from vineyards within the region through cellar door. These operations support tourism infrastructure and employment within rural regions. Removal of the rebate would affect the maintenance of profitability of many of these businesses.

We strongly support recommendations for reform that bring the application of the rebate to its original intent and those that suggest savings from reform being made available to AGWA for both export and domestic marketing programs and for R& D to strengthen and advance the industry.

Kind regards

A handwritten signature in blue ink, appearing to read 'Jim Barnes', enclosed in a light blue rectangular box.

Jim Barnes
Acting President



10 September 2015

Mr Paul Evans
Chief Executive
Winemakers' Federation of Australia
Industry Offices, National Wine Centre,
Botanic Road,
ADELAIDE SA 5000

By email: paulevans@wfa.org.au

Dear Paul,

Re: Wine Equalisation Tax Rebate – Discussion Paper

The South Australian Wine Industry Association (SAWIA) through its membership is taking a keen interest in the wine tax proposals developed by the wine industry over the last 12 months principally through the efforts of the Winemakers' Federation of Australia (WFA).

Since that time, the Federal Government has released a discussion paper on the wine equalisation tax rebate and SAWIA members are showing a great deal of interest and will be monitoring any developments.

SAWIA has consulted its members and following consideration of the member feedback will make a submission to The Treasury of the Australian Government.

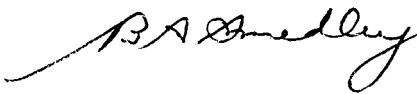
Taking into consideration many of the issues canvassed in the discussion paper, SAWIA members are supportive of reforms to the wine equalisation tax rebate including:

- A return of the WET rebate to its original policy intent allowing for the continuation of support to wine businesses, employment, tourism and communities in wine regions.
- Members want unintended recipients of the WET rebate to cease receiving the rebate and examples of schemes specifically created to claim the WET rebate should be investigated and closed as necessary. In addition, if schemes are identified that are contrary to WET rebate laws, industry associations should be advised to assist respective memberships comply with the law.
- A phase out of the WET rebate on bulk, unbranded and unpackaged wine over a four year period at 25% per annum. Given there are views for and against such a proposal close monitoring after the first twelve months of operation should occur to assess if the change meets intended outcomes.
- Support changes to the New Zealand WET rebate scheme which would result in abolishing the legislated NZ rebate scheme but provide for WET rebate claims on the same operational conditions for all wine producers regardless of nationality.
- Support the introduction of a transitional measure to encourage consolidation, allowing a second rebate on a merger of two businesses (which are entitled to the rebate) to remain with the new entity but phased out at 25% per year over 4 years.

- Support additional funding for market related programs (derived from WET rebate reform savings) for a finite period that can be applied to address wine market issues. SAWIA notes the industry is best placed to determine what programs should be undertaken to address specific markets issues. Industry involvement is crucial for success which includes any decision on which organisation is best placed to deliver the agreed activity.
- Where proposed reforms result in adverse impacts for either grape growing and / or winemaking businesses, there should be support provided for these businesses who genuinely are experiencing hardship as a result of transition measures.

Should you require any clarification please contact me.

Yours faithfully,



BRIAN SMEDLEY
Chief Executive



September 2015

Paul Evans
Chief Executive Officer
Winemakers' Federation of Australia
PO Box 2414
KENT TOWN SA 5071

Dear Paul,

This letter is to confirm Wine Tasmania's position on the Wine Equalisation Tax (WET) rebate, in line with its response to the Australian Government's WET Rebate discussion paper.

Wine Tasmania confirms its support for retaining the value-based system of taxation on wine, together with the Wine Equalisation Tax (WET) rebate, and only in conjunction with the rebate.

Wine Tasmania further confirms its support to reform the rebate to return it to its original intent of supporting small, regional wine producers, through removing the rebate from bulk, unpackaged, unbranded and private label wine. Additionally, we support removal of the WET rebate from foreign producers, whilst noting overarching trade agreements and requirements.

It is Wine Tasmania's position that significant change, reduction or removal of the WET rebate cannot be considered separately to the overall structure of wine tax.

Reforming and returning the WET rebate to its original intent through these changes, would also support the Australian wine sector's market-led approach to improve the sector's performance through promotion of our fine, branded wines.

Regards,

Sheralee Davies
Chief Executive Officer

10 September 2015

Paul Evans
Chief Executive
Winemakers' Federation of Australia
PO Box 2414
Kent Town SA 5071

Via: paulevans@wfa.org.au

Dear Paul,

Re: Endorsement of Winemakers' Federation of Australia position on WET Rebate
I am writing to express Wine Victoria's support for the reform measures contained in the Winemakers' Federation of Australia (WFA) submission on the Wine Equalisation Tax (WET) Rebate, specifically:

- Ensuring the WET Rebate is returned to its original intent of support for smaller Australian winemakers located in regional Australia;
- The introduction of measures to prevent the inappropriate access and abuse of the rebate system by Australian and offshore producers;
- Retention of the WET Rebate for branded wine because it continues to deliver on the original policy intent of long-term benefits to industry and tourism in regional Australia;
- Review of the access conditions to the Rebate, including foreign entities such as New Zealand producers, to ensure policy integrity and a competitive domestic environment.

Wine Victoria also endorses WFA's position to phase out the WET Rebate on bulk and unbranded wine over four years with the condition that work on the definition of 'bulk' and 'unbranded' wine is undertaken as part of the broader consultation process with industry.

Wine Victoria supports WFA's submission to the WET Rebate Discussion Paper along these lines, noting the condition outlined above.

If you wish to discuss these matters further, please don't hesitate to contact Wine Victoria Executive Officer Rachael Sweeney on 0422 067 858 or secretariat@winevictoria.org.au.

I look forward to working with you further on matters of importance to the wine industry.

Kind regards,



Damien Sheehan
Chair – Wine Victoria

Paul Evans
Chief Executive

9th Sept. 2015

Winemakers' Federation of Australia

Dear Paul,

Re: Winemakers' Federation of Australia - Tax Campaign

Our state wide consultation process with our industry stakeholders is now complete. I can confirm that Wines of WA strongly supports the WFA/WGGA response to the WET Rebate Discussion Paper.

We support the strategy proposed by the WFA to request that the revenue recovered by the ATO through the proposed integrity reforms outlined in the response should be reinvested back into the Australian wine industry. We agree that this investment should be used to restore AGWA's (Wine Australia's) core operational budget to a level that will sustain effective market development activities for the benefit of all wine producers. This will come at a time that enables the wine sector to capitalise on the recent Free Trade Agreements with Japan, Korea and pending China. In addition the weakening Australian dollar allows producers to kick start our wine exports to growing markets such as the USA which will assist in creating demand for our production and restore profitability and investment to create a sustainable industry that supports regional employment and communities in many regions of Australia.

Wines of WA has also submitted a response to the Discussion Paper. In this, we confirm our alignment with the WFA/WGGA response to all questions posed in the paper. We have provided additional information specific to WA producers where we feel this adds further weight to the Australian wine industry's position on amendments to the WET.

Kind regards,



Larry Jorgensen

Chief Executive Officer

Wines of Western Australia

T – 61 08 9284 3355

F – 61 08 9284 2199

M – 0448 884 161

E – ceo@winewa.asn.au

Snapshot of the Australian Wine Industry			
Wine Producers			
Wineries		Value	% change over last 12 months
2014	number	2,573	-3.6%
# Decrease	number	92	
Wineries by Size of Crush (2013)			
< 500 tonnes	number	2,244	0.04%
500-4,999 tonnes	number	177	-2.3%
5000-9,999 tonnes	number	14	-12.5%
>=10,000	number	28	-9.7%
Unspecified	number	110	0.9%
Direct Employment			
2014-15	number	16 186	0.4%
Viticulture			
Winegrape Crush			
2014	'000 tonnes	1 700	-7.4%
Winegrape Price			
Australian average, all varieties (2014)	\$A	441	-11.6%
Environment			
Water Use (2012-13)			
Megalitres per hectare	ML	2.52	21.7%
Beverage Wine Production			
2014	million litres	1 202	-2.4%
Sales & Trade			
Domestic Sales - Volume			
2013	million litres	459	1.0%
Domestic Sales - Value (wholesale, using fob prices)			
2012-13	\$A million	2 369	-5.0%
Imports - Volume			
2013	million litres	83	-1.2%
Imports - Value			
2013	\$A million	610	9.0%
Exports - Volume			
2014	million litres	700	2.0%
Exports - Value			
2014	\$A million	1 820	2.0%
Exports - Value per Litre			
2014	\$A/litre	\$2.60	0.0%
Wine as % of total value of crops export (fob)			
2013-14	%	8%	
Wine Exports' Ranking on major agricultural, fisheries and forestry commodities exports			
2012-13	ranking	6th	
Australian Wine's Contribution to Value of World Wine Trade (2012)			
Ranking	ranking	4th	
%	%	6%	
Tourism			
			% market share
International visitors to wineries (year ending Sep 2014)	no. of people	696 602	11.0%
Domestic visitor overnight trips to wineries (year ending Sep 2014)	no. of trips in million	3	4.0%
Estimated tourism revenue generated from international and domestic visits (year ending Sep 2014)	\$A billion	8.20	
Consumption			
Wine Consumption Per Capita			
2012-13	litres	29.11	-2.30%
Taxation			
Net Wine Equalisation Tax 2013-14	\$A million	766	3.0%
Sources: ABARES Commodity Statistics, Australian & New Zealand Wine Industry Directory, IBISWorld Industry Report, Tourism Australia, Entwine Member Database, ABS Domestic Sales and Import Statistics and Wine Australia Export Approval Database via Winefacts Statistics; ABS Catalogue No: 1329.0 Australian Wine and Grape Industry, ABS Catalogue No: 8504.0 Shipments of Wine and Brandy in Australia by Australian Winemakers and Importers, , ABS Catalogue No: 4307.0.55.001 Apparent Consumption of Alcohol ,Wine Australia and Treasury (Budget and Mid-year Economic and Fiscal Outlook), Aztec Report; Australian Taxation Office, Taxation Statistics; WFA analysis			

Winemakers' Federation of Australia

**Actions for Industry Profitability
2014 - 2016**

December 2013



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, <i>"Expert Report on the Profitability and Dynamics of the Australian Wine Industry"</i>	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.

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,

A handwritten signature in dark ink, appearing to be 'TD', written in a cursive style.

Tony D'Aloisio AM
President

A handwritten signature in dark ink, appearing to be 'PE', written in a cursive style.

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 website². 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 incoming 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 grades³. 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 WGGA⁴.

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.

Collaborate on shared issues and build relationships

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.

➤ 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 “rebateable 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. WGGGA 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'	\$0.5m			\$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 WGGGA, 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 competitiveness 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 website⁷.

➤ **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



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

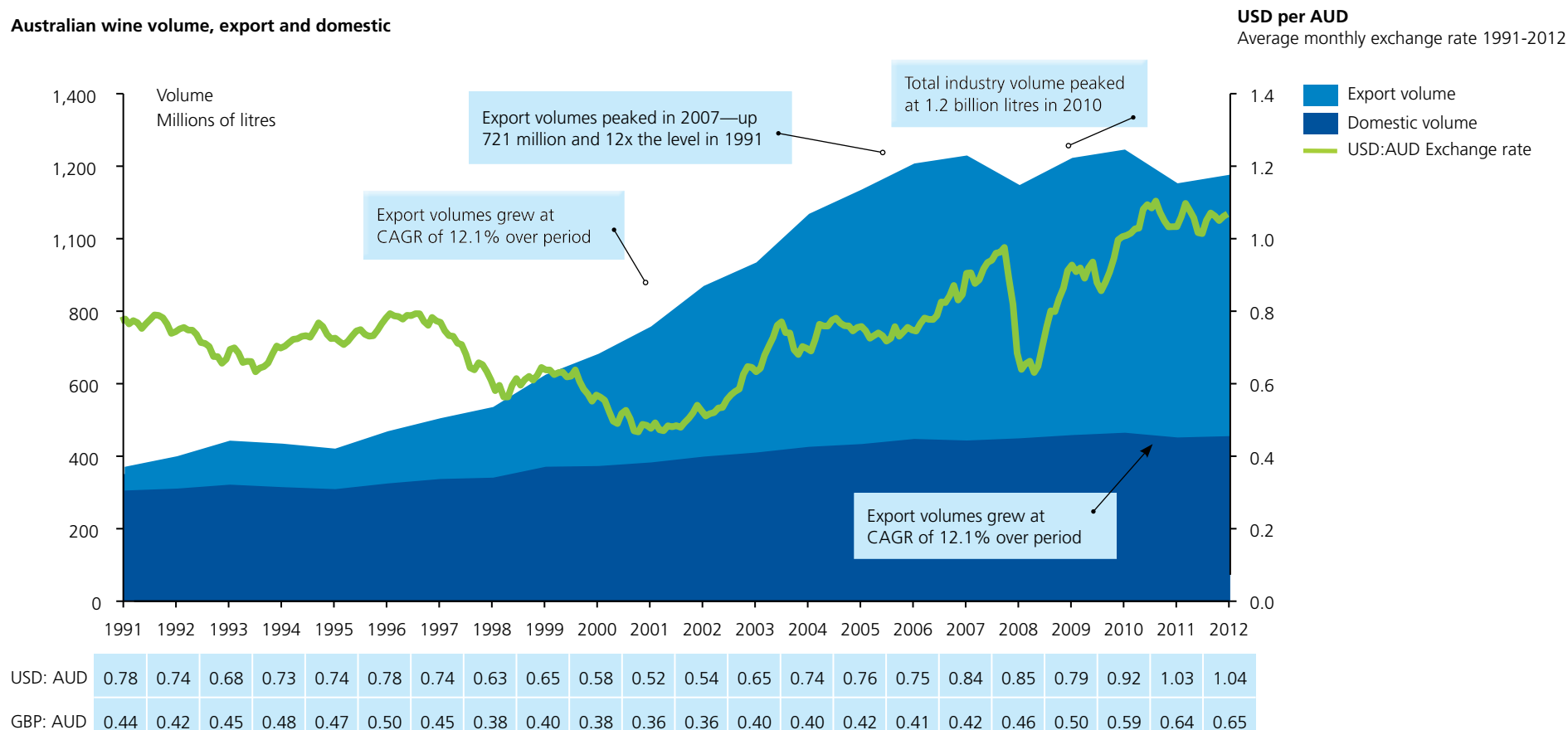
1. The Australian wine industry has tripled in size and been very successful at building export markets
2. Since 2007 the profitability of the Australian wine industry has declined significantly
3. This decline in profitability has been driven by a 'perfect storm' that has intensified
 - Export returns 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

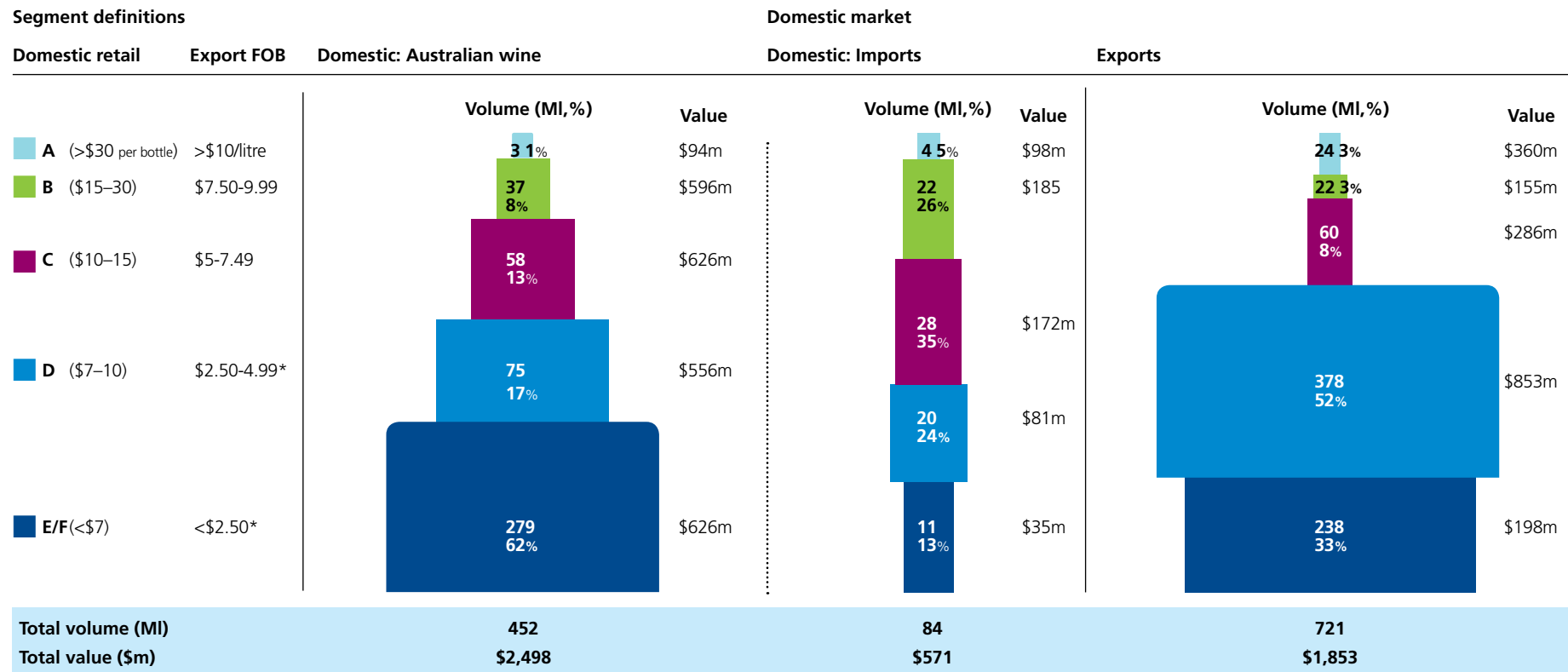


Source: ABS; Wine Australia; xe.com; US Treasury

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)



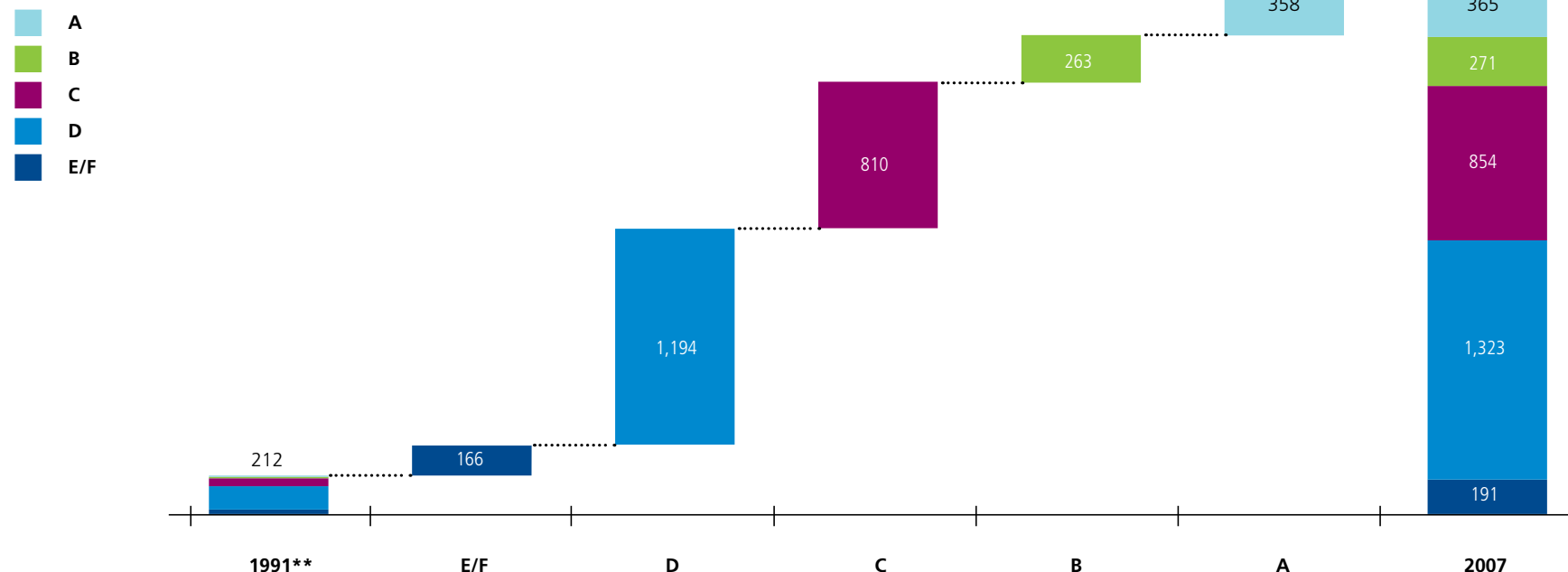
* Bulk under \$1.00 per litre is classified as E/F and above \$1.00 per litre as D
Source: ABS; Wine Australia; Nielsen; analysis

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



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, 2007–2012¹

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

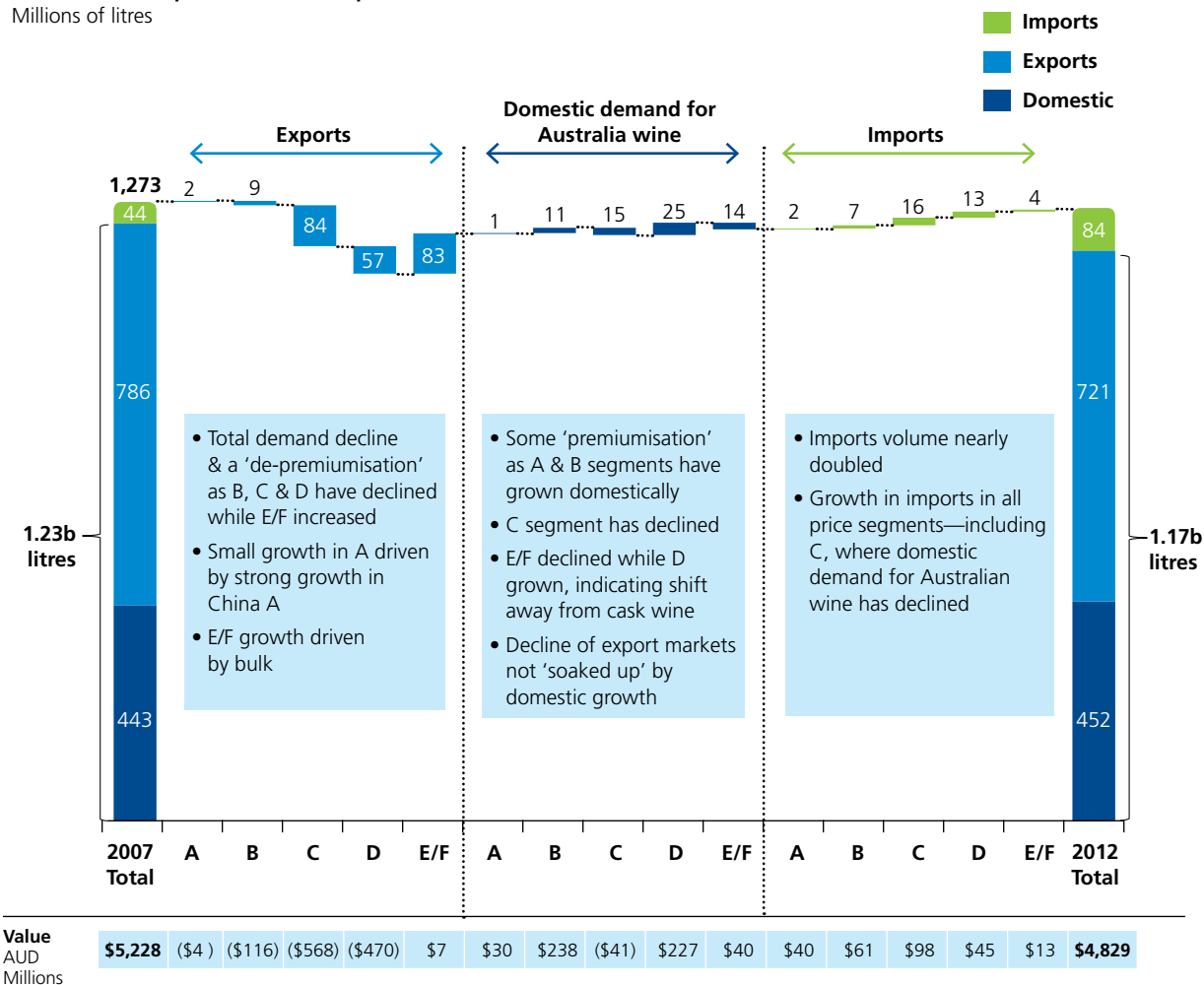
⁴ Total value and volume from ABS. Distribution by segment based on Nielsen data on retail glass bottle sales

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



* Imports are glass bottle only

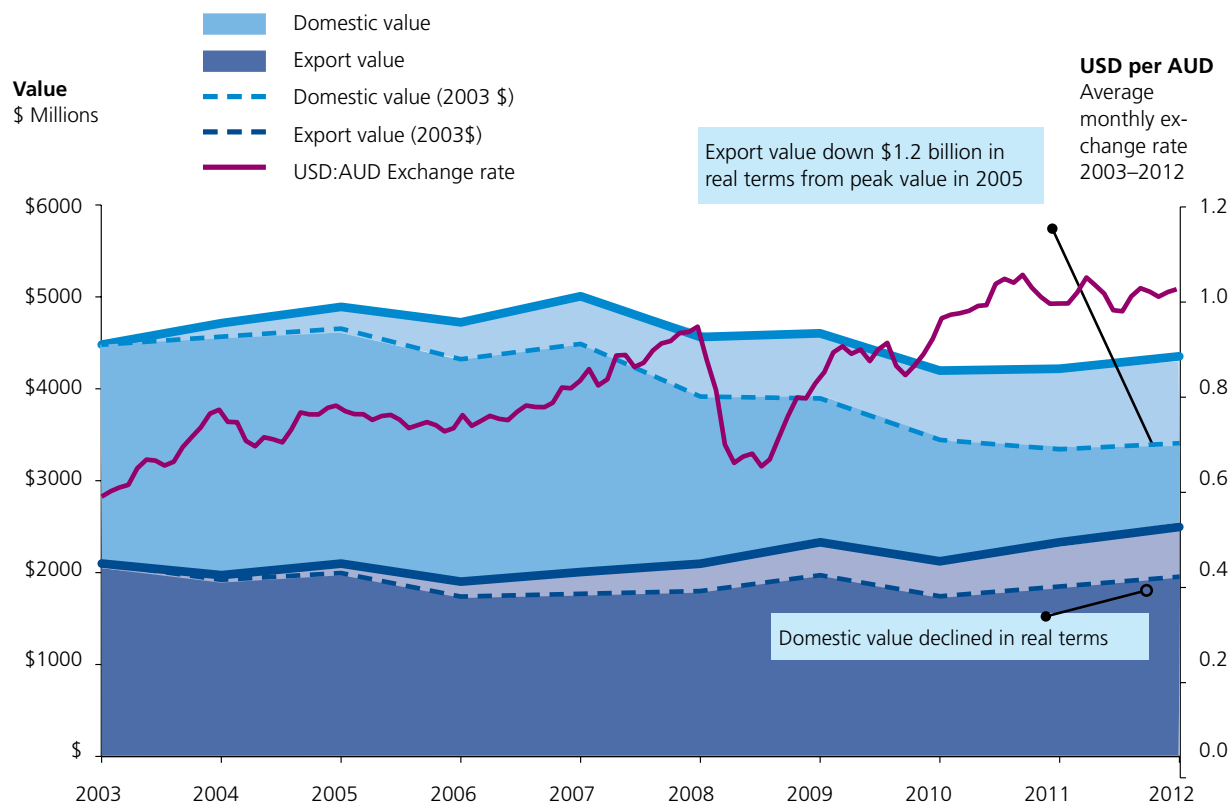
Source: Wine Australia; Nielsen; ABS; analysis

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 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.

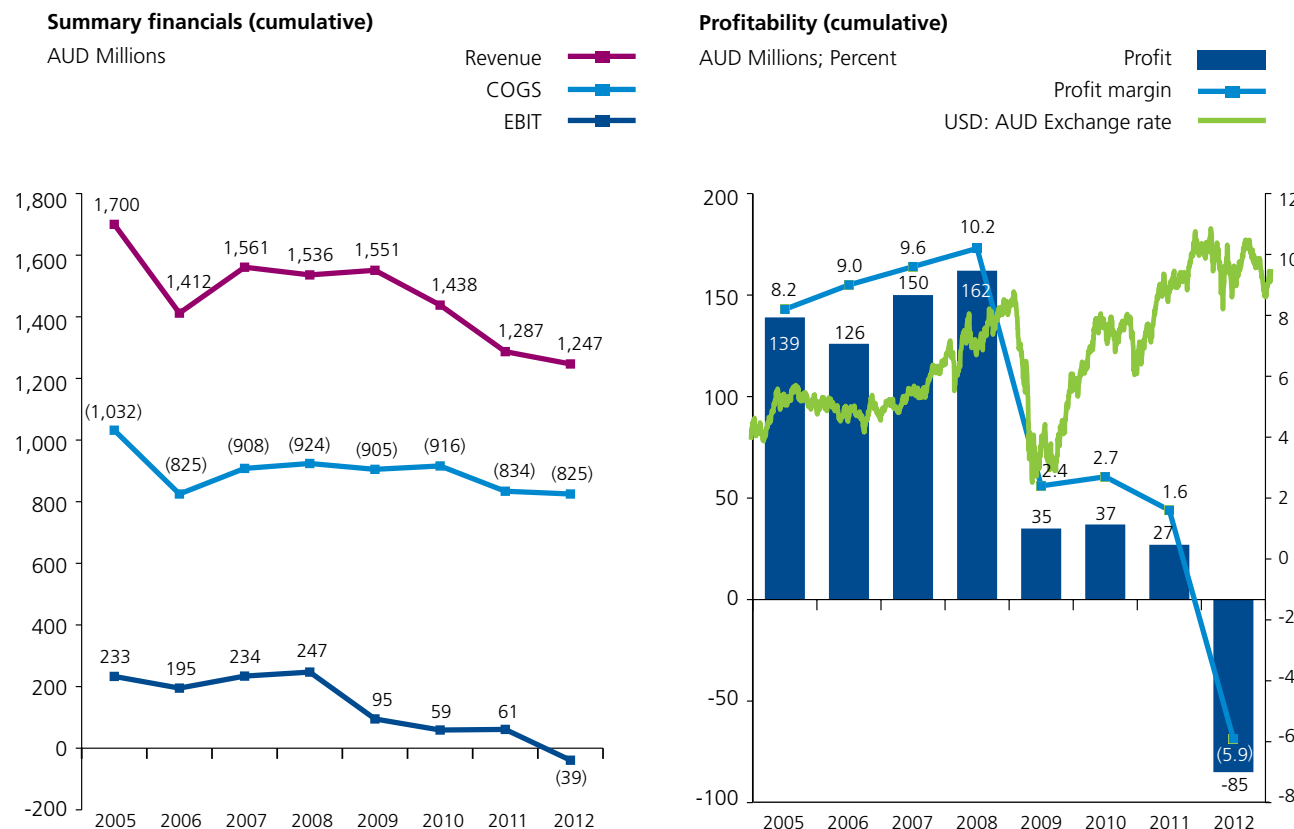
- In real terms the industry has declined since 2003, in both domestic and export sales, shown in Exhibit 7. The actual size of the industry has shrunk in real value terms almost 25% – from \$4.5 billion to \$3.4 billion

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)%

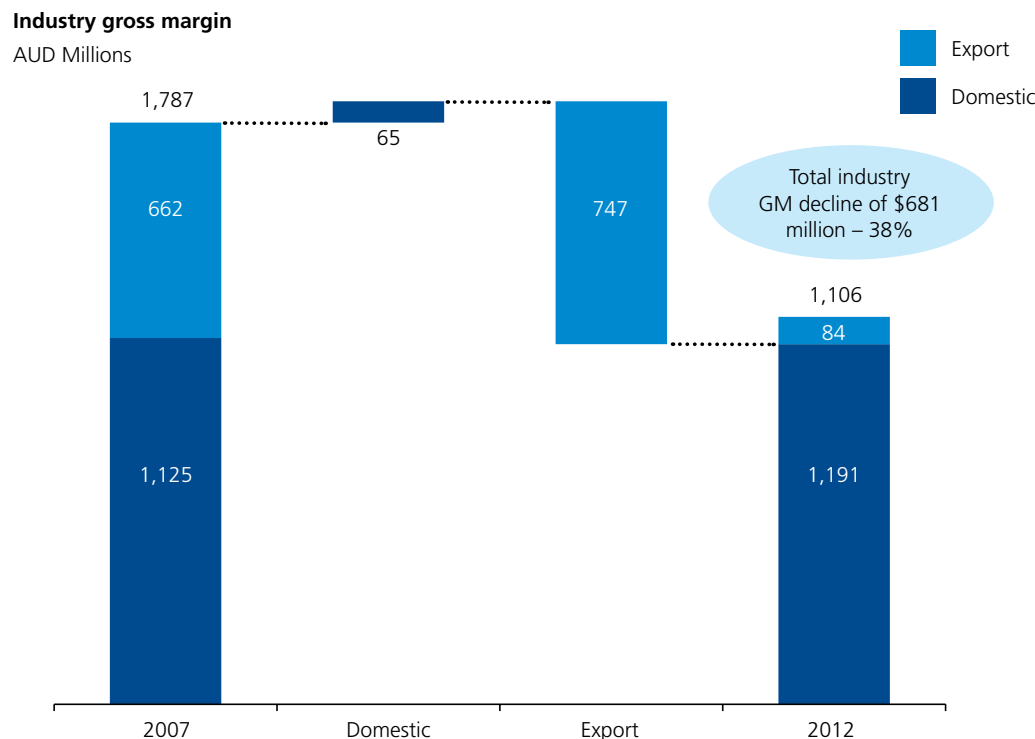
Exhibit 8: Profit performance of nine representative wine companies, 2005–2012



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

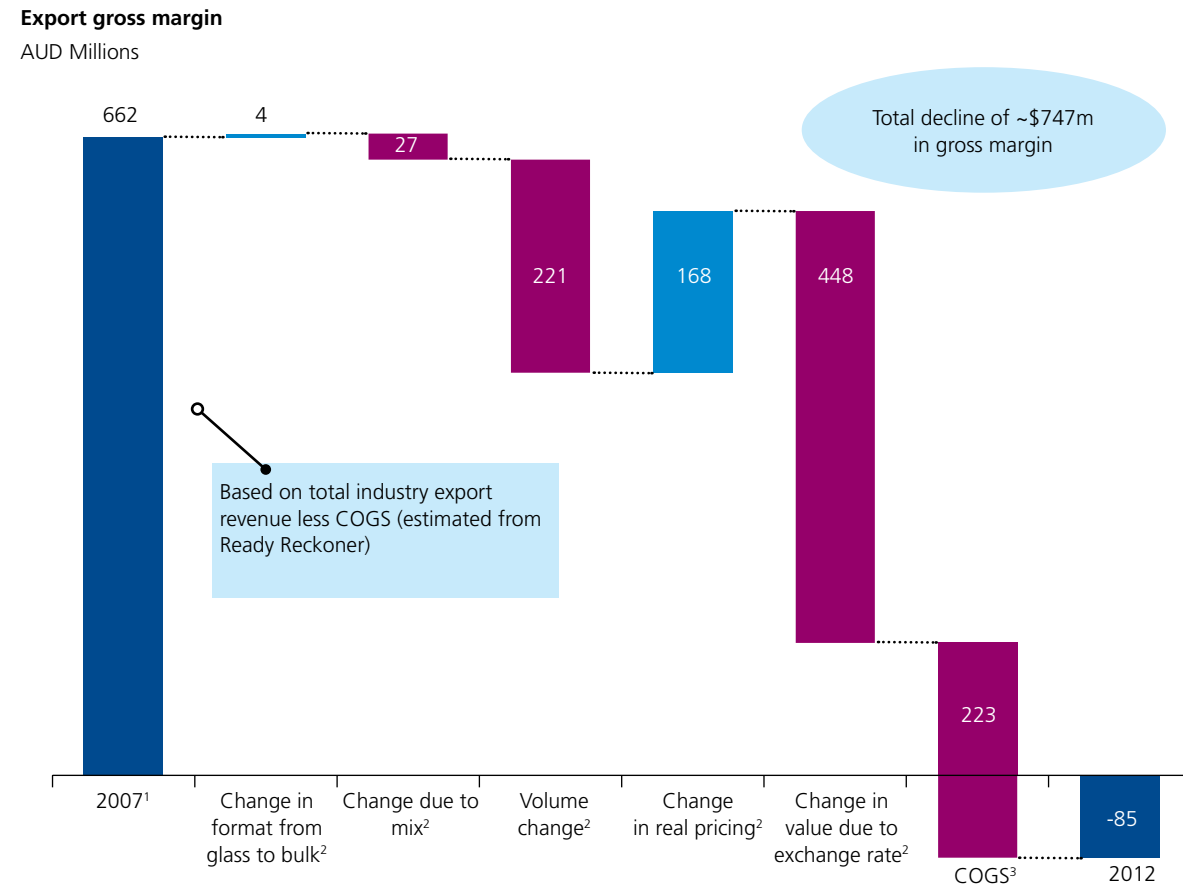
in export demand and rise in the \$A. This has created a series of responses with negative ‘feedback loops’ that: provide a market for uneconomic grapes and wine (ensuring supply is slow to respond to the fall in profitability), put further price and volume pressure on winemakers, educates the market 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

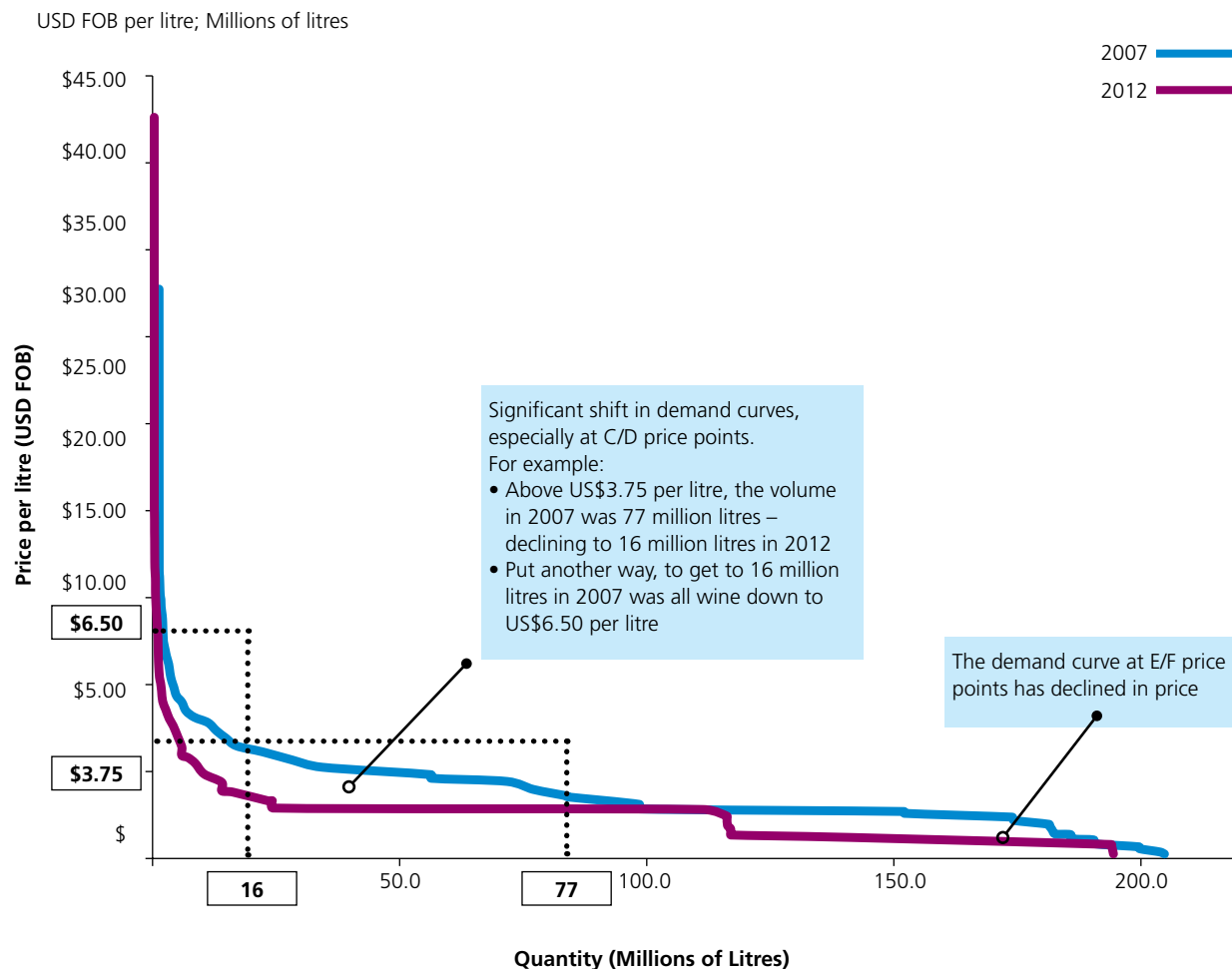
From 2007 to 2012 export volumes fell by 64 million litres (8%) and value by \$1.15 billion (38%)—causing an estimated \$750 million fall in total industry gross margin (**Exhibit 10**). The primary drivers of this are: a higher A\$, falling demand, increased competition from other wine exporting countries, 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*



* All formats—glass, bulk, and others

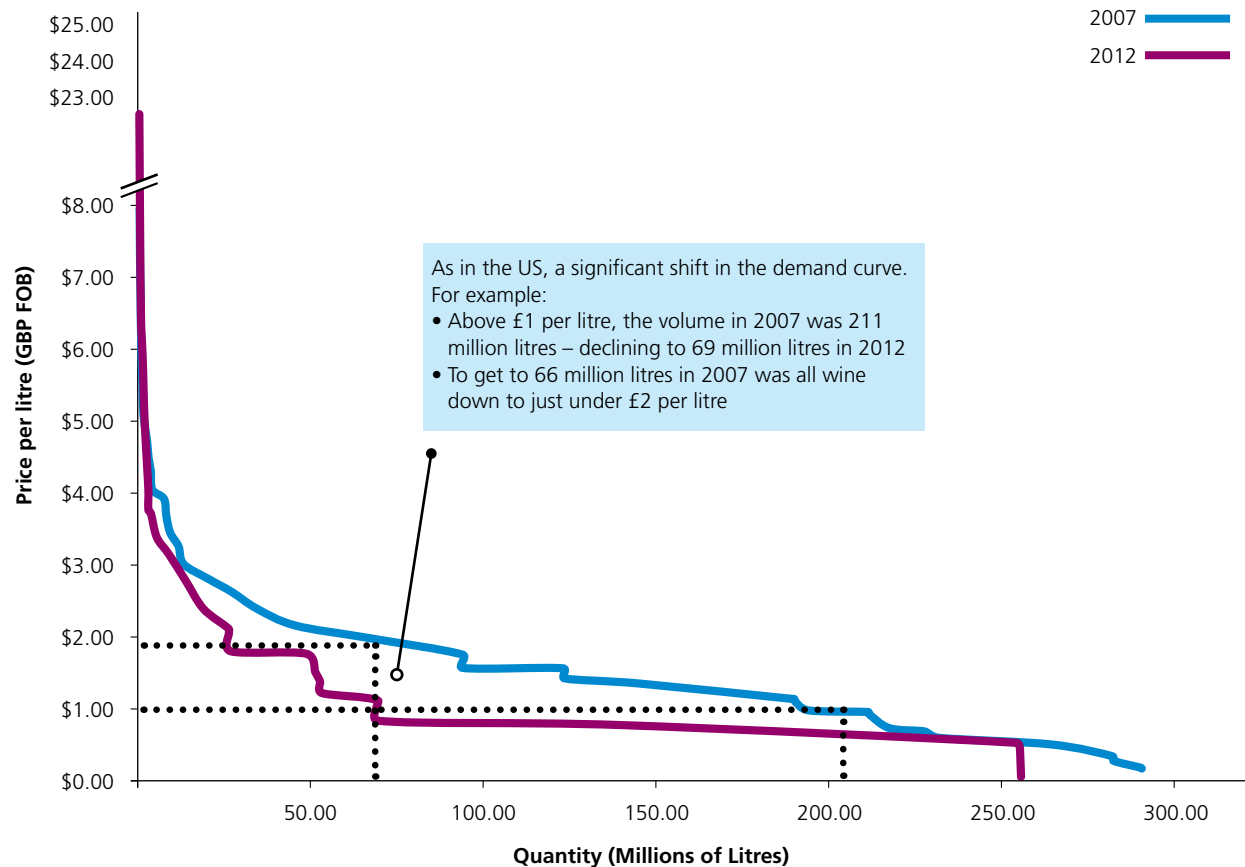
Source: Wine Australia; xe.com for foreign exchange rates; analysis

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

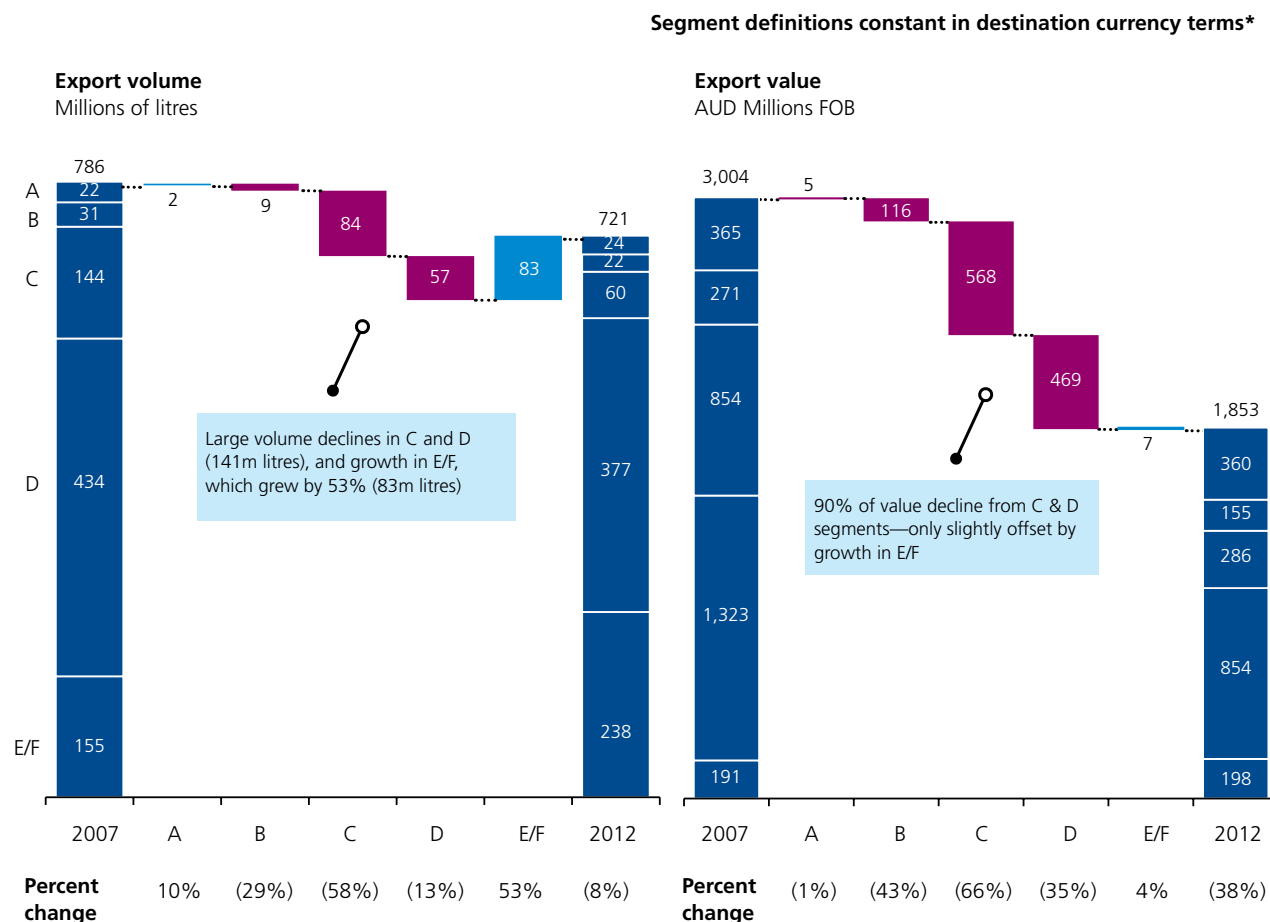


* All formats — glass, bulk and others

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



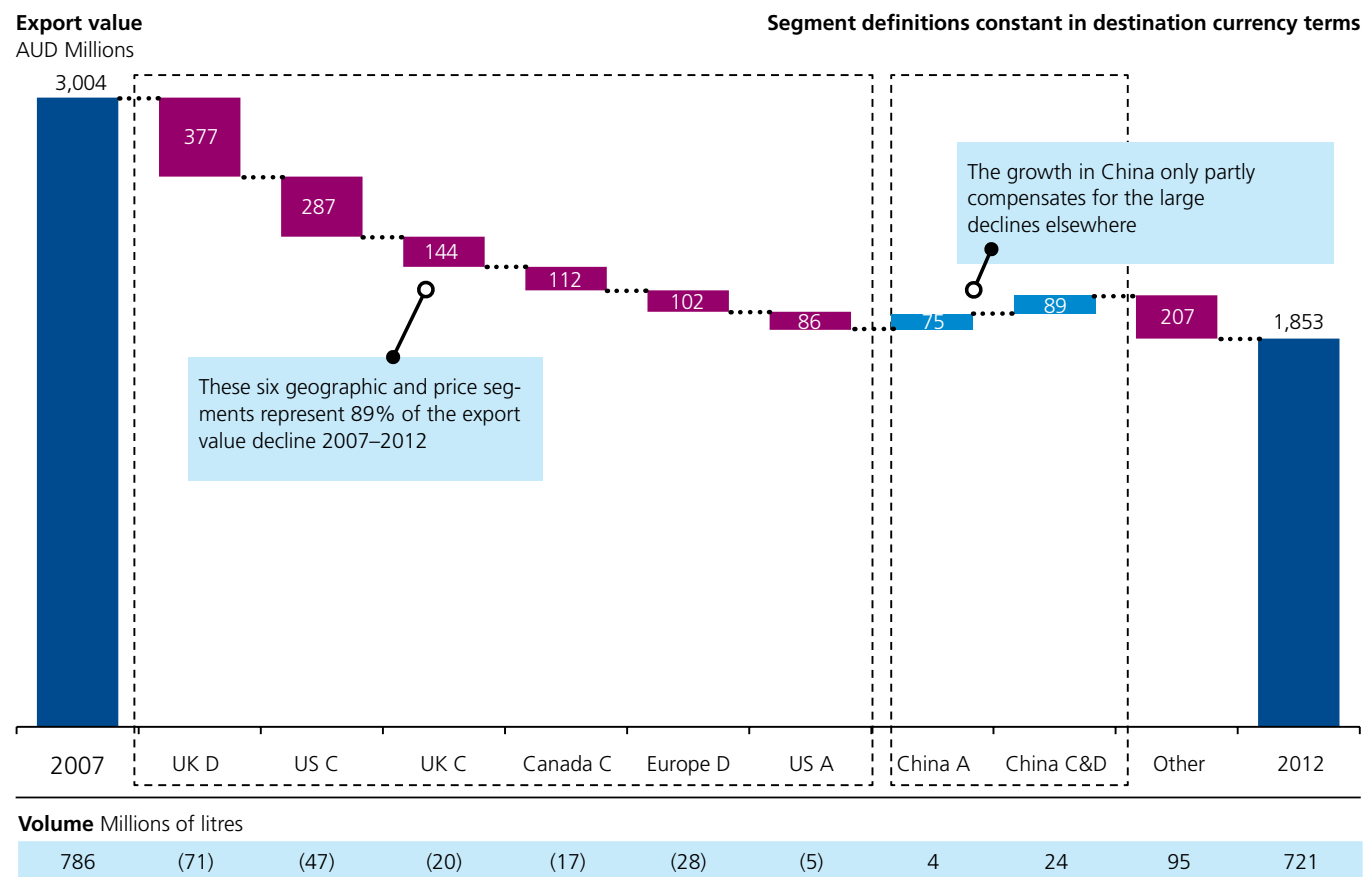
Further detail on the overall situation for exports from 2007 to 2012 is shown on Exhibits 13, 14, and 15, including:

- 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

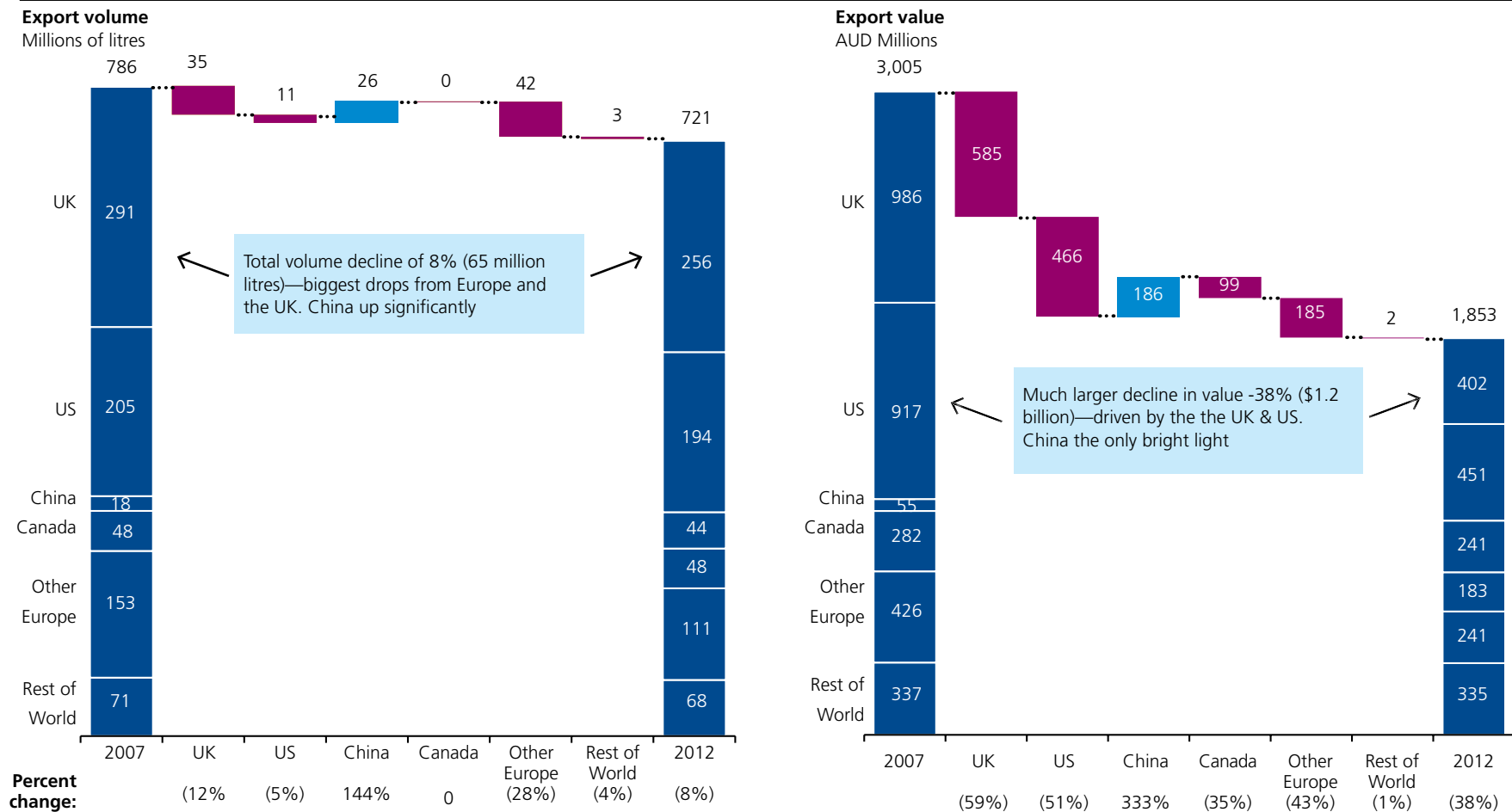
Exhibit 14: Decline in export value and volume by country and segment



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



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.

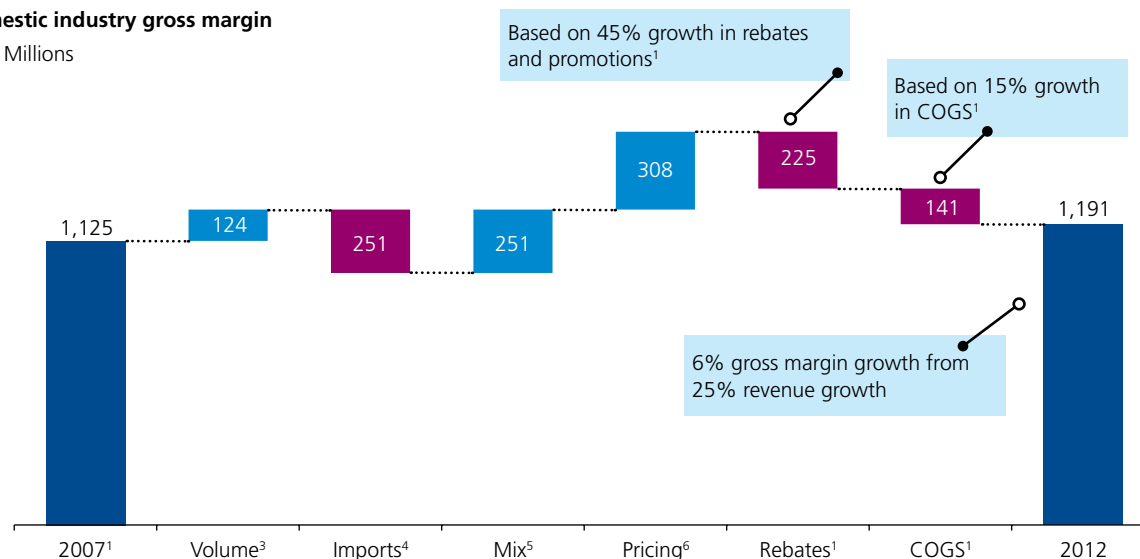
Previous [Exhibits 8 and 9](#) show the marked fall in profitability of Australian wine makers. The analysis in [Exhibit 16](#) shows that imported wine and increased rebates and discounts paid to retailers all but negated the gross margin benefits of premiumisation (increased sales of higher value wines—mix), 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

Domestic industry gross margin

AUD Millions



- 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](#))

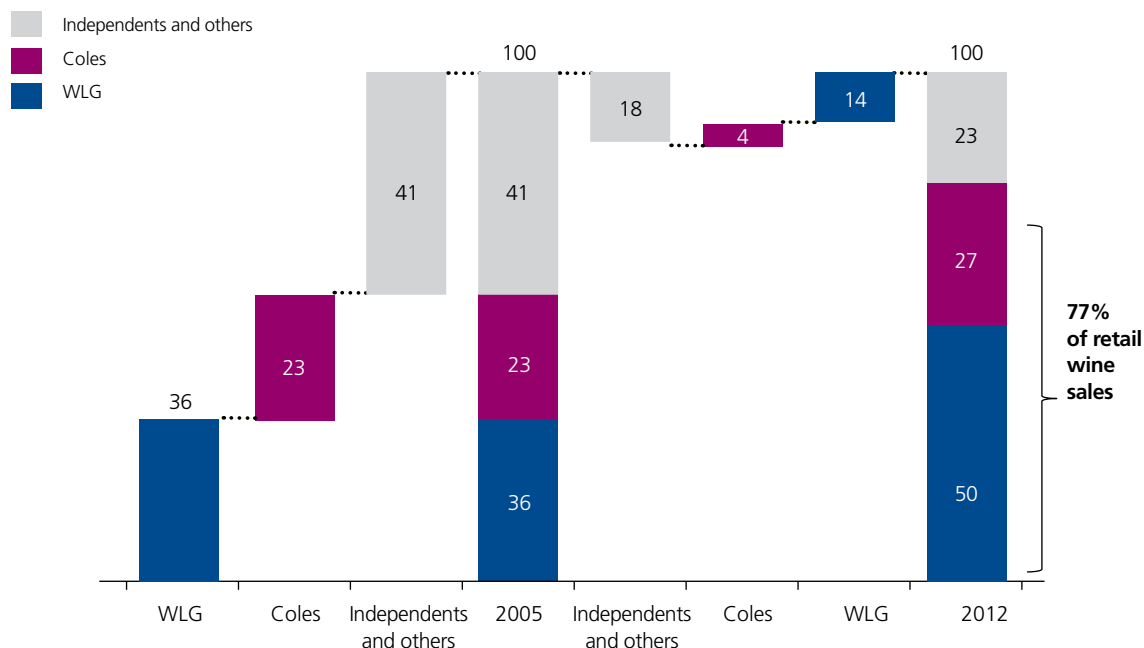
The retailers have numerous sourcing options to leverage due to: this fragmentation, the excess supply of grapes and wine, and the ability to sell imported wine at attractive margins. As a result:

- 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

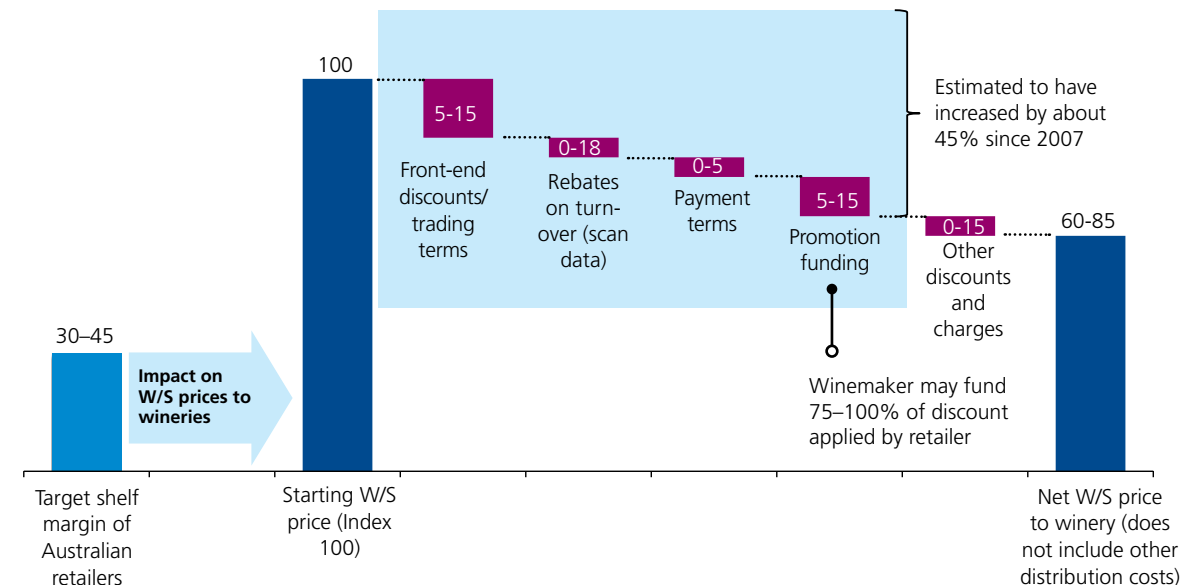
- The strong growth in market share of private label—including controlled and exclusive brands
- Many winemakers stated they struggle to pass on genuine cost increases to retailers that are not then taken away by increased rebates and discounts.

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](#)).

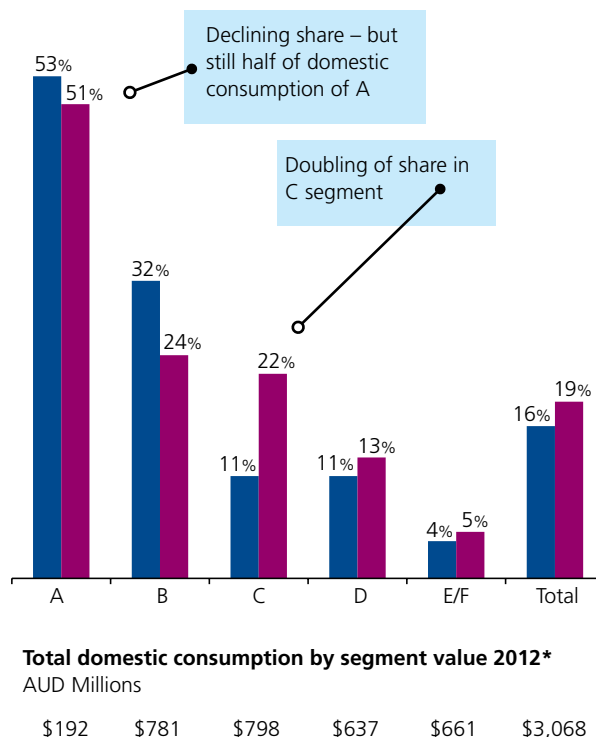
The differences in the results of the separate analyses illustrates a number of the challenges facing the industry:

- 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.

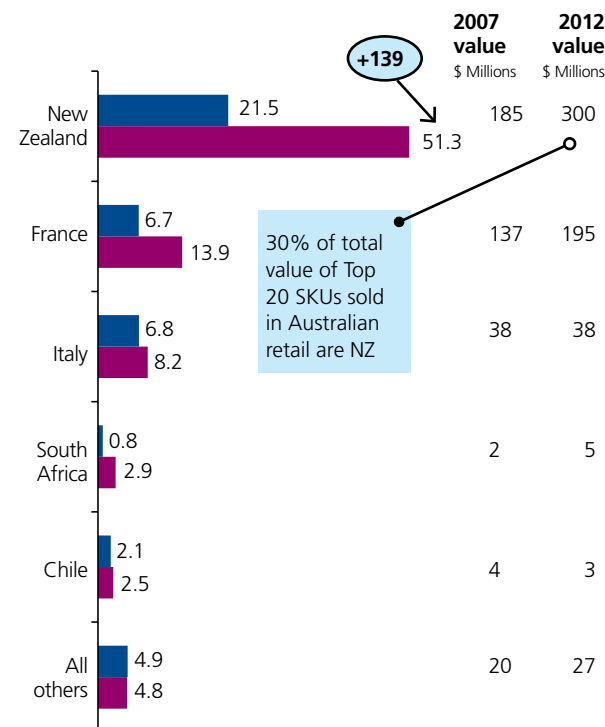
Exhibit 19: Growth in imports' share of domestic market 2007–2012

**Imports share of domestic market 2007 & 2012
by value by grade**
Percent of value*



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

Imports volume 2007 & 2012
Millions of litres



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:

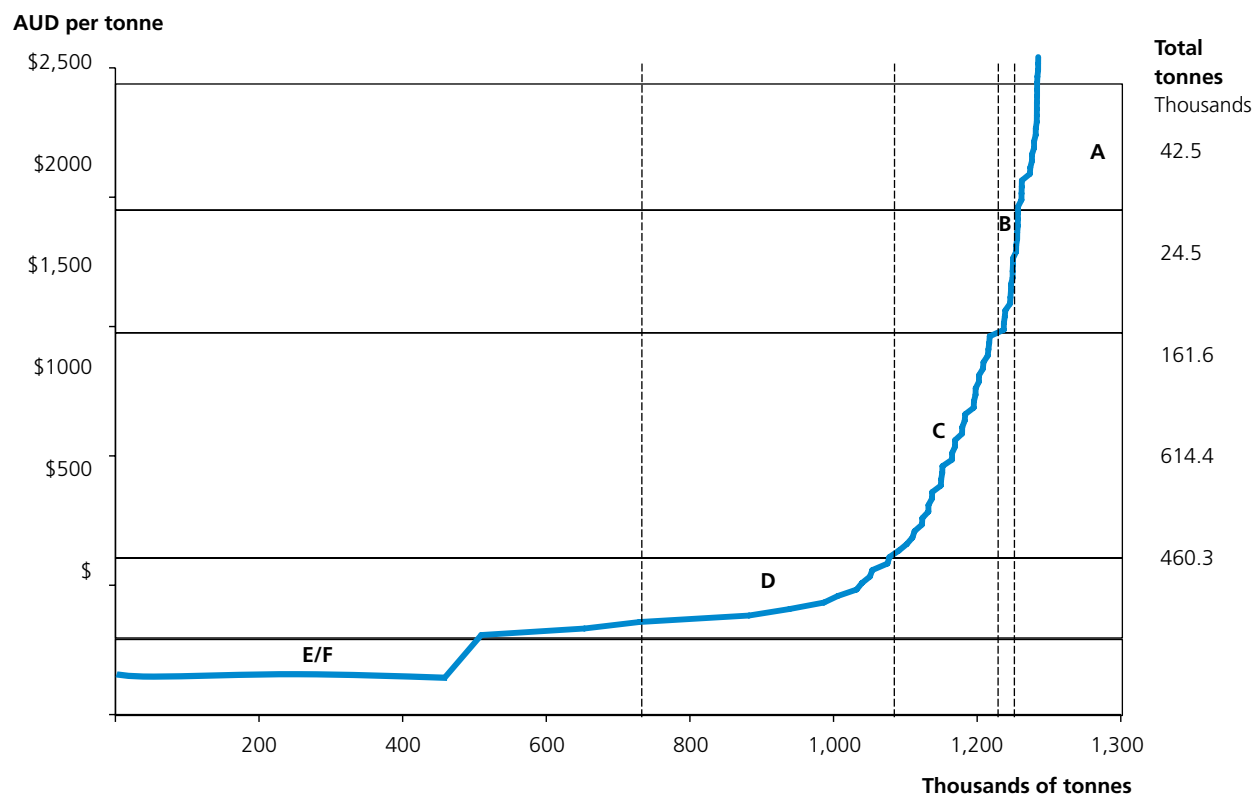
The analysis of 13 growing regions suggests the oversupply is significant.

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.

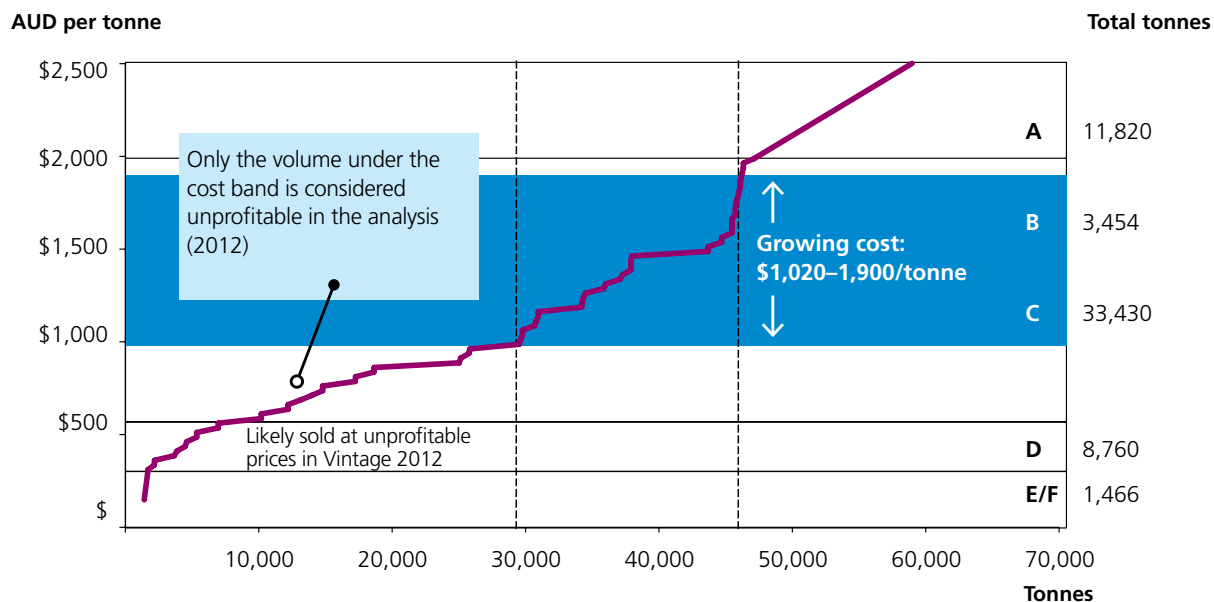
Exhibit 20 illustrates the supply curve (volume by sale price) for the 13 regions combined. The WGGGA and members of the WFA Board have provided further guidance on cost and yield assumptions for each region—however, it remains a work in progress that needs to be improved with further input from growers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

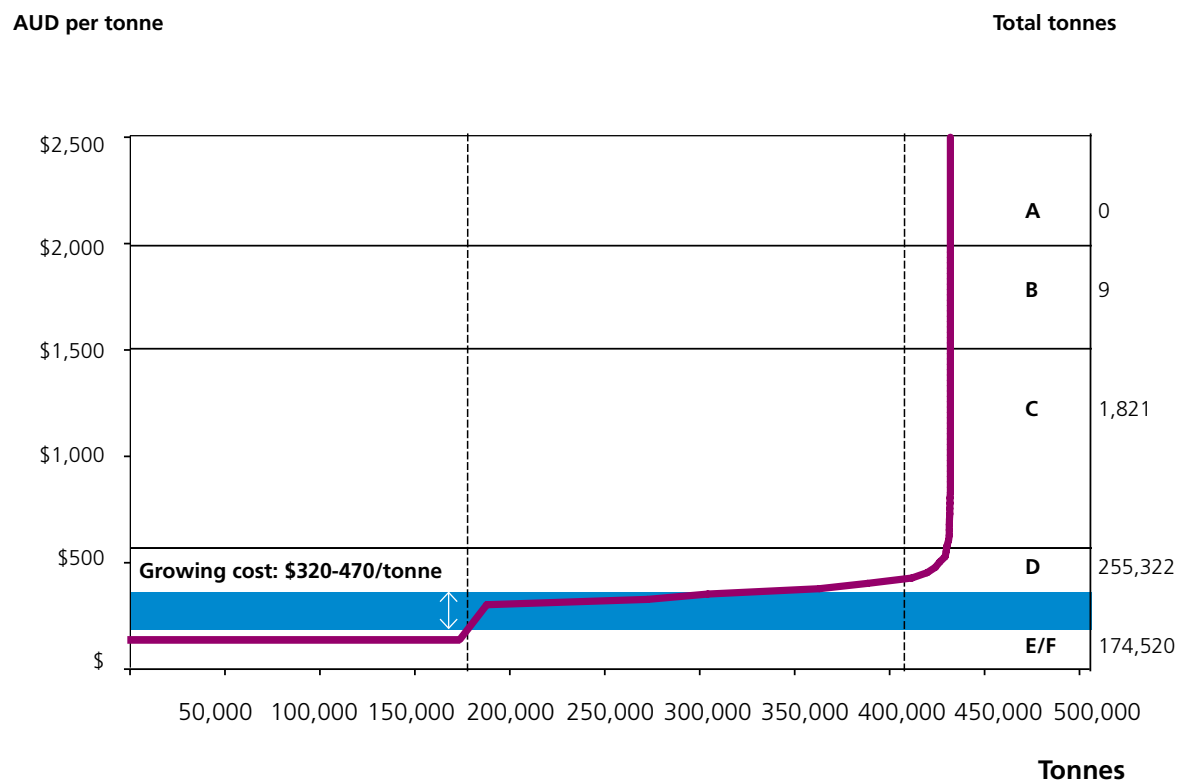


* Assumes price distribution of owned grapes matches that of those sold. Based on \$7500 per ha for C/D/E/F; \$8000 per ha for B; \$9000 per ha for A & average yield from 2006–2012 (7.3 tonnes per ha)
Source: Wine Australia price dispersion data and yields; ABS for total crush tonnage; WGGGA for growing 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 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

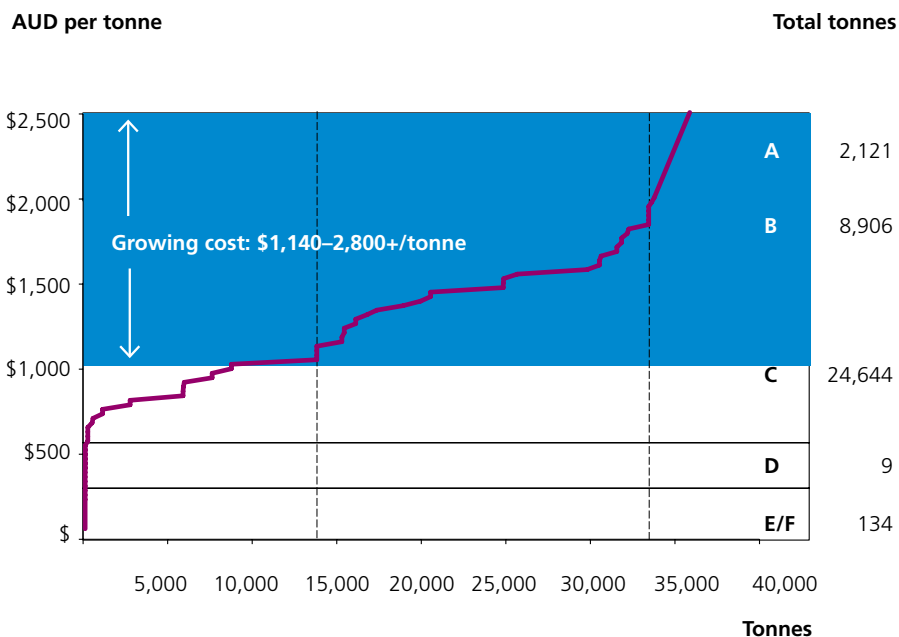
Purchase price and quantities, 2012 vintage



* 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

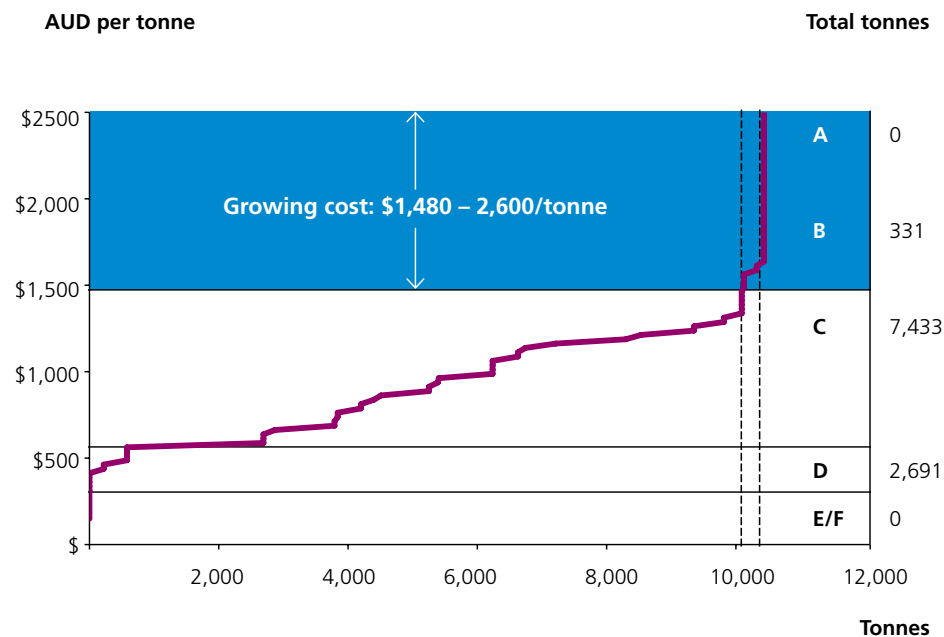
Purchase price and quantities, 2012 vintage



* 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

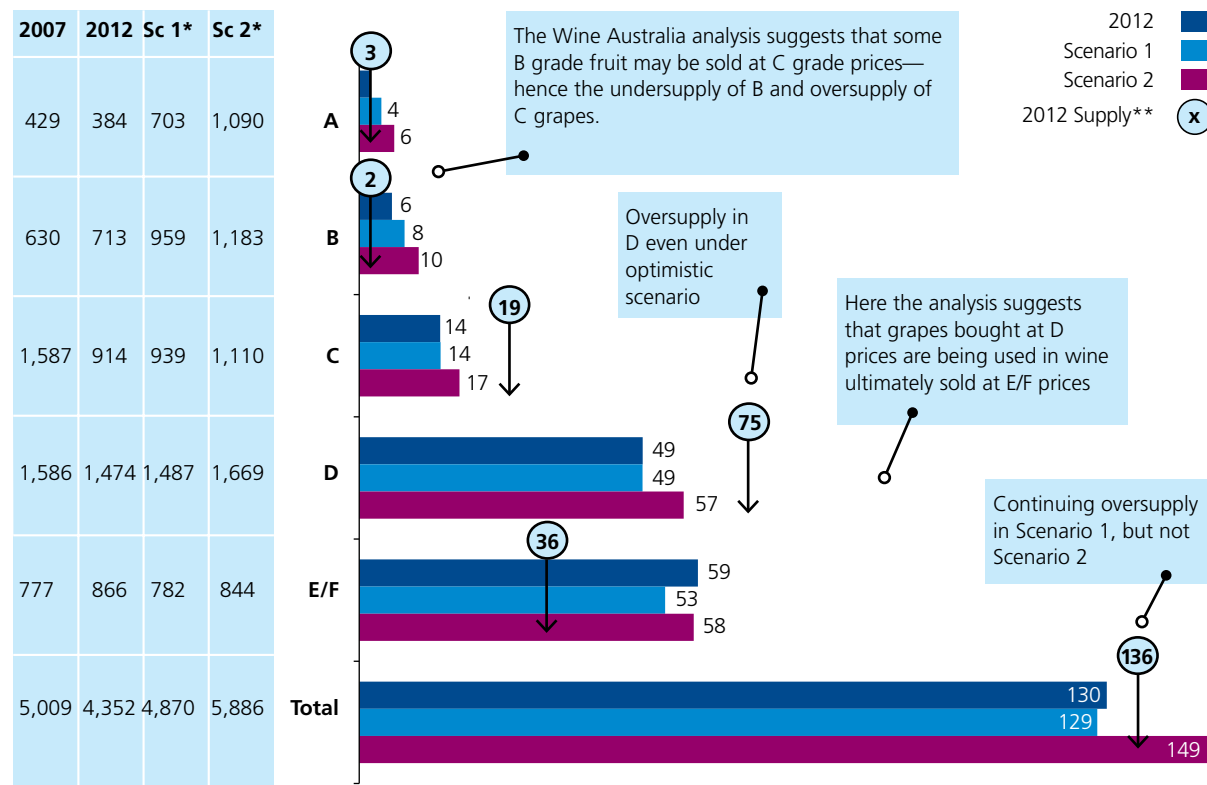


* Assumes price distribution of owned grapes matches that of those sold. Based on \$7500 per ha for C/D/E/F; \$8000 per ha for B; \$9000 per ha for A & average yield from 2006–2012 (5.1 tonnes per ha). High end of range above due to premium fruit production & weather impact in 2012 vintage
Source: Wine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



* 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 possibility

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

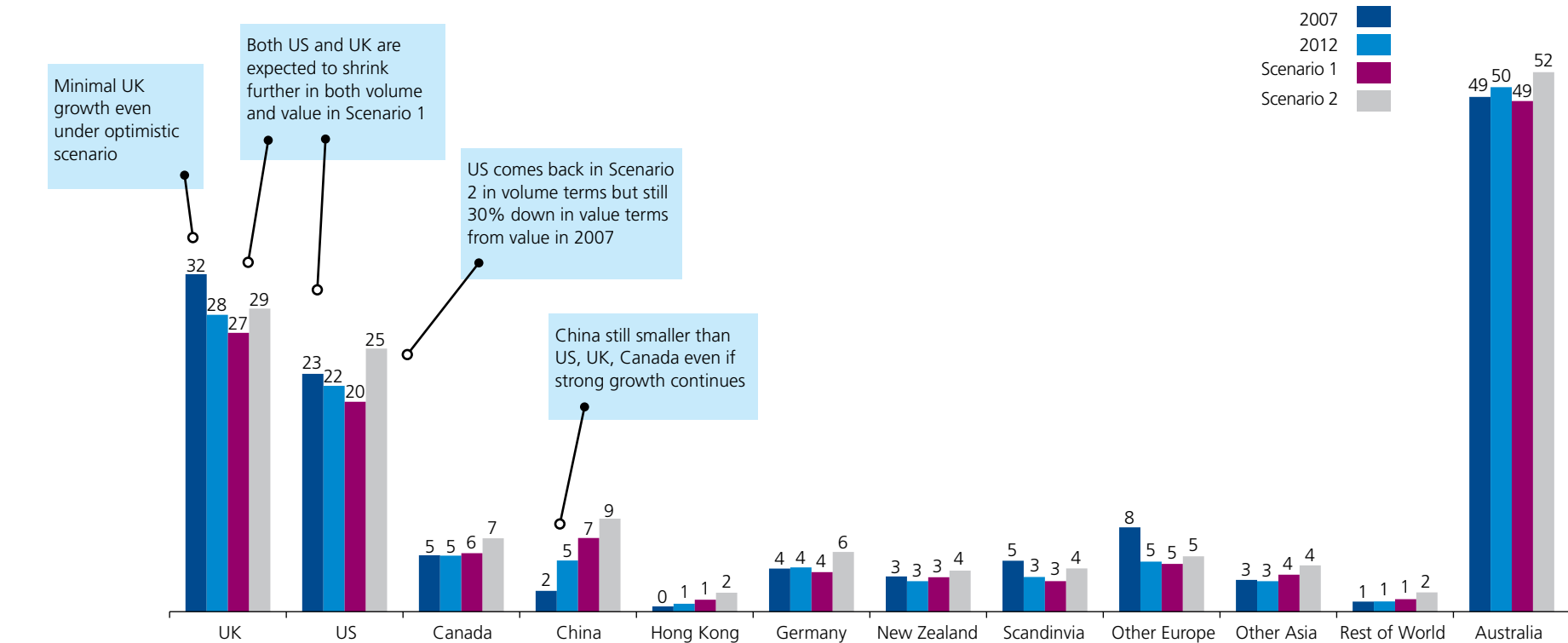
suffered from a perceived fall in value with consumers in the US and UK in particular

- 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 consumers 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.

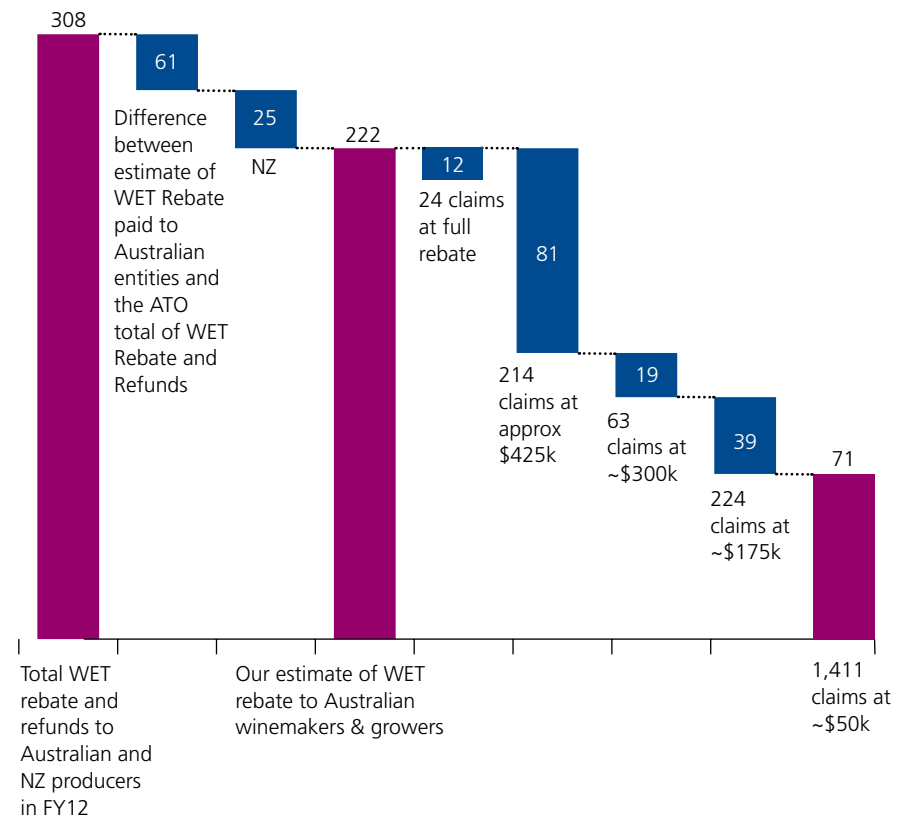
ATO breakdown of Australian WET rebate and refund recipients

% of Max rebate	07/08		11/12	
	#	\$ 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

% of Max rebate	07/08		11/12	
	#	\$ 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

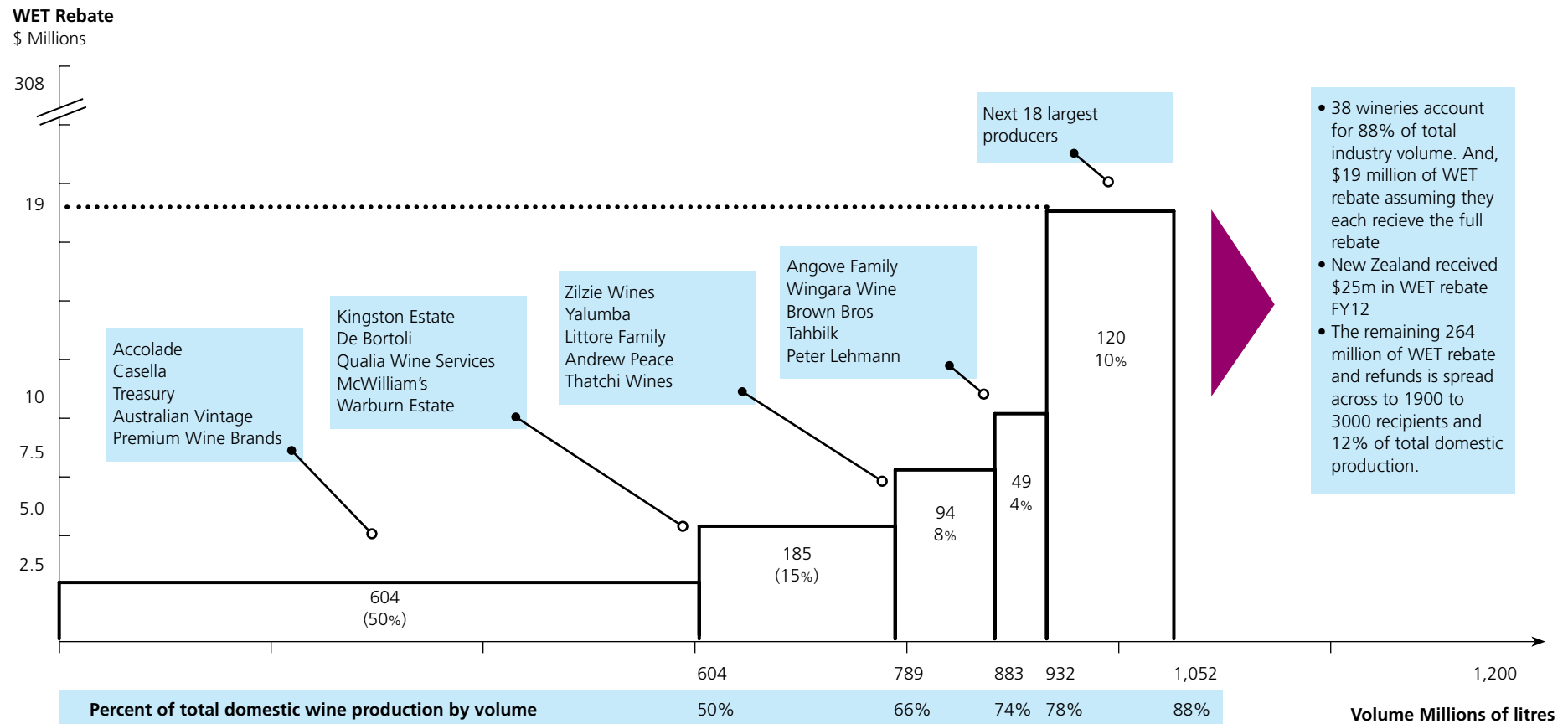


* Estimated by WFA based on mid point levels of rebate by % group and assumed maximum of \$500k for the > 100% category

** Different to ATO due to estimation approach

Source: ATO correspondence; Senate Estimates; analysis

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



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.





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'ALOSIO AM, Tony
Director
Oakridge Wines Pty Ltd
Victoria

tony.d'alosio@oakridgewines.com.au

Vice Chairs

McNAB, Stuart
Chief Supply Officer and Vintrepneur
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.

FINLAYSONS

Winemakers' Federation of Australia

Returning WET Rebate to Fairness & Original Policy Intent

I. Overview

We have been asked to provide a recommendation for amending the WET producer rebate, so that the WET rebate accords with the original policy intent, namely to support local employment and tourism in wine regions.

Summary

We recommend the introduction of a Model whereby the WET rebate would only be available to wine businesses who:

- manufacture and sell wine in a **form fit for retail sale**, where the finished product is identifiably theirs; and
- have **business premises** in Australia (potentially, in a designated wine region in Australia); and
- hold a **licence to sell liquor** in an Australian state or territory; and
- are **self-employed** or engage **one or more employees**; and
- sell their wine either: (i) by **retail sale**, or **under quotation**, from the business premises referred to above; or (ii) by **internet** or **mail order sales**.

We also recommend that:

- the amendments to the WET Act in 2005, which established the **NZ WET rebate system**, be **repealed**; and
- the WET rebate on **bulk** and **unbranded wine** be **phased out** at the rate of 25% per annum, starting at 75%; and
- a transitional measure be introduced to allow **two wine businesses to merge** but still **claim a second WET rebate**, which would be phased out at the rate of 25% per annum over four years.

FINLAYSONS

II. Recommended Model

We set out below a Recommended Model for eligibility for the WET producer rebate.

Under the Recommended Model, the rebate would only be available to wine businesses that:

- manufacture and sell wine in a **form packaged for retail sale**, where the finished product is identifiably theirs;¹ and
- have **business premises in Australia** (potentially, in a designated wine region in Australia); and
- hold a **licence**, issued by the Government of a state or territory in Australia, to sell liquor in that state or territory; and
- are **self-employed** or engage **one or more employees** (including associates of the wine business) to perform work for the wine business; and
- sell their wine either:
 - by **retail sale**, or **under quotation**, from the **business premises** referred to above; or
 - by **internet or mail order sales** (in which case the sales would be *deemed* to take place at the above premises).

We make the following comments.

¹ This measure would involve amending the definition of **rebateable wine* to refer only to wine packaged in a single container with a capacity not exceeding 5 litres, which is labelled with a brand that is wholly-owned by, or licensed exclusively to, the producer of the wine.

That would remove eligibility for the WET rebate from: (1) bulk, unpackaged and/or unbranded wine; (2) wine for the private labels of retailers; and (3) wine that is not a finished product fit for retail sale: see Section III (Phasing out WET rebate for bulk or unbranded wine).

FINLAYSONS

Recommended Model intended to support local employment & tourism

1. The intention of the Recommended Model is to make the WET rebate available to wine businesses that are carrying on business in Australia, are self-employed or have employees, and have business premises in Australia – possibly, in a designated wine region.
2. By doing so, the WET rebate should be restricted to wine businesses that provide local employment and tourism in wine regions, in line with the original intention when the rebate was introduced in 2000.

Note: The Explanatory Memorandum accompanying the introduction of the rebate in 2000, under the heading “Economic and social costs and benefits”, stated:²

2.38 *The threshold will also target the assistance towards small and medium sized winemakers.*

2.39 *The WET rebate is designed to promote tourism and industry in regional areas.*

3. When the rebate changed to the current producer system in October 2004, the benefit no longer exclusively attached to cellar doors. The clear intention, however, was that the benefit should be received by wine producers in rural and regional Australia.

Note: The Revised Explanatory Memorandum accompanying the 2004 amendments stated:³

1.7 *... small wine producers in rural and regional Australia will benefit significantly, receiving around 85% of the rebate benefits.*

² Supplementary Explanatory Memorandum, *Indirect Tax Legislation Amendment Bill 2000*, [2.38] – [2.39].

³ Revised Explanatory Memorandum, *Tax Laws Amendment (Wine Producer Rebate and Other Measures) Bill 2009*, [1.7].

FINLAYSONS

Wine business won't get rebate simply by registering for ABN and GST

4. Under the Recommended Model, the rebate will not be available simply because a wine business has registered for Australian ABN and GST purposes.

Note: This deals with one of the perceived shortcomings of the current rebate.

Wine business doesn't need production assets

5. Under the Recommended Model, a wine business will not be required to own winery production assets; and new industry participants are thus not excluded.

Note: Again, this deals with a perceived shortcoming of one of the models previously considered by the WFA.

Wine business must hold state or territory liquor licence

6. Under the Recommended Model, a wine business will be required to hold a liquor licence under relevant state or territory liquor licensing laws.

Note: There is no current requirement, under the WET Act, for a wine business to hold a producer's licence, or any other state or territory liquor license, in order to claim WET rebates.

As a practical matter, however, an entity that sells wine in Australia must hold a state or territory liquor licence of some description.

Since rebates are only payable on wine sold domestically in Australia, Australian and foreign wine businesses (excluding certain NZ wine businesses) who claim WET rebates, are already required to hold appropriate liquor licences.

The requirement under the Recommended Model therefore should not impose any additional burden for Australian or foreign wine businesses who currently claim WET rebates.

However, NZ wine businesses who sell on FOB terms for export to Australia would in future be required to obtain a state or territory liquor licence in order to continue to be eligible for the rebate.

FINLAYSONS

The liquor licence requirement should thus eliminate the preferential treatment currently given to NZ wine businesses, as they would in future be in the same position as Australian and other foreign wine businesses.

Accordingly, the change should remove one aspect of the current unfair treatment in favour of NZ wine businesses: see Section IV below.

7. In a separate report that accompanies this memorandum, PwC provide modelling that estimates:
 - 7.1. the cost of acquiring and maintaining a liquor licence and business premises; and
 - 7.2. the number of producers that potentially would exit the industry or would otherwise become ineligible to claim the rebate.

Wine business must sell by retail sale or under quotation from business premises

8. The Recommended Model contains a requirement that the wine business must sell wine either by retail sale, or under quotation, from its business premises (or sell by internet or mail order sales, in which case the sales will be *deemed* to take place at the above premises).
9. That will possibly result in foreign wine businesses having a “*permanent establishment*” (*PE*) in Australia, for Australian tax purposes. As such, it is likely that foreign wine businesses would be liable to Australian tax on the profits attributable to sales in Australia.

Note: In broad terms, a PE is a fixed place of business through which the business of an enterprise (in this case, the foreign wine business) is wholly or partly carried on.

The term includes a place of management, a branch, an office, a factory or a workshop and also a person — other than an independent agent — who substantially negotiates or concludes contracts on behalf of the enterprise in Australia.

If a foreign wine business has a PE in Australia, the profits of the foreign wine business that are attributable to the PE will be taxable in Australia.

FINLAYSONS

10. However, that should not change the current position in any great measure for most foreign wine producers, except possibly NZ wine businesses.
11. That is because foreign wine businesses who receive the WET rebate are currently: (1) treated as having derived Australian income; and (2) therefore required to lodge Australian income tax returns (subject to relief under any applicable double taxation treaty).

Note: According to para 39 of Taxation Ruling TR 2006/3 ('Government payments to industry to assist entities (including individuals) to continue, commence or cease business'), the WET rebate is:

... received in the ordinary course of the entity's wine distribution activities. It is received to offset the liability that arises because of business operations and is calculated with reference to business income. The rebate is ordinary income and is assessable under section 6-5 in the income year that it is received.

12. For NZ wine businesses, the WET producer rebate is considered to be assessable income for NZ tax purposes, and not for Australian tax purposes: see ATO guide 'Wine equalisation tax - producer rebate for New Zealand wine producers' under the heading 'Reporting your producer rebate'.
13. Under the Recommended Model, it is likely NZ wine businesses would be: (1) treated as having derived Australian income from the sales on which they claim the WET rebate (as those sales will be made through Australian business premises); and (2) therefore required to lodge Australian income tax returns.
14. Accordingly, NZ wine businesses will be in the same position as Australian and other foreign wine businesses.
15. That is, NZ producers would be subject to Australian tax on the sales on which they have claimed the WET rebate, and on the WET rebate itself.
16. That would remove another aspect of the current unfair treatment granted to NZ wine businesses (discussed in greater detail in Section IV below).

FINLAYSONS

Recommended Model should not breach ANZCERT Agreement

17. Under the *Australia & New Zealand Closer Economic Relations Trade Agreement (ANZCERT Agreement)*, a Member State (i.e. Australian or NZ) must not levy on goods, which are imported from the other Member State, any taxes or charges in excess of those applied, directly or indirectly, to like domestic goods: see Article 7.2.
18. It might be argued that the Recommended Model would potentially breach the ANZCERT on the basis it differentiates between the tax treatment of Australian and NZ wine producers – since NZ producers don't generally have Australian business premises or Australian employees and, in the absence of such premises and employees, would not be entitled to the rebate.
19. Under the ANZCERT, New Zealand could therefore request Australia:

... to enter into consultations with a view to seeking an equitable and mutually satisfactory solution if [NZ] considers that ... an obligation under this Agreement has not been or is not being fulfilled.
20. However, as noted by the Australian Department for Foreign Affairs and Trade:

Because consultations are non-binding, successful settlement relies on the goodwill of both parties to work out amicable and practical solutions.
21. Australia would strenuously argue that the proposed changes to the WET rebate would not give effect to a policy differentiation between the tax treatment of Australian and NZ wine producers; but instead – consistent with the original intention of the rebate (evidenced in the Explanatory Memorandum) – would promote employment and tourism in Australia's wine regions.
22. Australia would point to the fact there is nothing preventing NZ wine businesses qualifying for the rebate by having Australian premises and employees and, in that way, supporting employment and tourism. The rebate only applies to Australian domestic sales and if NZ wine businesses wish to claim the rebate, they need to be "on the ground" in Australia. Put at its simplest, you can't import employment or tourism.

FINLAYSONS

23. Australia would also note that limiting the rebate in the manner proposed would be unlikely to reduce the volume of NZ wine sold in Australia due to the strength of the “*Malborough*” brand. In addition, even if certain NZ wine businesses find it uneconomic to import into Australia in the absence of the rebate, their sales will be taken up by other NZ producers.
24. Finally, Australia could refer to the fact that the current system potentially places Australia at risk of trade disputes with other countries, on the basis Australia may be breaching the “Most Favoured Nation” principle in Article I of the WTO General Agreement on Tariffs and Trade 1994 (*GATT*) (discussed in Section IV below).
25. The proposed changes would remove that risk as they would provide consistent treatment for all rebate claimants, regardless of their nationality.

Recommended Model should not breach Australia’s WTO obligations

26. Under the GATT and the WTO Agreement on Subsidy & Countervailing Measures (*SCM Agreement*), “*actionable subsidies*”, such as production subsidies, are not prohibited per se.
27. However, actionable subsidies may be subject to challenge through multilateral dispute settlement or countervailing action if they cause “*serious prejudice*” (in the case of another country’s exports) or “*injury*” to another country’s domestic industry (caused by importation of subsidized goods).
28. As with the ANZCERT, although it might be suggested the Recommended Model would potentially contravene Australia’s WTO obligations, Australia should be able to displace any suggestion of “*serious prejudice*” (to NZ or any other importing country) by demonstrating:
 - 28.1. the effect of the WET rebate is not to displace or impede the imports of wine of another Member; and
 - 28.2. the effect of the subsidy is not a significant price undercutting by the subsidized Australian product.
29. The rebate would not be a subsidy for wine but for local employment and tourism.

FINLAYSONS

III. Phasing Out WET Rebate for Bulk & Unbranded Wine

30. The principal recommendation in this memorandum is that the WET rebate should be restricted to wine businesses that provide local employment and support tourism, in line with the original policy intention when the rebate was introduced.
31. The development of wine brands enables producers to develop customer loyalty, to maintain sustainable price margins, and to generate profit growth that can be reinvested back into regional communities and infrastructure.
32. However, unbranded wine ('cleanskins') and private labels of retailers do not assist with the development of brand loyalty and therefore do not play a long-term role in encouraging regional development.
33. For this reason, unpackaged (bulk) wine, unbranded wine, wholesale and retail private label wine, and wine that is not fit for retail sale, should not be eligible for the WET rebate.
34. The rebate should instead only be available to those who manufacture and sell wine in a form that is packaged and ready for retail sale, where the finished product is identifiably theirs.
35. To enable the industry time to plan and adjust for this measure, the removal of rebate eligibility for bulk and unbranded wine should be phased out at the rate of 25% per annum, starting at 75% of the rebate rate.

Note: This proposal would be implemented by:

- amending the definition of **rebateable wine*, in section 33-1 of the WET Act, as follows:

**rebateable wine* means **grape wine, *grape wine products, *fruit or vegetable wine, *cider or perry, *mead or *sake*, that is packaged in a single container with a capacity not exceeding 5 litres at the time of the dealing, and which is labelled with a brand on the primary packaging that is wholly owned by, or licensed exclusively to, the producer of the wine.

- including a transitional provision in the amending legislation which provides that the eligibility of bulk and unbranded wine for the rebate should be phased out at 25% per annum, starting at 75% of the rebate rate (currently \$500,000), from the first day of the financial year in which the amending legislation receives Royal Assent.

FINLAYSONS

36. In a separate report that accompanies this memorandum, PwC provide modelling that estimates the savings from removing the rebate from bulk and unbranded wine.

IV. Repeal WET Act Provisions Allowing NZ Wine Businesses to Claim WET Rebate

37. For the reasons set out below, there is also a strong case for abolishing the current New Zealand WET rebate scheme.
38. However, it is important that this recommendation does not breach Australia's obligations under the ANZCERT Agreement.

Current system provides preferential treatment for NZ wine businesses

39. As discussed above, foreign wine businesses who receive the WET rebate are: (1) treated as having derived Australian income; and (2) therefore required to lodge Australian income tax returns.
40. However, NZ wine businesses are not required to lodge Australian income tax returns, as the WET producer rebate is considered to be assessable in NZ and not Australia.
41. In addition, NZ wine businesses are not required to be registered for Australian GST purposes and hold a state or territory liquor license, unlike Australian wine producers and other foreign wine producers.
42. NZ wine businesses are therefore not subject to the compliance costs associated with lodging Australian income tax returns, Business Activity Statements (BAS), or with ongoing state or territory liquor licensing requirements.
43. Further, the ATO allows the NZ Inland Revenue to administer the WET rebate for NZ wine businesses. The ability for NZ wine businesses to deal with their local revenue authority is not available to other foreign wine producers.
44. These preferential conditions make it easier and cheaper for NZ wine businesses to access to the WET rebate, than for other foreign wine producers.

FINLAYSONS

45. The following table summarises the requirements to claim the producer rebate, and the benefits afforded to NZ wine producers that are not available to other foreign wine producers.

<i>Claim requirements under the current WET producer rebate schemes</i>			
	<i>Australian wine producers</i>	<i>New Zealand participants</i>	<i>Other foreign wine producers</i>
<i>GST registration required</i>	✓	✗	✓
<i>Wine tax must be paid</i>	✗	✓	✗
<i>Australian income tax obligations</i>	✓	✗	✓
<i>In-country administrative assistance provided</i>	✓	✓	✗
<i>Required to hold a State/Territory Liquor License</i>	✓	✗	✓

Preferential treatment to NZ wine businesses may cause Australia to breach “Most Favoured Nation” principle

46. Under the WTO agreements, if Australia grants special treatment to goods from one country (such as a tax rebate or preferential administrative treatment), it must do the same for similar goods from all other WTO members.
47. This is known as the ‘Most Favoured Nation’ principle (*MFN principle*).
48. While the current WET rebate system remains in operation, it is arguable Australia may be breaching the MFN principle.
49. That is because the separate rebate scheme for NZ wine businesses discriminates against other foreign wine businesses, by giving preferential treatment to NZ wine businesses relative to foreign producers (as discussed above).

FINLAYSONS

50. Such a breach potentially exposes the Australian government to trade disputes with other trading partners, claiming that NZ producers have preferential treatment relative to their producers.
51. However, if the current NZ rebate scheme is abolished, all foreign producers of wine would be treated equally in terms of access to the WET rebate.
52. There could then be no argument that the MFN principle had been violated.

However, ANZCERT may provide exception to MFN principle

53. It is possible, however, that Australia would have a defence to a claim that it had breached the MFN principle.
54. Article XXIV of the GATT provides that the MFN principle does not prevent the formation of a “free trade area”.⁴
55. Since the ANZCERT has established a free-trade area that substantially eliminates trade barriers (such as duties and other restrictive regulations of commerce) between Australia and NZ, it is possible that this exception would apply.
56. At first sight, Australia therefore has a potential defence against any claims by other trading partners that it has breached the MFN principle by giving preferential treatment to NZ wine businesses.
57. However, before being able to rely on such a defence, Australia may need to demonstrate that the ANZCERT would not have been entered into, if the NZ WET rebate provisions were not incorporated into the WET Act.⁵

⁴ Article XXIV: 5(b) & 8(b).

⁵ See WTO Appellate Body Report, *Turkey-Textiles*, adopted 19 November 1999 (*Turkey-Textiles*).

FINLAYSONS

For example, in the Turkey-Textiles case, the Appellate Body considered whether Turkey could rely on Article XXIV as a defence to a claim by India that Turkey's quantitative restrictions on textile imports from India breached Articles XI (General Elimination of Quantitative Restrictions) and XIII (Non-discriminatory Administration of Quantitative Restrictions) of the GATT.

The Appellate Body held that:⁶

Turkey has not demonstrated that the formation of a customs union between Turkey and the European Communities would be prevented if it were not allowed to adopt these quantitative restrictions. Thus, the defence afforded by Article XXIV under certain conditions is not available to Turkey in this case, and Article XXIV does not justify the adoption by Turkey of these quantitative restrictions. [Emphasis added.]

Accordingly, Turkey could not rely on Article XXIV as a defence.

Although Turkey-Textiles considered the application of Article XXIV with respect to customs unions, the decision could possibly, by parity of reasoning, also apply to free trade areas.

58. Unless Australia can demonstrate that the non-inclusion of the NZ WET rebate provisions would have been a "stumbling block" to the formation of the ANZCERT, Australia may not be able to rely on Article XXIV as a defence to any claim that it has breached the MFN principle by giving NZ wine businesses preferential treatment.
59. The repeal of the NZ WET rebate provisions would thus reduce the risk of Australia's trading partners arguing that the NZ WET rebate provisions breach Australia's international treaty obligations.

Abolishing NZ WET rebate scheme is logically consistent with Recommended Model

60. If the Recommended Model is implemented, NZ wine businesses should be in the same position as Australian and all other foreign wine businesses with respect to Australian tax.
61. That is, by having business premises and selling wine in Australia, NZ and other foreign producers will, with respect to their Australian sales, need to: (1) hold a state or territory liquor license; (2) register for GST; and (3) lodge Australian income tax returns.

⁶ Paragraph 63.

FINLAYSONS

62. Therefore, regardless of whether the NZ WET rebate provisions breach the MFN principle, those provisions would essentially become redundant under the Recommended Model.
63. The NZ WET rebate system should thus be repealed, in order to create logical consistency in the WET Act.
64. The following amendments would be required to repeal the current NZ WET rebate scheme.

- Sections 19-5(2) (Entitlement to producer rebates for New Zealand participants) should be repealed to disallow eligibility to NZ entities via the separate scheme.
- In addition, the following sections should be repealed since, once the entitlement provisions in section 19-5(2) are removed, those sections become obsolete:
 - 17-10(2A) (Claims for wine tax credits);
 - 19-7 (Approval as NZ participant);
 - 19-8 (Revoking an approval as a NZ participant);
 - 19-9 (Notification of changed circumstances);
 - 19-10(3) and (4) (Exceptions);
 - 19-15(1C) (Amount of producer rebates); and
 - 33-1: (Dictionary) definition of 'New Zealand' and 'New Zealand participant'.

The reference in section 19-25(4) to '*except in the case of a New Zealand participant*' would also need to be removed.

65. In a separate report that accompanies this memorandum, PwC provide modelling that estimates:
 - 65.1. the cost for NZ producers of shifting to "*level playing field*" arrangements; and
 - 65.2. the number of NZ producers that would exit the industry or become ineligible for the rebate.

FINLAYSONS

V. Allow Second WET Rebate on Merger of Two Wine Businesses

66. To generate long term sustainable profits in the industry, wine businesses need to rationalize and capture efficiencies and economies of scale.
67. However, wine businesses that believe their future lies in consolidation may be stymied by the fact that they would lose up to \$500,000 in annual WET rebates if they merged with another wine business.
68. This issue could be overcome by introducing a transitional rebate rule, which, on a merger of two businesses that are entitled to the rebate, would allow for a second rebate to remain with the new entity.
69. As this is a transitional measure, the additional rebate would need to be phased out at the rate of 25% per annum over 4 years.
70. To allow time for adequate merger activity to occur within the industry, this transitional arrangement should be made available to the industry for up to 5 years from the date the amending legislation receives Royal Assent.
71. In a separate report that accompanies this memorandum, PwC provide modelling that estimates:
 - 71.1. the expected take up of the transitional measures; and
 - 71.2. the savings that would be generated.

Finlaysons
(MRB/ MJB/JJP)
January 30, 2015

Returning WET Rebate to Fairness & Original Policy Intent – Supporting Advice on the Impact to Government Revenue

*Winemakers'
Federation of Australia*

January 2015

Disclaimer

Returning WET Rebate to Fairness & Original Policy Intent-Supporting Advice on the Impact to Government Revenue has been prepared by PricewaterhouseCoopers (PwC) at the request of the **Winemakers' Federation of Australia (WFA)** in our capacity as advisors in accordance with the Terms of Business contained in the Engagement Email (dated 08/01/2015) between WFA and PwC.

This document is not intended to be utilised or relied upon by any persons other than WFA, or to be used for any purpose other than that articulated above. Accordingly, PwC accepts no responsibility in any way whatsoever for the use of this report by any other persons or for any other purpose.

The information, statements, statistics and commentary (together the 'Information') contained in this note have been prepared by PwC from publicly available material and from material provided by WFA. PwC has not sought any independent confirmation of the reliability, accuracy or completeness of this information. It should not be construed that PwC has carried out any form of audit of the information which has been relied upon.

Accordingly, whilst the statements made in this report are given in good faith, PwC accepts no responsibility for any errors in the information provided by WFA or other parties nor the effect of any such errors on our analysis, suggestions or report.

Table of Contents

Executive summary	iii
II. Recommended Model	1
III. Phasing Out WET Rebate for Bulk & Unbranded Wine	3
IV. Repeal WET Act Provisions Allowing New Zealand Winemakers to Claim WET Rebate	7
V. Allow second WET rebate on merger of two wine businesses	12
Appendix	16

Executive summary

PwC Australia (PwC) has been engaged by the Winemakers' Federation of Australia (WFA) to estimate the impact to government savings from the recommended changes to the Wine Equalisation Tax (WET) as described in the Finlaysons report *Returning WET Rebate to Fairness & Original Policy Intent* (dated 17 December 2014).

Key Findings

Table 1: Summary of estimated government savings

Finlaysons' reference	Details	Estimated savings (\$m)				Total savings (\$m)	Notes
		2015-16	2016-17	2017-18	2018-19		
II. Recommended Model Pages 2-8	<p>Under the Recommended Model, the rebate would only be available to winemakers that:</p> <ul style="list-style-type: none"> • manufacture and sell wine in a form packaged for retail sale, where the finished product is identifiably theirs; and • have business premises in Australia (potentially, in a designated wine region in Australia); and • hold a licence, issued by the Government of a state or territory in Australia, to sell liquor in that state or territory; and • are self-employed or engage one or more employees (including associates of the winemaker) to perform work for the winemaker; and • sell their wine either: 	0	0	0	0	0	While there are no savings estimated for this measure, it should be noted that introducing the proposed eligibility criteria will ensure future claims are reduced from potential claimants, regardless of origin, who do not have investments in regional Australia.

Estimated savings (\$m)						
	<ul style="list-style-type: none"> by retail sale, or under quotation, from the business premises referred to above; or by internet or mail order sales (in which case the sales would be deemed to take place at the above premises). 					
III. Phasing Out WET Rebate for Bulk & Unbranded Wine Page 9-10	<p><u>Note:</u> This proposal would be implemented by:</p> <ul style="list-style-type: none"> amending the definition of *rebateable wine, in section 33-1 of the WET Act, as follows: *rebateable wine means *grape wine, *grape wine products, *fruit or vegetable wine, *cider or perry, *mead or *sake, that is packaged in a single container with a capacity not exceeding 5 litres at the time of the dealing, and which is labelled with a brand on the primary packaging that is wholly owned by, or licensed exclusively to, the producer of the wine. including a transitional provision in the amending legislation which provides that the eligibility of bulk and unbranded wine for the rebate should be phased out at 25% per annum, starting at 75% of the rebate rate (currently \$500,000), from the first day of the financial year in which the amending legislation receives Royal Assent. 	29	43	57	73	<p>202 This analysis includes all sales of Australian bulk and unbranded wine, excluding producers claiming the WET rebate from New Zealand.</p> <p>The New Zealand producer rebate savings are included in IV - Repeal WET Act Provisions Allowing New Zealand Winemakers to Claim WET Rebate.</p>

		Estimated savings (\$m)					
		7.9	10.1	12.3	14.6	44.9	
IV.	<ul style="list-style-type: none"> Sections 19-5(2) (Entitlement to producer rebates for New Zealand participants) should be repealed to disallow eligibility to NZ entities via the separate scheme. In addition, the following sections should be repealed since, once the entitlement provisions in section 19-5(2) are removed, those sections become obsolete: <ul style="list-style-type: none"> 17-10(2A) (Claims for wine tax credits); 19-7 (Approval as NZ participant); 19-8 (Revoking an approval as a NZ participant); 19-9 (Notification of changed circumstances); 19-10(3) and (4) (Exceptions); 19-15(1C) (Amount of producer rebates); and 33-1: (Dictionary) definition of <i>'New Zealand'</i> and <i>'New Zealand participant'</i>. <p>The reference in section 19-25(4) to <i>'except in the case of a New Zealand participant'</i> would also need to be removed.</p>	total savings ¹	total savings ¹	total savings ¹	total savings ¹	total savings ¹	This analysis includes the cannibalism of producer sales taken up by larger producers still operating in the Australian market. This cannibalism rate has been calculated through a sensitivity assumption of 10% of lost New Zealand sales.
Repeal WET Act Provisions		(6.4 level playing field savings	(6.5 level playing field savings	(6.7 level playing field savings	(6.8 level playing field savings	(26.4 level playing field savings	
Allowing New Zealand Winemakers to Claim WET Rebate		0.6 market cannibalism reduction in savings	0.7 market cannibalism reduction in savings	0.7 market cannibalism reduction in savings	0.7 market cannibalism reduction in savings	2.6 market cannibalism reduction in savings	
Pages 10-14		2.1 bulk and unbranded wine savings)	4.2 bulk and unbranded wine savings)	6.4 bulk and unbranded wine savings)	8.5 bulk and unbranded wine savings)	21.2 bulk and unbranded wine savings)	

¹ Sums may not add due to rounding

		Estimated savings (\$m)					
V. Allow Second WET Rebate on Merger of Two Wine Businesses Page 15	Government support to 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.	3 to 12	6 to 24	9 to 37	13 to 50	31 to 123	The range of savings is based on four scenarios ranging from 25% take up to 100% take up.
Total savings		39.9 to 48.9	59.1 to 77.1	78.3 to 106.3	100.6 to 137.6	277.9 to 369.9	

II. Recommended Model

Task

PwC has been asked by WFA to analyse the impact on WET rebate savings if the New Zealand WET rebate system is repealed and Finlaysons' "Recommended Model" for eligibility is applied to New Zealand winemakers.

Under the Recommended Model, the rebate would only be available to winemakers that:

- manufacture and sell wine in a form packaged for retail sale, where the finished product is identifiably theirs; and
- have business premises in Australia (potentially, in a designated wine region in Australia); and
- hold a licence, issued by the Government of a state or territory in Australia, to sell liquor in that state or territory; and
- are self-employed or engage one or more employees (including associates of the winemaker) to perform work for the winemaker; and
- sell their wine either:
 - by retail sale, or under quotation, from the business premises referred to above; or
 - by internet or mail order sales (in which case the sales would be deemed to take place at the above premises).

Specifically, PwC has been asked to respond to Finlaysons' references:

- 7 – PwC provide modelling that estimates:
 - 7.1 – the cost of acquiring and maintaining a liquor licence and business premises; and
 - 7.2 – the number of producers that potentially would exit the industry or would otherwise become ineligible to claim the rebate.

Findings

Estimated number of producers that would become ineligible to claim the rebate

The Recommended Model proposed by Finlaysons is not anticipated to impose additional costs to Australian wine producers. One potential impact on Australian producers is the inclusion of the requirement to hold a liquor licence. However the acquisition of a licence is a minor cost to producers (estimated at approximately \$1,000) and would not deter producers from claiming the WET rebate.

Finlaysons' report states that it is expected that most, if not all, Australian producers who claim the WET rebate currently hold a state or territory liquor licence of some description and would qualify for the rebate under the Recommended Model.

Table 2: Summary of Recommended Model findings

Finlaysons' reference	Estimated savings (\$m)				Total savings (\$m)	Notes
	2015-16	2016-17	2017-18	2018-19		
II. Recommended Model Pages 2-8	0	0	0	0	0	While there are no savings estimated for this measure, it should be noted that introducing the proposed eligibility criteria outlined above will ensure future claims are reduced from potential claimants, regardless of origin, who do not have investments in regional Australia.

III. Phasing Out WET Rebate for Bulk & Unbranded Wine

Task

PwC has been asked by WFA to model a reduction in the WET rebate from bulk and unbranded wine. The model is to be updated to reflect a reduction in the rebate from bulk, private label and unbranded wine at 25 per cent per annum from 75 per cent in 2015-16 to 0 per cent in 2018-19.

This proposal would be implemented by:

- Amending the definition of *rebateable wine, in section 33-1 of the WET Act, as follows:
 - *rebateable wine means *grape wine, *grape wine products, *fruit or vegetable wine, *cider or perry, *mead or *sake, that is packaged in a single container with a capacity not exceeding 5 litres at the time of the dealing, and which is labelled with a brand on the primary packaging that is wholly owned by, or licensed exclusively to, the producer of the wine.
- including a transitional provision in the amending legislation which provides that the eligibility of bulk and unbranded wine for the rebate should be phased out at 25% per annum, starting at 75% of the rebate rate (currently \$500,000), from the first day of the financial year in which the amending legislation receives Royal Assent.

Specifically, PwC has been asked to respond to Finlaysons' reference:

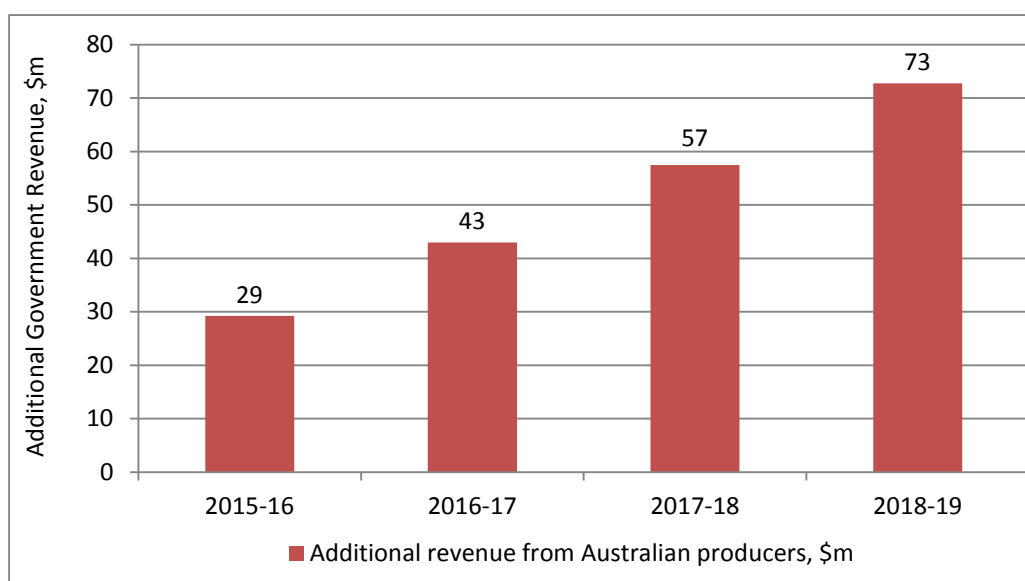
- 36 – modelling that estimates the savings from removing the rebate from bulk and unbranded wine.

Findings

Estimated savings from removing the rebate from bulk and unbranded wine

The estimated government saving from removing the rebate from bulk and unbranded wine has been developed using an industry structure method. This method has been developed from those producers in the Australian Bureau of Statistics (ABS) catalogue 1329.0 publication and micro producers identified by the Australian Tax Office (ATO) who are currently eligible for the rebate.

Through the industry structure method, the government savings from removing the rebate on Australian bulk and unbranded wine is estimated to be approximately \$73 million in 2018-19, as show in Figure 1. The removal of bulk and unbranded wine will also impact New Zealand producers. However, the New Zealand impact is shown in *Chapter IV – Repeal WET Act Provisions Allowing New Zealand Winemakers to Claim WET Rebate* and not included in Figure 1.

Figure 1: Update of WET – additional commonwealth government savings, \$m

Source: *PwC analysis*

The industry structure method combines data from the ABS and ATO to give a complete picture of the Australian wine industry. This model is then used to estimate the total value of bulk and unbranded wine from Australian producers. The phasing out of the bulk and unbranded wine rebates have been applied to this model to show the estimated impact to government savings from the policy change. Further information on the methodology of this industry structure method is attached in Appendix A.

Table 3 below shows the total estimated savings from all Australian producers of bulk and unbranded wine

Table 3: Summary of phasing out WET rebate for bulk & unbranded wine findings

Estimated savings (\$m)						Notes
Finlaysons' reference	2015-16	2016-17	2017-18	2018-19	Total savings (\$m)	
III. Phasing Out WET Rebate for Bulk & Unbranded Wine Page 9-10	29	43	57	73	202	This analysis includes all sales of Australian bulk and unbranded wine, excluding producers claiming the WET rebate from New Zealand. The New Zealand producer rebate savings are included in <i>IV - Repeal WET Act Provisions Allowing New Zealand Winemakers to Claim WET Rebate</i> .

Data sources

The table below outlines the data sources and assumptions.

Table 4: Data sources and assumptions

Item	Source
1 Domestic sales volume by container type	
ABS Catalogue: 8504.0 - Shipments of Wine and Brandy in Australia by Australian Winemakers and Importers, March 2014: Table 1	http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/8504.0March%202014?OpenDocument
2 FOB price for wholesale wine	
Australian Grape and Wine Authority - database	http://www.wineaustralia.com/en/Winefacts%20Landing.aspx
3 Wine imports	
Australian Grape and Wine Authority - database	http://www.wineaustralia.com/en/Winefacts%20Landing.aspx
4 WET rebate detail	
WET rebate Australian claimants	file:'140801 ATO data original.xls', DATA Derived from SENATE ESTIMATES QUESTIONS 15/03/2013
Total of rebate and refund	file:'140801 ATO data original.xls', DATA Derived from SENATE ESTIMATES QUESTIONS 15/03/2013
Total value of WET rebate claim by Industry	file:'140801 ATO data original.xls', DATA Derived from SENATE ESTIMATES QUESTIONS 15/03/2013
5 WET collected	
WET payable	Taxation statistics 2011–12, Table 1: Goods and services tax, Selected GST, WET and LCT items, 2001-02 to 2012-13
WET refundable	Taxation statistics 2011–12, Table 1: Goods and services tax, Selected GST, WET and LCT items, 2001-02 to 2012-13
Net WET	Taxation statistics 2011–12, Table 1: Goods and services tax, Selected GST, WET and LCT items, 2001-02 to 2012-13
Net WET (Forward Estimates)	Mid Year Economic and Fiscal Outlook, 2013-14, Note 3: Taxation revenue by type
NZ producer rebate	Taxation statistics 2011–12, Table 1: Goods and services tax, Selected GST, WET and LCT items, 2001-02 to 2012-13

	Item	Source
6	Wine producers by size of crush	
	ABS Catalogue 1329.0 - Australian Wine and Grape Industry, 2012-13	http://www.abs.gov.au/AUSSTATS/abs@.nsf/Latest products/1329.0Main%20Features22012-13?opendocument&tabname=Summary&prodno=1329.0&issue=2012-13&num=&view=
7	Wine retail sales	
	Off premises trade	Aztec liquor outlook 2014.pdf
	Domestic	Aztec liquor outlook 2014.pdf
	Imported	Aztec liquor outlook 2014.pdf

Source: Modelling Changes to Wine Equalisation Tax (WET) Producer Rebates

Key assumptions

- The proportion of bulk and unbranded wine produced is 20% of total wine produced.
- The WET rebate is reduced to 75 per cent in 15-16 and reduced to 0 per cent in 2018-19, reducing at 25 per cent per year.
- Growth in wholesale sales (domestic/imported): domestic 2.9 per cent - 3.7 per cent, imported 12 per cent.
- Growth in volume by container type, bulk (5 per cent), container unspecified (1 per cent), glass bottle (2 per cent), softpack (-2 per cent), total (1 per cent).
- The margin on wholesale sales F.O.B. price remains constant.
- The private label share of sales increase by 0.5 per cent p.a offset by a fall of 0.5 per cent of the share of unbranded wholesale sales.
- Share of bulk wine, private labels, unbranded sales that attracts rebate is at system, ie 29 per cent.
- Additional volume is absorbed by the producers in the largest two categories.

IV. Repeal WET Act Provisions Allowing New Zealand Winemakers to Claim WET Rebate

Task

PwC has been asked by WFA to model the savings in the WET rebate from repealing WET Act provisions allowing New Zealand winemakers to claim WET rebate.

Finlaysons' **report** notes that:

- Sections 19-5(2) (Entitlement to producer rebates for New Zealand participants) should be repealed to disallow eligibility to NZ entities via the separate scheme.
- In addition, the following sections should be repealed since, once the entitlement provisions in section 19-5(2) are removed, those sections become obsolete:
 - 17-10(2A) (Claims for wine tax credits);
 - 19-7 (Approval as NZ participant);
 - 19-8 (Revoking an approval as a NZ participant);
 - 19-9 (Notification of changed circumstances);
 - 19-10(3) and (4) (Exceptions);
 - 19-15(1C) (Amount of producer rebates); and
 - 33-1: (Dictionary) definition of 'New Zealand' and 'New Zealand participant'.
- The reference in section 19-25(4) to 'except in the case of a New Zealand participant' would also need to be removed.

Specifically, PwC has been asked to respond to Finlaysons' reference:

- 23 – Australia would also note that limiting the rebate in the manner proposed would be unlikely to reduce the volume of New Zealand wine sold in Australia due to **the strength of the “Malborough” brand. In addition, even if certain New Zealand winemakers find it uneconomic to import into Australia in the absence of the rebate, their sales will be taken up by other New Zealand producers.**
- 65 – PwC provide modelling that estimates:
 - 65.1 – **the cost for New Zealand producers of shifting to “level playing field” arrangements; and**
 - 65.2 – the number of New Zealand producers that would exit the industry or become ineligible for the rebate.

Findings

Estimated cost for New Zealand producers of shifting to “level playing field” arrangements & the cost of acquiring and maintaining a liquor licence and business premises

Based on PwC research and survey responses from WFA members, the cost of acquiring and maintaining a liquor licence and maintaining business premises in Australia is estimated to be approximately \$100,000 per annum. This cost has been estimated to be the cost of a New Zealand producer shifting to a “level playing field” arrangement and continuing to claim the rebate.

The estimated business costs are shown in Table 6.

Estimated number of New Zealand producers that would become ineligible for the rebate

Based on the estimated business cost of approximately \$100,000 (see Table 6), there is estimated to be 156 New Zealand producers not claiming a rebate sufficient enough to justify opening business presence in Australia in 2018-19. These New Zealand producers would not be able to justify the business costs and would become ineligible for the WET rebate under the Recommended Model.

The reduction in New Zealand producers claiming the WET rebate from the estimated business cost represents a further government saving of approximately \$6.8 million in 2018-19.

Consumer brand loyalty for New Zealand products

Although there will be an overall loss in New Zealand wine sales from the recommended changes to eligibility, consumer brand and wine region loyalty could increase sales to the New Zealand producers that continue to export wine to Australia. A sensitivity analysis with an assumed substitution effect of 10 per cent found this could represent up to \$700,000 in WET rebate in 2018-19 as Australian consumers continue to purchase New Zealand products.

Any substitution effect such as this will reduce the government saving from New Zealand producers. For example the assumed 10 per cent sensitivity analysis will reduce the government saving from New Zealand producers to approximately \$6.1 million.

Phasing out New Zealand WET rebate for bulk & unbranded wine

In addition to the increase in government savings from Australian producers from the removal of the WET rebate for bulk and unbranded wine (as discussed in chapter III), there is also a further government saving from the reduction in bulk and unbranded wine from New Zealand.

Based on assumptions provided by WFA, approximately 75 per cent of all New Zealand bulk and unlabelled wine could be claimed by producers. This assumption has been applied to estimate the Australian government rebate savings from removing New Zealand bulk and unlabelled wine. From this, it is estimated that the savings from the removal of New Zealand bulk and unlabelled wine could be approximately 8.5 million in 2018-19.

Table 5 below summaries the total Australian government savings from the findings discussed above.

Table 5: Summary of repeal WET act provisions allowing New Zealand winemakers to claim WET rebate findings

Estimated savings (\$m)						Notes
Finlaysons' reference	2015-16	2016-17	2017-18	2018-19	Total savings (\$m)	
IV. Repeal WET Act Provisions Allowing New Zealand Winemakers to Claim WET Rebate	7.9 total savings ²	10.1 total savings ¹	12.3 total savings ¹	14.6 total savings ¹	44.9 total savings ¹	This analysis includes the cannibalism of producer sales taken up by larger producers still operating in the Australian market. This cannibalism rate has been calculated through a sensitivity assumption of 10% of lost New Zealand sales.
	(6.4 level playing field savings)	(6.5 level playing field savings)	(6.7 level playing field savings)	(6.8 level playing field savings)	(26.4 level playing field savings)	
Pages 10-14	0.6 market cannibalism reduction in savings	0.7 market cannibalism reduction in savings	0.7 market cannibalism reduction in savings	0.7 market cannibalism reduction in savings	2.6 market cannibalism reduction in savings	
	2.1 bulk and unbranded wine savings)	4.2 bulk and unbranded wine savings)	6.4 bulk and unbranded wine savings)	8.5 bulk and unbranded wine savings)	21.2 bulk and unbranded wine savings)	

Data sources

The assumed business costs for maintaining business presence in the Australian marketplace are shown in the Table 6. These costs have been assumed from estimates provided from WFA and its members.³

The business costs will vary considerably depending on the business strategy. For example Table 6 below assumes a relatively small business with a rent of \$55,000 per annum. A business strategy that supports activities such as wine tasting, sales and marketing may require a business location and fit out that would cost over the assumed \$55,000 rental expense.

PwC has conducted research on the cost for maintaining business presence in the Australian market and found that the upper scale of business costs can exceed \$400,000. Changing the assumed business presence cost to \$400,000 considerably increases the number of New Zealand producers that would not enter the Australian market, estimated to be 229 producers. This assumption would increase the Government New Zealand rebate savings to \$15.5 million (excluding the savings from the removal of New Zealand bulk wine from III - Phasing Out WET Rebate for Bulk & Unbranded Wine).

² Sums may not add due to rounding

³ Provided to PwC by WFA

Table 6: Cost of Australian business presence

Cost Category	Estimate	Source
Company registration costs	\$500	Australian Securities and Investment Commission website
Annual ASIC filing costs	\$243	Assumed annual review fee through private company
Employee salary	\$33,327	www.fairwork.gov.au minimum wages factsheet
Employee-related compliance costs	\$9,998	Estimated to be an additional 25% - 30% of the basic wage paid to employees. Government of South Australia, The cost of employing someone (www.sa.gov.au)
Business premises costs	\$55,000	Assumption developed through consultation with WFA and their members
Application for licence to sell liquor	\$973	Average of licence costs across NSW, QLD, VIC and SA
Total business premise costs	\$100,041	

Source: provided by WFA based on member input

These business cost are expected to vary depending on the level of business presence and business strategy of each producer. The employee salary and business premise cost are the two major contributors to the total business costs and are expected to be the most diverse. This analysis uses the Australian minimum employee wage rate. However alternative scenarios could increase this cost, such as assuming the average Australian salary or employment multiple employees.

The business premise cost is another highly subjective cost. One WFA member reported that this could be as low as \$6,000 per annum. This analysis has assumed the average business premise costs of \$55,000 per annum.

The level of New Zealand claimants of WET were sourced from Senate Estimates data and forecasted out to 2018-19. The table below shows the original data sourced from Senate Estimates data.

Table 7: 2011-12 New Zealand claimants of WET

% of max rebate	Value of rebate	No.	Estimated average rebate	\$m
0-20%	\$0 to \$100,000	137	\$50,000	6.9
20-50%	\$100,000 - \$250,000	32	\$150,000	4.8
50-70%	\$250,000 - \$350,000	12	\$300,000	3.6
70-100%	\$350,000 - \$500,000	24	\$400,000	9.6
Total		205		\$24.9

Source: ATO, file: '140801 ATO data original.xls', DATA Derived from SENATE ESTIMATES QUESTIONS 15/03/2013

Key assumptions

- Producers need to have separate business premises. This means we have assumed that there are no joint premises between two or more producers.
- There are no additional barriers to entry other than the business premise costs outlined in Table 6.
- Within each percentage of maximum rebate grouping, the average value of WET rebate has been used as a proxy for each producer rebate within that group.
- The New Zealand producer rebate value on bulk and unlabelled wine is 75 per cent of the total value of bulk and unlabelled wine imported into Australia.
- There is no growth in the value of New Zealand wine imported into Australia over the forecast period.

V. Allow second WET rebate on merger of two wine businesses

Task

PwC has been asked by WFA to calculate the government savings from Finlaysons recommended Transitional Measure. The recommended 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.

The analysis below allows two wine businesses to merge but still claim a second WET rebate. This Transitional Measure is phased out from 2015-16 at the rate of 25 per cent per annum over four years.

Specifically, PwC has been asked to respond to Finlaysons' reference:

- 71 – PwC provide modelling that estimates:

71.1 – the expected take up of the Transitional Measure, and

71.2 – the savings that would be generated

Findings

Four scenarios have been estimated and costed: 100 per cent, 75 per cent, 50 per cent and 25 per cent take up of the recommended Transitional Measure.

Take up of the Transitional Measures

Up to 318 producers in 2018-19 could benefit from the take up of the recommended Transitional Measure. These producers are all currently claiming above 50 per cent of the total rebate value and any merger would result in a total rebate value over the \$500,000 cap. However this is a maximum estimation and in practice not all producers would choose to merge.

For each of the four take up scenarios, the potential take up is outlined in the below table.

Table 8: 2018-19 take up of Transitional Measure

Scenario	Total producer take up	Take up 50-70% of rebate value	Take up 70-100% of rebate value	Take up >100% of rebate value
100% take up	318	72	218	28
75% take up	238	54	164	20
50% take up	159	36	109	14
25% take up	80	18	55	7

Source: PwC Analysis

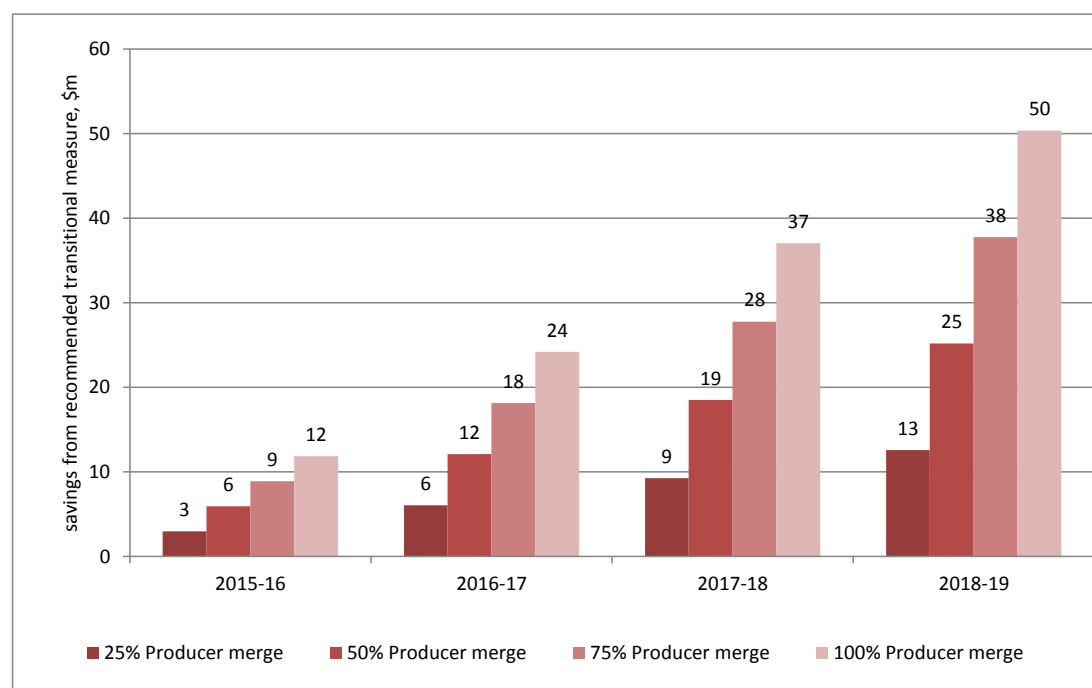
The biggest expected take up of the Transitional Measure would be producers currently claiming in between 50 per cent to 70 per cent of the total rebate value. The potential efficiency gains from a merge is relatively high for these producers, with relatively low reductions in rebate value over the four year period compared to producers already claiming a high rebate value. In 2018-19, there are estimated to be 72 producers claiming a rebate in between 50 per cent to 70 per cent.

Potential savings from Transitional Measure

Figure 2 below shows that in 2018-19, there could be up to \$50 million in rebate savings to the government from the introduction of the Transitional Measure. The largest contributor to this estimated saving is producers currently claiming in between 70 per cent to 100 per cent of the total rebate value. This group alone has a maximum rebate saving of up to \$39.5 million in 2018-19.

Figure 2 below shows the estimated government rebate savings from each of the four scenarios: 100 per cent, 75 per cent, 50 per cent and 25 per cent take up of the Transitional Measure.

Figure 2: Potential rebate savings from recommended Transitional Measure, \$m



Source: derived from *Modelling Changes to Wine Equalisation Tax (WET) Producer Rebates* outputs

Table 9: Summary of allowing second WET rebate on merger of two wine businesses findings

Finlaysons' reference	Estimated savings (\$m)				Total savings (\$m)	Notes
	2015-16	2016-17	2017-18	2018-19		
V. Allow Second WET Rebate on Merger of Two Wine Businesses	3 to 12	6 to 24	9 to 37	13 to 50	31 to 123	The range of savings is based on four scenarios ranging from 25% take up to 100% take up.

Page 15

Data sources/methodology

Table 10 below highlights the original 2010-11 number of producers potentially impacted from the Transitional Measure. This table has been expanded to calculate the amount of producers with an incentive to merge and still claim a second WET.

Table 10: 2010-11 WET Rebate pool

% of max rebate	Value of rebate	No.	\$m
50-70%	\$250,000 - \$350,000	41	12.3
70-100%	\$350,000 - \$500,000	174	74.1
>100%	> \$500,000	17	8.5
Total		232	\$94.9

Source: ATO, file: '140801 ATO data original.xls', DATA Derived from SENATE ESTIMATES QUESTIONS 15/03/2013

Key assumptions

- Mergers between providers that currently claim less than 50 per cent of the total rebate allowance have not been considered in this analysis, since their total rebate value is under the cap and would not be impacted by the recommended transitional measure.
- Take up of the recommended Transitional Measure is spread across three groupings listed in Table 2; 50-70 per cent, 70-100 per cent and >100 per cent of maximum rebate. It is assumed that these groups will be equally proportionally affected.
- No more than two producers merge together.
- The average percentage of rebate claimed for each grouping has been assumed to be consistent across the forecasted years. Table 11 outlines the assumed 2018-19 average rebate value claimed for each grouping.

Table 11: Assumed average rebate value claimed

% of max rebate	Average percentage claimed	2018-19 average rebate value claimed
0-20%	6%	\$30,594.82
20-50%	30%	\$152,172.60
50-70%	61%	\$304,345.20
70-100%	86%	\$431,155.70
>100%	100%	\$500,000.00

Source: derived from *Modelling Changes to Wine Equalisation Tax (WET) Producer Rebates* outputs

Appendix

Appendix A Industry structure approach

17

Appendix A Industry structure approach

Industry structure approach

The size of the Australian wine industry has been estimated and forecasted using a bottom up industry structure approach. This method has been developed from those producers in the Australian Bureau of Statistics (ABS) catalogue 1329.0 publication and micro producers identified by the Australian Tax Office (ATO) who are currently eligible for the rebate.

The ABS and ATO data by themselves do not capture the entire production of wine in Australia. To develop a complete picture of the Australian wine industry, the industry structure method combines these two data sources.

The model is then used to estimate the total value of wine produced by Australian producers over the forecasted period. This framework has been used to answer specific questions regarding bulk and unbranded wine in this report. The development of the industry structure method is provided in a step by step explanation below.

Development of the industry structure approach

The ATO detailed the recipients of the WET producer rebate in answers to senate estimate questions by number and size of rebate. An alternative approach is to examine the industry structure of the producers of wine to match those producing wine with those receiving the rebate. We match producers by size of production to rebate claimants by size of claim.

The ABS publication 1329.0 provides an estimate of the number of producers by size of crush. Table 12 details the number of producers by tonnes crushed and the production of litres of wine. Using this information we can assign an approximate value to the wine produced.

Table 12: Wine produced by size of crush, 2010 -11

Size of crush (tonnes)	Production '000L	No.
50 - 99	1,858	36
100 - 149	2,453	45
150 - 199	2,268	19
200 - 400	9,913	51
401 - 1,000	31,374	71
1,001 - 3,000	40,567	48
3,001 - 5,000	59,660	21
5,001 - 10,000	55,735	11
10,001 - 20,000	69,297	8

Size of crush (tonnes)	Production '000L	No.
20,001 or more	844,712	15
Total	1,117,837	325

It is difficult to assign an exact value of the wine for each individual producer as some may have a high value, per litre >\$10, others low, used in the production of bulk wine for around \$1 per litre. However, on average, the value of wine produced must equate to the wholesale value of wine sold. The values in Table 13 show an approximate value of domestic sales and associated WET for each producer given the size of their crush. Exports are the difference between the value of production and the domestic sales. The total of domestic sales sum to the total of the Australian produced domestic sales for 2010-11.

Table 13: Wine value, WET by size of crush per producer, 2010 -11

Size of crush (tonnes)	Production '000L	Value ⁴ \$'000's	Domestic wholesales \$'000's	WET \$'000's
50 – 99	52	\$325	\$260	\$75
100 – 149	55	\$343	\$274	\$80
150 – 199	119	\$751	\$526	\$152
200 - 400	194	\$1,223	\$734	\$213
401 - 1,000	442	\$2,779	\$1,390	\$403
1,001 - 3,000	845	\$5,316	\$1,913	\$555
3,001 - 5,000	2,841	\$17,868	\$6,431	\$1,865
5,001 - 10,000	5,067	\$31,868	\$11,469	\$3,326
10,001 - 20,000	8,662	\$54,481	\$19,607	\$5,686
20,001 or more	56,314	\$354,193	\$127,468	\$36,966
Total all production	1,117,837	-	\$2,589,654	\$751,000

Source: ABS 1329.0, derived

Next, each of the producers must be placed into broad value 'bins' based on their domestic sales. These bins have a wide range which means the majority of producers will fall entirely within one of the bins. Where they might fall into more than one bin, the quantity of production is split across the two or more bins using an approximate share.

⁴ This values all wine produced at the average domestic price per litre. Final exports prices and value will be a different.

Table 14 shows the domestic sales bins that producers belong to. The values of the bins have been chosen to match the bins used by the ATO in the analysis of the WET rebate. The final row shows the number of producers in each bin. This is the result of the share in each bin multiplied by the number of producers of that size. For example, there are 51 producers of between 200 and 400 tonnes crushed, 100% of these belong in the \$344,829 to \$862,069 bin.

Table 14: Share of domestic sales by value, by size of crush per producer, 2010-11

Size of crush (tonnes)	\$0 to \$344,828	\$344,829 to \$862,069	\$862,070 to \$1,206,898	\$1,206,898 to \$1,724,139	Greater than \$1,724,139
50 - 99	100%				
100 - 149	100%				
150 - 199	20%	80%			
200 - 400		100%			
401 - 1,000		20%	30%	50%	
1,001 - 3,000			20%	30%	50%
3,001 - 5,000					100%
5,001 - 10,000					100%
10,001 - 20,000					100%
20,001 or more					100%
No of Producers	85	80	31	50	79

Source: ABS 1329.0, derived

The next step is contrast to these producer bins value to the ATO rebate analysis. The ATO analysis shown in Table 15 has 1,387 producers claiming a rebate of less than 20%. The ABS **1329 publication doesn't capture** micro producers (below 50 tonnes crushed). The ATO analysis is concluded to capture all the producers in this group receiving less than 20% of the maximum rebate.

Table 15: WET Rebate pool

% of max rebate	Value of rebate	No.	\$m
0-20%	\$0 to \$100,000	1,387	41.7
20-50%	\$100,000 - \$250,000	214	32.1
50-70%	\$250,000 - \$350,000	41	12.3
70-100%	\$350,000 - \$500,000	174	74.1

% of max rebate	Value of rebate	No.	\$m
>100%	> \$500,000	17	8.5
Total		1,833	\$168.7

Source: ATO, file: '140801 ATO data original.xls', DATA Derived from SENATE ESTIMATES QUESTIONS 15/03/2013

Excluding the 0-20% category where producers of less than 50 tonnes can apply for rebate, there are 446 producers receiving rebate over \$100,000. This is in contrast to the 240 producers which are identified as having produced \$344,829 of wine or more. The additional claimants of WET rebate above those identified producers are likely to have manufactured or blended wine produced from one or more of the larger producers. This is confirmed when we compare those producers claiming the maximum rebate. Only 17 entities claimed the maximum \$500,000 rebate when value estimates imply 79 producers are large enough to have claimed the full rebate.

If the definition of the rebate is changed so only producers of wine are eligible for the rebate, thereby removing any rebate from the on-sale of wine to related or unrelated entities for processing.

Based on the volume of the crush and average wholesale price per litre, 240 of the 325 producers would generate enough wholesale domestic sales revenue to qualify for a rebate greater than 20% of the \$500,000 cap (Table 16). This compares with the 446 recipients of the greater than 20% of the rebate in 2010-11. Based on the average amount of rebate received in each of the bands and the revised number of eligible producers of wine from the ABS 1329 publication, it implies a total rebate of \$122 million. This compares with the \$168.7 million identified by the ATO claiming the rebate involved in grape growing or manufacture of wine industries in 2010-11.

Table 16: Producer only WET Rebate recipients, 2010-11

% of max rebate	No.	\$m
0-20%	1,387	41.7
20-50%	80	12.1
50-70%	31	9.3
70-100%	74	31.5
>100%	55	27.5
Total	1,627	122.0

The number of recipients of the rebate identified by the ATO has continued to rise since 2010-11. The last available figure in 2011-12 showed 501 recipients receiving more than 20% of the rebate. As the ABS 1329 publication was discontinued, no further facts on the change in the number of producers are available.

July 2015



Vintage Report



WFA winegrape crush and 2016 outlook

Overview

This year's Vintage Report includes some positive signs for the industry. Along with shifts in the macro-economic climate – including favorable shifts in exchange rates, the signing of key Free Trade Agreements and strengthening consumer demand in some key market segments – the outlook for the industry has improved from last year. However, the Report also indicates an industry under sustained profit pressure and the persistence of a structural mismatch between the supply and demand for our wine at profitable price points.

The 2015 Vintage of 1.67 million tonnes which is marginally lower than “average” and while average grape prices have strengthened, this is off a low base.

Favorable changes in seasonal market conditions and the macro-economic environment will not be enough to restore the Australian wine sector's lost share and margin. We need to take pro-active steps with the support of government to boost demand and our resourcing of promotional activities. On the supply side, better informed decision making is required with the aid of improved data, analysis and price signaling. This Report is part of that data set.

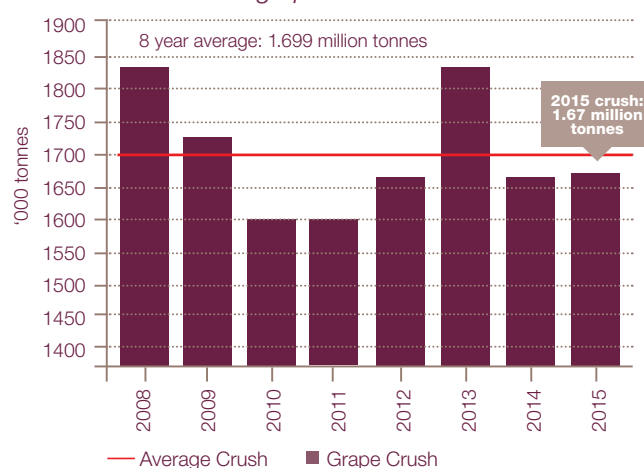
2015 winegrape crush

The 2015 Australian grape crush is 1.67 million tonnes – just a 0.4% increase from last year's Levies Finance 2014 recorded crush of 1.66 million tonnes¹. This figure is just below the 8-year average of 1.70 million tonnes and around 7,000 tonnes higher than last year's crush. The slight increase in overall crush is attributable to Riverina's increase in yields, offset by lower yields in Murray Darling and most cooler temperate regions.

Crush by industry structure suggests that the largest 22 respondents accounted for around 85% of the total crush. In terms of crush by state/regions, Murray Darling-Swan Hill accounted for 382,000 tonnes or 25% of the total crush, New South Wales (excluding Murray Darling-Swan Hill) at 332,000 tonnes or 22%, Victoria (excluding Murray Darling-Swan Hill) at 60,000 or 4%, South Australia at 717,000 tonnes or 47%, Western Australia at 30,000 or 2% of total crush. See page 3 for more detail.

The 2012 Expert Review analysis on production profitability has been further expanded to include 2015 data. Increasing 2012 cost of production by 1.5%, profitable production across 15 representative regions decreased from 7% in 2014 to 6% this reporting period. Low profitability and breakeven during this time were unchanged, while unprofitable production increased to 85%. See pages 5 and 6 for discussion.

Total Winegrape Crush in Australia



Sources: Historical crush figures – Levies Revenue Service (LRS), ABS and WFA

This year the WFA Vintage Survey was combined with the Wine Australia Price Dispersion Survey, the South Australian Grape Crush Survey and the Murray-Darling / Swan Hill Wine Grape Crush Report into a single collection process known as the Australian Wine Sector Survey 2015. See details of the Australian Wine Sector Survey 2015 methodology on page 8.

The Wine Australia Price Dispersion Survey shows that, overall, the national average winegrape purchase price in 2015 was \$463 per tonne – up 5% from the 2014 average of \$441 per tonne. See summary of Wine Australia's Price Dispersion Survey on page 4.

The 2016 vintage will continue to present challenges to the industry since we have not seen significant structural shifts. The potential benefits from recent Free Trade Agreements and favorable currency movements should be seized by the industry. The Federation's submissions to government recommend an increase in funding to assist industry reap the benefits of these economic opportunities and to recapture share and margin in our global markets. Unlocking trade opportunities and addressing the challenges requires a coordinated effort, including from the industry, groups of stakeholders, and individual companies. See discussion on page 7.

¹ This is based on Levies Finance 2014 recorded crush at 1,662,791 tonnes. See survey methodology for further details.

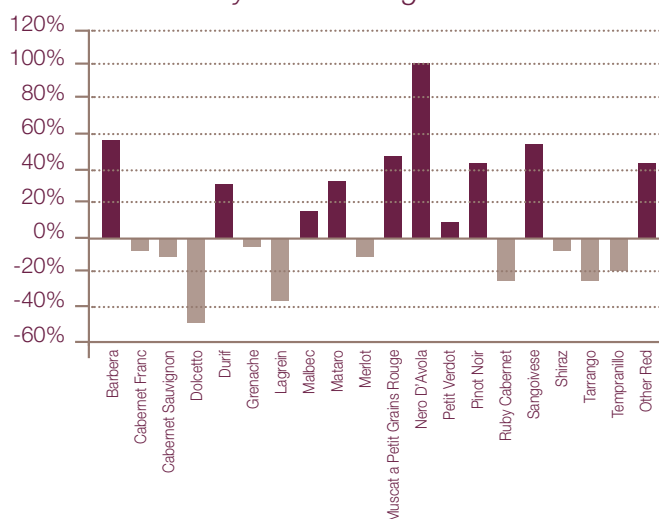
02 Vintage Report

Crush by variety

The 2015 red crush stands at 835,500 tonnes and the white crush stands at 834,000 tonnes. Compared to last vintage, the 2015 red crush has decreased by 4% or 30,751 tonnes and the white crush has increased by 5% or 37,524 tonnes.

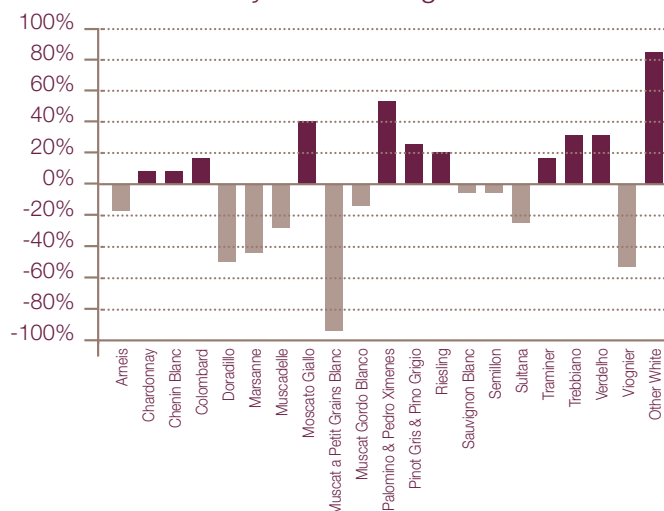
The top three red varieties by crush were Shiraz, Cabernet Sauvignon and Merlot, together accounting for 85% of the total red crush. Shiraz continues to dominate with 47% of the total red crush though with a 6% decrease from last year. Largest decreases were Dolcetto (-50% or -640 tonnes), Lagrein (-35% or -90 tonnes), Ruby Cabernet (-25% or -4,052 tonnes) and Tarrango (-23% or -109 tonnes).

Red variety crush change 2014-2015



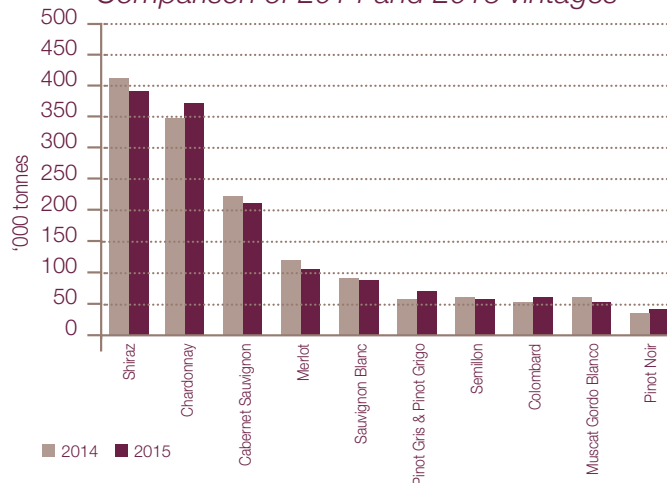
In the whites, Chardonnay still dominates the white crush at 45% – an increase of 28,726 tonnes from last year. Sauvignon Blanc remains in second place with 11%, followed by Pinot Gris and Pinot Grigio accounting for 9% of total white crush. Largest increases are Other white (+85% or +17,731 tonnes), Palomino & Pedro Ximenes (+51% or +91 tonnes), Muscadelle (+41% or +152 tonnes) and Verdelho +29% or +2,308 tonnes). Largest decreases are Muscat a Petit Grains Blanc (-95% or -13,881 tonnes), Viognier (-52% or -7,488 tonnes), Doradillo (-51% or -580 tonnes) and Marsanne (-44% or -1,767 tonnes).

White variety crush change 2014-2015



There was no change in the composition of the Top 10 varieties from last year, but some of the rankings have changed – Pinot Gris & Pinot Grigio ranked 6th (previously 8th), Semillon ranked 7th (previously 6th), Colombard ranked 8th (previously 9th) and Muscat Gordo Blanco now ranked 9th (previously 7th).

*Top 10 Varieties
Comparison of 2014 and 2015 vintages*



<i>Variety</i>	<i>2014</i>	<i>2015</i>	<i>Change 2014-2015 (tonnes)</i>	<i>% change 2014-2015</i>	<i>% of grape crush</i>
Red Varieties					
Barbera	266	417	151	56%	0.02%
Cabernet Franc	1,119	1,070	(49)	-4%	0.06%
Cabernet Sauvignon	226,386	209,588	(16,798)	-7%	12.55%
Dolcetto	1,273	633	(640)	-50%	0.04%
Durif	4,535	5,858	1,323	29%	0.35%
Grenache	13,045	12,614	(431)	-3%	0.76%
Lagrein	259	169	(90)	-35%	0.01%
Malbec	2,674	3,123	449	17%	0.19%
Mataro	5,006	6,554	1,548	31%	0.39%
Merlot	114,413	107,280	(7,133)	-6%	6.43%
Muscat a Petit Grains Rouge	769	1,133	364	47%	0.07%
Nero D'Avola	412	825	413	100%	0.05%
Petit Verdot	19,534	20,861	1,327	7%	1.25%
Pinot Noir	30,260	43,488	13,228	44%	2.60%
Ruby Cabernet	16,125	12,073	(4,052)	-25%	0.72%
Sangiovese	2,991	4,554	1,563	52%	0.27%
Shiraz	415,138	391,649	(23,489)	-6%	23.46%
Tarrango	481	372	(109)	-23%	0.02%
Tempranillo	5,364	4,280	(1,084)	-20%	0.26%
Other red	6,221	8,983	2,762	44%	0.54%
Total Red Varieties	866,274	835,523	(30,751)	-4%	50.04%

White Varieties

Arneis	213	175	(38)	-18%	0.01%
Chardonnay	347,613	376,339	28,726	8%	22.54%
Chenin Blanc	5,458	5,880	422	8%	0.35%
Colombard	54,503	63,093	8,590	16%	3.78%
Doradillo	1,142	562	(580)	-51%	0.03%
Marsanne	3,999	2,232	(1,767)	-44%	0.13%
Moscato Giallo	3,708	2,518	(1,190)	-32%	0.15%
Muscadelle	375	527	152	41%	0.03%
Muscat a Petit Grains Blanc	14,674	793	(13,881)	-95%	0.05%
Muscat Gordo Blanco	64,051	55,303	(8,748)	-14%	3.31%
Palomino & Pedro Ximenes	177	268	91	51%	0.02%
Pinot Gris & Pinot Grigio	60,303	74,867	14,564	24%	4.48%
Riesling	22,200	26,735	4,535	20%	1.60%
Sauvignon Blanc	93,364	89,125	(4,239)	-5%	5.34%
Semillon	69,766	66,572	(3,194)	-5%	3.99%
Sultana	703	527	(176)	-25%	0.03%
Traminer	10,870	12,484	1,614	15%	0.75%
Trebbiano	319	410	91	29%	0.02%
Verdelho	7,996	10,304	2,308	29%	0.62%
Viognier	14,299	6,811	(7,488)	-52%	0.41%
Other white	20,784	38,515	17,731	85%	2.31%
Total White Grapes	796,517	834,041	37,524	5%	49.96%
Total All Varieties	1,662,791	1,669,564	6,773	0.4%	100%

Crush by wine industry structure

The Australian wine industry is made up of a small number of large wineries and a large number of small wineries. The crush survey results demonstrates this – the largest 20 crush respondents accounted for 85% of the total crush and largest 30 accounted for 90%.

The respondents to the 2015 Vintage Survey resemble this:

<i>Size of reported crush</i>	<i># of respondents</i>
10,000 tonnes +	22
5,000-10,000 tonnes	11
1,000-5,000 tonnes	37
500-1,000 tonnes	42
50-500 tonnes	166
Under 50 tonnes	245
Total	523

Crush by state and region

Looking at the raw crush data by state/regions, Murray Darling-Swan Hill accounted for 382,000 tonnes or 25% of the total crush, New South Wales at 332,000 tonnes or 22%, Victoria at 60,000 or 4%, South Australia at 717,000 tonnes or 47%, Western Australia at 30,000 or 2% – ACT, Queensland and Tasmania contribute under 1% of the total crush.

State/regions *2015 Raw Crush
Data Tonnes*

Australian Capital Territory	21
Murray Darling-Swan Hill	381,732
New South Wales	332,092
- Hunter Valley	4,904
- Mudgee	2,887
- Riverina	291,405
Victoria	60,258
- Mornington Peninsula	1,883
- Rutherglen	2,116
- Yarra Valley	10,462
South Australia	716,592
- Barossa Valley	38,094
- McLaren Vale	28,416
- Riverland	454,019
Western Australia	30,069
- Great Southern	4,852
- Margaret River	16,993
- Pemberton	1,852
Queensland	610
Tasmania	7,197
Total Raw Crush Data	1,528,571

04 Vintage Report

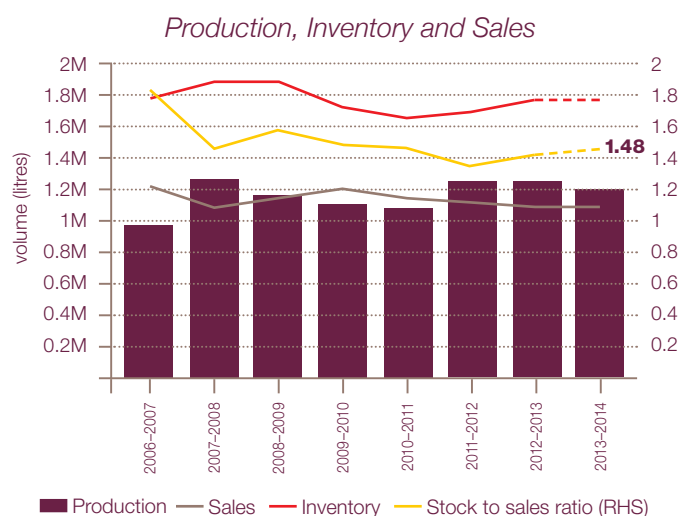
Inventory

At the time of writing, production, inventory and sales figures for year ended June 2015 are not yet available. However, if we take last year's analysis and given that we have an average winegrape crush for 2015, it is WFA's view that inventories and the corresponding stock-to-sales ratio for 2014-15 would be similar to 2013-14 at 1.48.

An extract of the last year's analysis follows:

The estimated 2014 beverage wine production decreased at a lower rate than the crush estimate (-2% vs -7%) suggesting an increase in extraction rates (litres per tonne). The implied 2014 extraction rate of 708 litres per tonne is marginally higher than the 8-year average of 700 litres per tonne.

In interpreting production levels, inventory and sales levels need to be considered. Beverage wine inventory for 2012-13 (1,776 million litres) was up 5% from the previous year while sales (domestic sales plus export sales) decreased 2% to 1,151 million litres. Consequently, the stock-to-sales ratio for 2012-13 increased 4% bringing it to 1.44 from 1.38 the previous year. If we (conservatively) assume that inventories remain the same as last year and given this year's sales decreased 1% (1,142 million litres), then stock-to-sales ratio will increase to an estimate of 1.48.



Sources: ABS cat no 1329 and 8504, Wine Australia Wine Export Approval Database and WFA Vintage Survey

2015 Wine Australia Price Dispersion Summary

The winegrape purchases collected in the 2015 survey totalled 1,094,197 tonnes valued at \$506 million equating to an average purchase price of \$463 per tonne, up 5% on the average of \$441 per tonne recorded in the equivalent survey in 2014 (see figure 1). Over 36,000 separate transactions were collected and form the basis of the reporting.

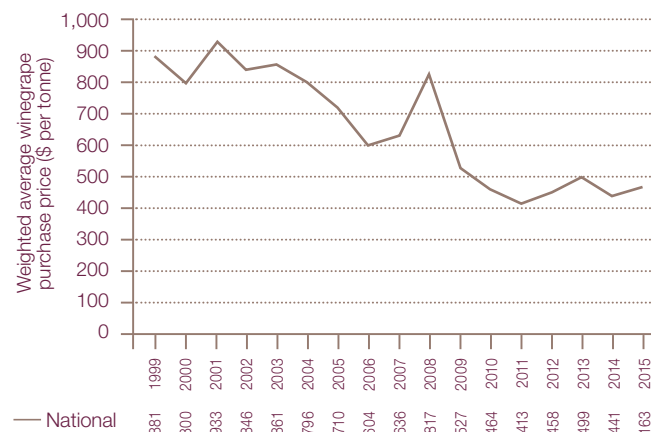


Figure 1: Winegrape average purchase prices over time.

Overall, red wine grapes recorded a stronger price increase compared to white wine grapes. The price paid for red wine grapes increased by 6% to \$575 per tonne while white wine grapes increased by 3% to \$356 per tonne.

A summary of the price outcomes for 2015 by key variety are illustrated in figure 2. Of the varieties shown in the table, there were mixed results. Among the reds, the average purchase price increased for Shiraz, Pinot Noir, and Grenache. For the whites, the price increased for Chardonnay, Pinot Gris, Sauvignon Blanc, Colombard and Riesling.

	2015	2014	Change
Shiraz	600	564	6%
Chardonnay	316	304	4%
Cabernet Sauvignon	559	563	-1%
Pinot Gris	597	518	15%
Sauvignon Blanc	514	482	7%
Merlot	415	417	-0.4%
Pinot Noir	856	696	23%
Semillon	310	371	-17%
Muscat Gordo Blanco	236	239	-13%
Colombard	196	192	2%
Riesling	768	611	26%
Grenache	719	577	25%

Figure 2: National Winegrape Average Purchase Prices by Variety (\$ per tonne).

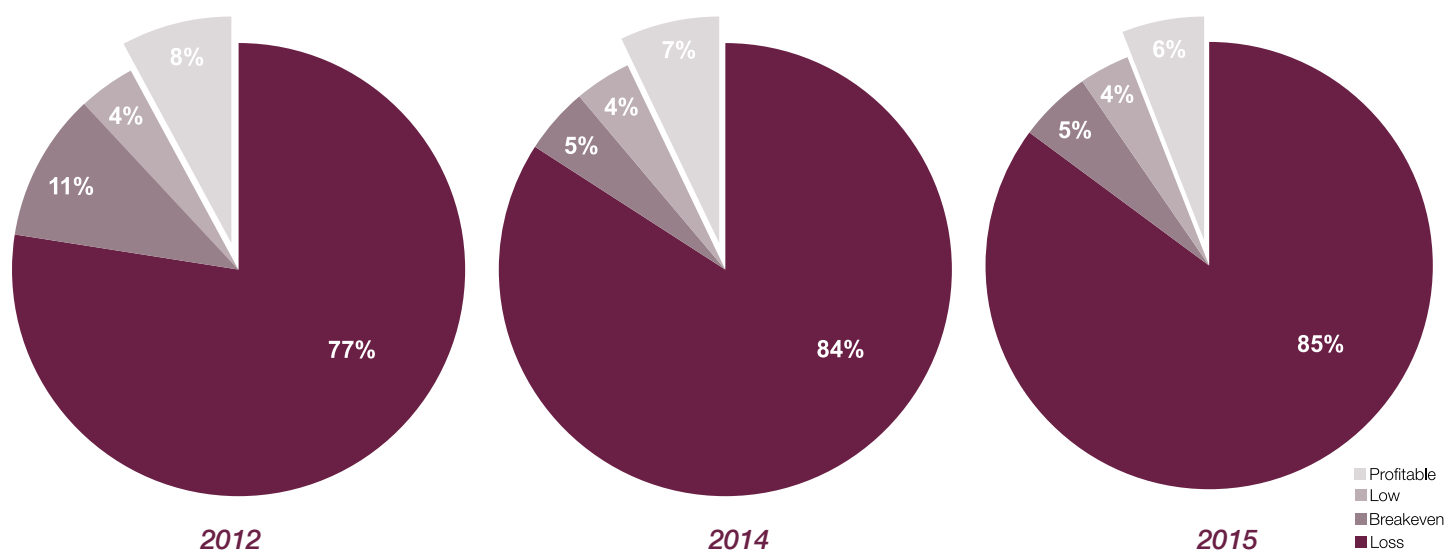
For the complete Price Dispersion Report, see Wine Australia's website at www.wineaustralia.com/winefacts.



2015 Production profitability analysis²

2015 production profitability analysis illustrates that when compared to 2014, profitable production (profit of greater than \$300 per tonne) decreased to 6%, low profitability (profit between \$100 and \$300 per tonne) and breakeven production (profit between 0 to \$100 per tonne) remained constant and unprofitable production increased to 85%. Although, the overall production profitability analysis would indicate a higher proportion of unprofitable production, there were some regions which successfully grew their proportion of profitable production.

2012-2015 Production Profitability Analysis



Extending the analysis to similar regions discussed in the 2012 and 2014 production profitability analysis³, Barossa Valley, Riverland and Hunter Valley increased profitable production, while Margaret River increased its unprofitable production.

The production profitability analysis for the Barossa Valley illustrates that the proportion of profitable production increased by 10,335 tonnes. This increase is predominantly from the increase of grapes purchased above \$2,000 per tonne. This year's report shows the lowest proportion of unprofitable production compared to 2012 and 2014 reports.

The Hunter Valley increased its profitable production to 3% and low profitability to 2% in 2015 compared to 2012 and 2014. Similarly, its 2015 unprofitable production is lower than the previous analyses. Purchases between \$1,500-\$2,000 per tonne exhibited most improvement where 52% are profitable, while in 2014 this figure was 17%.

The Riverland exhibited 8% breakeven and profitable production in 2015 – a 2% increase from the 2014 analysis. Unprofitable production of 92% is lower than last year's 94%, but still higher than the 2012 figure of 84%. Purchases between \$300-\$600 per tonne exhibited most improvement – the proportion of breakeven and profitable production increased from 7% in 2014 to 13% this vintage.

Margaret River maintained its 2014 profitable production at 30% in 2015, but increased its unprofitable production to 50%. Purchases between \$600-\$1,500 exhibited most change since the proportion of breakeven and profitable purchases within this range decreased from 36% in 2014 to 30% this vintage.

More regional analysis can be obtained from the WFA website at wfa.org.au.

Continued on page 6.

² See section on methodology for detailed discussion.

³ We have conducted the analysis for 15 regions but in keeping with the Expert Review, discussed only 4 in this report. Analysis for the remaining regions can be obtained from the WFA website.

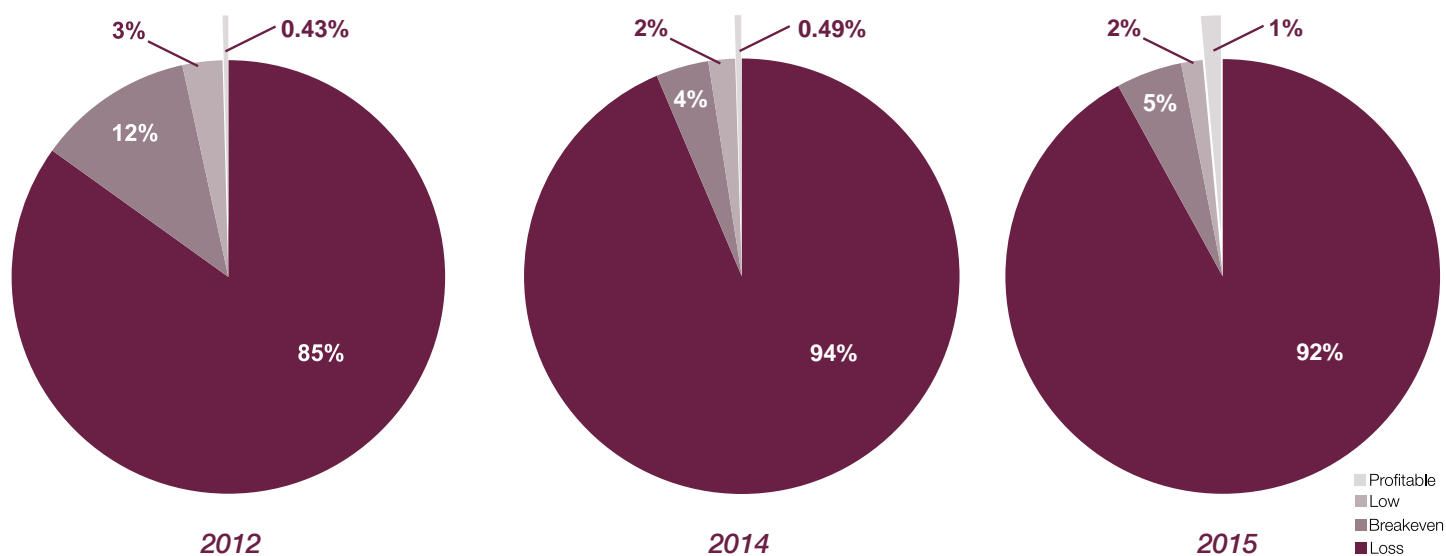
06 Vintage Report

2015 Production profitability analysis

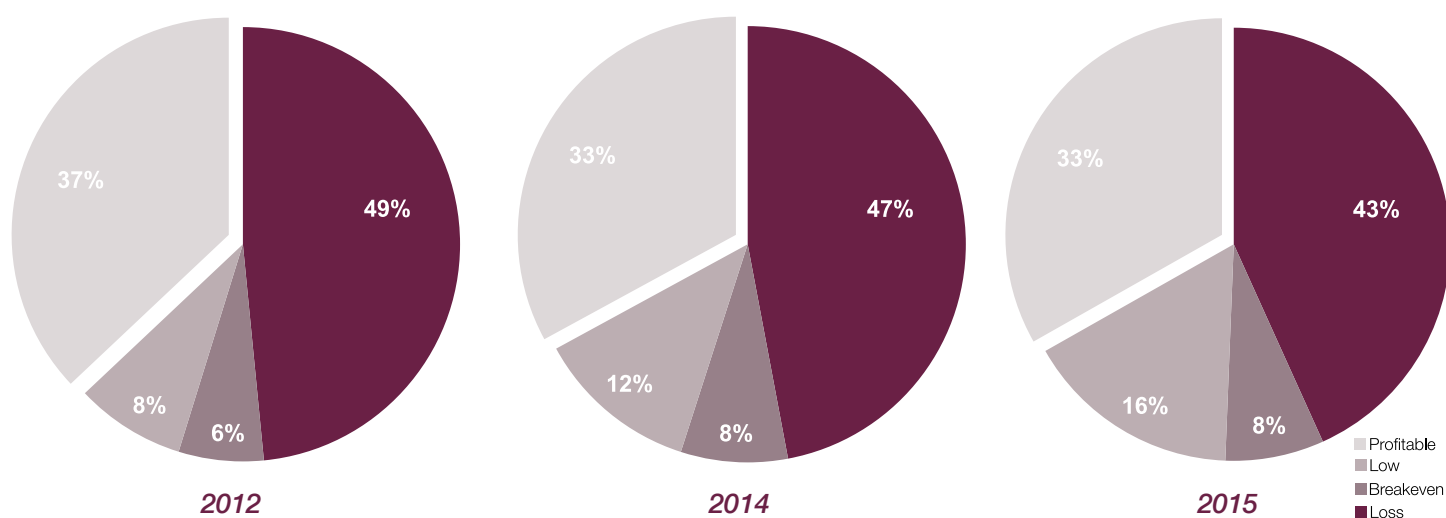
Continued from page 5

Looking at the data in terms of warm inland and cool climate, we see similarities in results for 2015 – unprofitable production decreased while the proportion of breakeven and profitable production increased. The main difference between the results of warm inland and cool climate is that the cool climate's proportion of purchases breaking even has increased to 57%.

Warm Inland



Cool Climate



Winemakers' Federation 2016 Vintage Outlook

There are positive indicators for the Australian wine industry with a 5% increase in average winegrape price and an increase in volume and value of wine exports reported for 2014-15. This is despite the winegrape crush remaining relatively unchanged this vintage, a modest 1% increase in overall unprofitable production and yet-to-be realised structural shifts that could see further sustained upside potential across numerous indicators.

Looking at Wine Australia's export approvals data, there are some signs that Australia's export performance has strengthened, with growth in volume and value in 2014-15 – the first time we've seen an increase in total value since 2006-07. The majority of exporters recorded growth and the number of products (SKUs) exported hit a record 17,562. Growth is strongest at the highest price points and contributed to the average value of bottled exports hitting its highest level since 2004.

WFA continues to work towards securing additional funding to help Wine Australia unlock the longer-term structural opportunities presented by favorable economic developments. These include the weaker Australian dollar, the Free Trade Agreements with Japan, South Korea and China, a rebound from austerity measures in China, improved economic conditions in the UK and the US, favourable response to Wine Australia promotional activities such as ProWein and the Vancouver International Wine Festival, and the growing positivity towards Australian wine around the world.

The WFA continues to advocate for an additional \$25 million over four years from government to help boost the international promotion and marketing of our wine in key markets. This initiative, along with a number of other recommended industry actions can be found at www.wfa.org.au.

United States

The US remains a substantial but largely unrealised opportunity for Australian premium wine. The US is the largest premium wine market in the world and it continues to grow. Australia is seeing some recovery at the premium end of the market but has a significant way to go. Our image as a low-cost value producer continues, which is understandable given 95% of Australian exports to the US are below A\$5 per litre.

To change perceptions and unlock the opportunity in the US requires a substantial increase in marketing investment. However, Australia faces enormous challenges from France, Italy and other European producers targeting the US who have access to substantial promotional funds through the European Commission's National Support Programmes (NSP). The export market (outside of the EU) promotion spend through the NSPs is to double from €522 million in 2009-13 to €1.156 billion (A\$1.7 billion) over 2014-18.

Asia

Asia is the stand-out growth region for Australian wine exports.

China is our major Asian market and volumes are on the rise after austerity measures caused a slowdown in the imported wine market in the previous 18 months. China remains the number one destination for Australian exports priced at over A\$7.50 per litre.

Opportunities do exist across the broader Asian market outside China, with different levels of maturity and accessibility across our focus markets of Japan, Hong Kong, Singapore, South Korea and Taiwan. These countries display relatively high wine consumption for Asia and this translates into a greater expertise in wine and potential for genuine appreciation of Australia's wine offer. The average value per litre across these markets is considerably higher than the average value for Australian exports to all destinations, with Hong Kong and Singapore being number one and number three respectively in dollars per litre. In some of these markets, the market position of Australian wine is high (for example, number 2 in Hong Kong and Singapore) and will need defending.

United Kingdom and Europe

The United Kingdom is our biggest export market. For year ended March 2015, exports to the UK grew by 2% to 251 million litres valued at A\$371 million. The strongest growth to the UK is coming at above A\$10 per litre. The UK can be regarded as a "defend" market for Australia as we have been the number one category in the UK off-trade market for over a decade.

Europe accounts for more than half the volume of Australian wine exports and growth to the region has been solid – exports to Europe (excluding UK) grew 10% from 111 million litres in 2013-14 to 123 million litres in 2014-15. Wine Australia's strategy in Europe is to target key markets where it can deliver an educational message in addition to trade and consumer tastings.

Domestic sales

While exports are vital to the future of the Australian wine sector, the domestic market remains the largest for Australian wine, accounting for 40% of sales. However, the volume of Australian sales in the domestic market has been relatively flat over the past four years. The Australian category has faced increasing pressure from imports, particularly from New Zealand but also from France, Italy and Spain.

An increase in export performance will help relieve some of the competitive pressure on the domestic market and the lower exchange rate may see a decline in imports.

Methodology – 2015 Vintage Survey

This year the WFA Vintage Survey was combined with the Wine Australia Price Dispersion Survey, the South Australian Grape Crush Survey and the Murray-Darling / Swan Hill Wine Grape Crush Report into a single collection process known as the Australian Wine Sector Survey 2015. All Wine Australia levy payers (approximately 2,700 businesses) were surveyed. Respondents were asked to provide individual transaction data by variety and region for grape purchases and a summary of their own grown fruit by variety and region. This enables accurate reporting of production and price dispersion data by variety and GI region as well as at a national and state level. Contract processed fruit was excluded as was any “internal valuation” pricing for own grown fruit.

The response rate was over 25% of the total businesses by number, including 100% of wineries known to crush (or to have crushed on their behalf) over 10,000 tonnes. The total tonnage collected through the survey was 1.53 million tonnes and it is estimated that this accounted for 92% of the total crush.

To estimate the total crush, a calculation was made of the change in crush size for those businesses that reported their crush in both the 2014 Wine Australia Vintage Survey and the 2015 Wine Sector Survey. This percentage change was applied to the 2014 crush figure provided by Levies Finance, which collects levies based on crush and is the most accurate crush estimate available when finalised later in the year.

Please direct any question on methodology and data to Peter Bailey of Wine Australia at peter.bailey@wineaustralia.com.

2015 Production profitability analysis: an update from the Expert Review.

The analysis estimated 2015 growing costs by region and by grade, and compared with actual prices paid. Growing costs per tonne by grade were estimated using the following data sources:

- 2015 price dispersion data from Wine Australia. Limitations of the price dispersion data include: 1) Price dispersion data is based on winegrape purchases only and therefore does not account for winery-owned fruit; 2) Tonnages purchased and reported at the aggregate level are estimated to represent around 90% of the total purchases
- Average yield by region was based on 2006/08/10/12/14/15
- Estimated cost per hectare figures from consultations with Wine Grape Growers Australia and CPI movement
- Definitions of profitability levels are as follows:
 - Loss: growing costs (per tonne) are greater than purchase price (per tonne)
 - Breakeven: profit per tonne is between \$0-100
 - Low: profit per tonne is between \$100-300
 - Profitable: profit per tonne is above \$300

For more information about the Vintage Report, please contact WFA on (08) 8133 4300 or wfa@wfa.org.au.



Winemakers' Federation of Australia

Adelaide Office: 08 8133 4300
Canberra Office: 02 6239 8300
wfa@wfa.org.au

www.wfa.org.au