



thewinesociety

2011

**ANNUAL REPORT
TO
MEMBERS**

**Annual General Meeting Date
15th December 2011**

Australian Wine Consumers' Co-operative Society Limited Annual Report 2011

Chairman's Report

THE SOCIETY'S YEAR IN REVIEW

Since assuming the Chair in late May 2011 it is with great disappointment that on behalf of the Board I must again report a deficit for The Society of \$2,575,100 for the 2010/2011 financial year.

The quantum of the loss recorded in 2010/11 is exacerbated by a \$2.3M expense recorded for the write-down in the value of certain assets, most notably \$1,765,000 for the 66 Bay St Ultimo premises, which at the time of writing is in the final stages of being sold. Your Society originally breached in early 2011 an interest cover covenant with Westpac, after which the bank indicated a desire to exit our 64 year relationship. As a result of subsequent and ongoing dialogue, Westpac have (at a cost) provided some further forbearance to enable an orderly sale of the building. Unfortunately your board was left with no alternative but to repay the bank debt and reduce outstanding creditors from the proceeds of this sale.

Unlike a corporation, The Society is a co-operative and raising additional capital is difficult. Over the years many co-operatives and mutual societies have adopted a corporate structure in order to circumvent the difficulties of raising capital.

The operating deficit for the year was incurred on a sales base some 7.6% below 2009/2010, with market conditions and competitive pressures also resulting in further margin erosion. Operating costs have been well contained and are \$1m down on the previous year.

The Society's performance over the past year has been significantly impacted by the particular activities of the large retailers. Moreover the current wine oversupply and strong Australian dollar has resulted in falling international sales and a concomitant increase in domestic competition, all of which have created significant challenges for our business model in maintaining both sales volumes and margin.

The 2010-2011 year in summary:

- Reported deficit before taxation of \$2,575,100 (2010: deficit of \$569,033)
- With the impairment losses for asset write-downs added back, the current year deficit is \$228,100, an improvement over 2010 (\$421,033)
- 2,266 (2010: 2,995) new members
- Society labels awarded 3 gold, 3 silver and 18 bronze medals
- Total freight member subsidy of \$1,131,447 provided.

The problems faced by The Society over the past three years were in large part driven by the expansion in 2007 with the acquisition of CBD Cellars, unfortunately just prior to the global financial crisis. A primary focus of that business was in servicing substantial CBD-based corporations which, since the GFC, have effectively withdrawn from such entertaining. As such it has been necessary to sell / write-down the value of these assets and to seek to exit entirely where possible. Additionally the board has reviewed its ongoing business model and determined to focus only on the core wine club business model (but even this is under considerable stress), and the profitable on-premise (restaurants, pubs and clubs) business.

The on-premise business market continues to develop brand value in John Boston Beer, Society labels and agency lines.

While the CEO provides regular updates to members in the magazine and through our website I am conscious that this may still fall short of the level of communication expected by some members. As such I have recently written to creditors advising them of the sale of the building and the intention of the Board to utilise surplus funds to ensure our trading terms remain at normal industry standards. The Board is well aware of longstanding ongoing support given by many of our creditors and we will certainly be looking to fully reciprocate in these relationships. We will also look to focus more on member communications around group governance issues during 2012.

As a consequence of the shrinking sales and the sale of less profitable businesses unfortunately it has been necessary to reduce staff numbers in line with restructuring changes. This is never an easy process and causes considerable strain on all concerned and the Board is fully cognisant of and greatly appreciates the ongoing efforts of all staff.

On a more positive note during 2011 we have been able to establish new wine club ventures with both David Jones and Dymocks which draws upon our extensive co-operative wine club expertise. After 10 years of hosting the Young Winemakers Awards 'event' a considerably slimmed down version was extremely successful this year with a total focus on the young winemakers and the wine industry. We continue to see Society events as a real benefit to members and as financial circumstances allow will continue to subsidise these events. During 2010-2011 this subsidy was amounted to \$210,409.

Members are aware we have a longstanding policy of benchmarking our own Society wines in wine shows throughout Australia and are justifiably proud of our wine selections and in particular our own label wines. During the year we were awarded 3 gold, 3 silver and 18 bronze medals, demonstrating the ongoing value to members of our highly qualified tasting panel.

The Board continually reviews the strategic business model being followed to ensure that it is appropriate for the circumstances. Over the past few years there has been a noticeable move to different retail distribution models within the Australian market that have adversely affected our ability to survive and grow as a co-operative. Please be assured that the Board is working extremely hard to ensure The Society more quickly adjusts to these changing circumstances.

On behalf of the Board I thank you our members for your support throughout the past year. We look forward to your continued support in the year ahead as we continue to adapt to the changing and challenging market.

John Love
Chairman
November 2011

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Audit, Risk and Governance Committee Report

The Audit, Risk and Governance Committee consists of three non-executive member Directors. Details of the qualifications of the members and their attendance at Committee Meetings throughout the financial year are detailed in the Directors' Report enclosed in this Annual Report.

The role and responsibility of the Audit, Risk and Corporate Governance Committee is detailed in the Charter which is available on The Wine Society's web site.

As in the previous financial year, in 2010-11 the Committee's major focus was on addressing the business risk associated with The Society's deteriorating liquidity and the need for additional working capital in order to sustain operations.

For the financial year to 30 June 2011, on the back of an overall decline in sales revenue of 7.6%, The Society recorded a net loss of \$2,575,100 (2010: \$569,033 loss). It must be highlighted that this loss in 2010-11 was exacerbated by impairment charges of \$2,347,000 (2010: \$148,000) arising from the write-down in the value of certain assets, most notably the building housing The Society's head office at 66 Bay St Ultimo.

The effect of this 2010-11 loss on The Society's balance sheet has been most deleterious, with retained profits diminished to \$814K (2010: \$3.89M). With the ratio of current liabilities to current assets unacceptably high at 1.98, net working capital is once again negative. Combined with the ongoing cashflow constraints as a result of year-on-year losses, restoring balance sheet health now becomes a critical issue for the Committee.

The notification by Westpac Bank in March 2011 that The Society would be required to repay all its debt facilities in full by 30 June was a significant event. Subsequent periods of forbearance achieved through ongoing dialogue and negotiation have most recently been extended to 17 January 2012, which will allow completion of the sale of the Ultimo premises.

Completion of this sale will not only generate sufficient funds to clear all outstanding bank loans but also surplus proceeds to provide a significant working capital injection.

Further, an exit from, or restructuring of, unprofitable business segments is expected to see The Society's overall profitability and operating cashflow improve during 2011-12 and remain sustainable beyond.

The Committee draws your attention to the Annual Report and audited financial statements wherein the assumptions underlying the belief that The Wine Society will be able to pay its debts as and when they fall due are detailed, with specific reference to the Review of Operations in the Directors' Report, Note 2 to the accounts (Going Concern) and Note 23 (Events Subsequent to Balance Date).

Looking to financial year 2011-12 and beyond, the Committee must remain focused on oversight of the business restructuring program already underway, the aim of which is to return The Society to profitability and in time restore health to the balance sheet.

Robert Whitton
Chairman, Audit, Risk and Governance Committee
November 2011

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Wine Committee Report

Briefly, the prime purpose of the Wine Committee is to oversee the tasting panels and the wine buying cycle from product planning, assessments, price points and intended use through to sales success, quality assurance and slow moving stocks re-assessment.

The membership of the Wine Committee for 2010/11 was Ian Walsh (until April 2011), Greg Melick, Lance Hogan, Paul Foster and chaired by Ian McKenzie, all of whom are extremely well qualified in wine assessment and have day to day contact with the wine industry and its associated endeavours. Having a committee with such experience arguably gives The Wine Society a clear advantage over all our competitors giving our Members confidence that only appropriate wines are sourced.

During the year the tasting panel met on 34 occasions and assessed 2811 wines, of which 1274 met our quite stringent criteria. This represents a pass rate of 45.3% which is significantly higher than last year. The concept of more focussed targeting of wine producers who are more consistent in wine quality terms introduced a couple of years ago appears to continue to be successful. Also the program of inviting suitably qualified and experienced guest panellists on the tasting panels continues to be of considerable benefit.

Once again, of the many classes of wines tasted, shiraz had the highest representation and was also the strongest with some outstanding wines being presented. Reflecting the increased popularity of the variety we were presented with many more pinot gris/grigio wines and very pleasing to see was the further development of these styles as winemakers acquire more understanding of how to make interesting wines from an otherwise quite bland variety. Also pleasing to see was the quite marked increase in the number of 'other' white varieties such as vermentino, fiano, arneis, garganega etc., being presented. Australian sauvignon blancs continue to increase in quality and many are now the equal of the 'benchmark' New Zealand styles. The weakest wines presented once again tended to be from merlot and 'other' dry red classes but as with the 'other' whites there were quite a few more interesting examples of newer (to Australia) varieties such as tempranillo, sangiovese, touriga etc. The chardonnay classes produced some of the best examples we have seen for some time but, disappointingly, also some of the worst. The finer and more elegant modern styles tended to be the more favoured amongst the panellists.

We are continuing to assess and source wines from around the world to add interest to our range and as we have in the recent past we will continue to offer interesting wines from Argentina, Chile and South Africa as well as from the more traditional European countries France, Spain and Italy. However, with the pressure on reducing stock holdings our program of sourcing such wines has been curtailed somewhat.

The range of wines under our own Society labels continues to expand and as a form of benchmarking we enter many of these into national wine shows with solid results, achieving 3 gold, 3 silver and 18 bronze medals. Winestate Magazine favourably reviewed a number of Society label and Kettle Lane wines.

Ian Walsh and Ian McKenzie continue to be pro-active in sourcing some great wines for the Best in Society release and for our own super premium Dr. Gilbert Phillips label. Rather than waiting for wines to be submitted from producers we visited high quality producers and selected wines 'in the raw' from a range offered and then blended them to our own specifications.

The two sparkling wines from the 2010 vintage made from grapes grown in the King Valley for our own Society label have developed very nicely and the NV version is to be released for the 2011 Xmas trading period.

The Australian wine industry continues to face considerable surpluses with many grapes left on the vine during the 2011 harvest, some of which were potentially of high quality. The 2011 vintage proved to be one of the most difficult on record in many regions but with some notable exceptions such as rieslings from the Clare Valley and semillons from the Hunter Valley. Wine producers continue to face considerable pressure in the traditional international export markets of the UK and USA. There have been some significant sales in China with increasing margins and this market is now becoming very important to a number of Australian producers. The domestic market continued to benefit from these depressed international sales with plenty of sound quality wines being sold at what might have been regarded as ridiculous prices a couple of years ago. This has led to an extremely competitive market with reduced margins and reduced profitability.

The Wine Committee is proud of its achievements and we are quite certain the quality of wines selected for our Members continues to be of the very highest standard.

Ian McKenzie
Chairman, Wine Committee
November 2011