

Fewer, bigger, better brand campaigns driving shopper behaviour change and category growth



Insight led innovation delivering sustainable growth



Leveraging brand equity of Masstige and Luxury portfolio for sustainable future growth, despite reallocation of Luxury volumes



TREASURY WINE ESTATES

Business and Marketing Strategy



TREASURY WINE ESTATES

ABSTRACT

This report on Treasury Wine Estates Ltd delivers a detailed strategy analysis of the company's business, examine its performance in the Alcoholic Drinks and the global economy. The company and market share data and forecasting provide a detailed look at the financial position of Treasury Wine Estate Ltd, While in-depth qualitative analysis will used to better understand the brand strategy and growth prospects of Treasury Wine Estate Ltd.

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Treasury Wine Estate

-From Agricultural to Brand -Led

Company Background

Treasury Wine Estate is one of the world's largest wine companies listed on the ASX. It is focused on delivering shareholder value through the production of quality wine, and marketing and selling quality wine brands to consumers around the world.

| | | |
|--|--|---|
| 3,400+ EMPLOYEES | 70+ BRANDS | 36.4 million WINE CASES SOLD |
| <small>We employ more than 3,400 to serve people across the world</small> | <small>An award winning portfolio of more than 70 brands</small> | <small>36.4 million 9L cases of wine sold in FY17</small> |
| 4 REGIONS | 13,000+ HECTARES | 70+ COUNTRIES |
| <small>Our business is focused on four principal regions:</small> • Australia and New Zealand • Americas • Asia • Europe | <small>We access more than 13,000 planted hectares of owned and leased vineyards in internationally recognised regions</small> | <small>Our estate wines are sold in more than 70 countries around the world</small> |

TWE AU

Investment Fundamentals

Price
(at 4:01pm, 2nd July 2018 GMT) **A\$17.17**

GICS Sector:
Food, Beverage & Tobacco

Market Cap **A\$12.258b**
Issued Shares **718.66m**

| | |
|---------------------------|------------------|
| 52 weeks high | 20.2 |
| 52 weeks low | 12.12 |
| 30 Days Avg Volume | 3,476,622 |
| 1 Year Return | 46.11% |
| EPS | 0.44 |
| Dividend | 1.97% |
| Dividend Reported | 0.15 |
| P/E ratio | 41.34 |

Treasury Wine is a vertical integrated business, it is focus on three principle activities including : Grape Growing and Sourcing, Winemaking and Brand-led Marketing. The company's key business is primarily focused on four principal regions such as Australia & New Zealand(ANZ), Americas, Asia, and Europe.

The Evolution of Treasury Wine Estate

The company separated from a beer company -- Foster's Group Limited(Forster's) on 29th April 2011 and available to be traded on ASX on 10th May 2011.

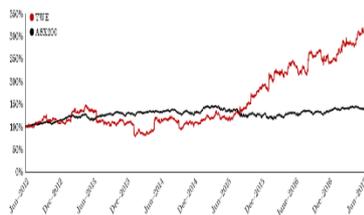
Treasury Wine was formed from the merger of the former Beringer Blass and Southcorp wine businesses under the ownership of what was originally Australia's Foster's Group. A series s of financial problems in the latter half of the 2000s prompted Foster's to spin off the business as an independent company in 2011.

The Melbourne-based company has faced difficulties ever since it was spun off in 2011 from Forster's, which was later bought by SabMiller PLC. In 2013, a Particularly bad year for the company, Treasury Wine vastly overestimated U.S. demand for its Beringer mass-market label and ended up having to destroy thousands of gallons that has passed the sell-by date. That faux pas led to a large write-down that hastened the departure of its former Chief Executive Officer, David Dearie, later that year. It also sent the company's shares into a tailspin, attracting two failed takeovers bid from Private Equity firm.

The Current CEO Michael Clarke was brought in to steady the boat. His strategy has involved prioritizing the marketing of 15 of the company's roughly 80 labels, including Wynns and

TWE vs ASX200 FY2012-FY 2017

The following graph shows movement in the Company share price against movement in the ASX200 over the last five years



Pepperjack. He has also begun targeting the U.S. with more luxurious wines that are gradually becoming more popular than cheaper brands such as Beringer. Since then, Clark brought the company into a next stage, and the share price jumped approximately six times to the highest around \$19 in May 2018.

What element drives the price up? And what strategies that lead the company to become one of the largest wine companies worldwide? A detailed business and marketing strategy analysis will be presented in this report to deeply understand the company and the wine market.

❖ **Key Company Facts:**

TWE's strategy is to transition from a regionally focused, agricultural company to a brand-led, high-performance organisation.

In 2014, Michael Clark, the Chief Executive Officer of Treasury Wine Estates changed the company's business model, it transferred the company's business structure from Order-taking, agricultural company to a brand-led and marketing group. There are several steps of the company's business strategy revolution, including:

1. **Slim down company portfolio:** from around 80 brands to on 45 wine labels, and then cut another 12 US 'commercial' brands since 2014;
2. **Asia Strategy (2014)-** a growing market in Asia with the appetite for the big taste of Australia's Penfolds and Wolf Blass wines growth from China;
3. **Supply Chain optimisation plans (2015)-** extracting supply chain optimisation savings and accelerate its separate focus on the Luxury & Masstige versus Commercial portfolios globally, by making significant change to its supply chain network and cost base in both USA & Australia, and continually consolidate its production facilities base on company's production needs in Australia and US.
4. **Acquisition & integration:** Acquired Diageo's Wine portfolio (2016) to transform the firm's US business into a 'larger player of scale' in the faster-growing luxury and masstige segments of the US market. It is expecting the sales revenue of Americas would be doubled;
5. **Change the Wine-Making to Brand-Building (2015)-** previously the company mainly focus on the vineyards and making wine, and the ratings and scores the company get for the wine, the new strategy changing the company mainly focus on customer-led new category products under the company priority brands, and moving towards premium wines away from bulk sales;
6. **New Marketing strategy uncorks potential (2015)-** Appointing J Walter to oversee all brand marketing communications, creative strategy, trade marketing, shopper marketing, digital marketing and consumer and lifestyle public relations, **the exception is Penfolds**, which retains its own global creative agency, Leagas Delaney. Market Campaign including: Focused on higher-end labels that offer 69% discount on wine fridges with purchase of six bottles of its upmarket Penfolds range; Steep discount on LED TV, Sponsor Cricket World Cup, etc;
7. **Sell some asset-like vineyards-** Sell excess assets to change to funds for investment;
8. **Invest heavily in advertising behind priority brands:** Different marketing strategy in different region based on the local culture. e.g. Penfolds with red packaging in China (Red mains lucky)
9. **New France Portfolio focusing on Asia:** TWE partnership with T-mall to sales, marketing and distribution across China of Baron Philippe de Rothschild's range of French and Chilean brands led by Mouton Cadet and Escudo Rojo, the group's wine brand from Chile.

TWE's strategic framework



Source: Company presentation, March 2017

❖ Business & Marketing Strategy Analysis(SWOT)

Strengths:

- **Customer loyalty:** Treasury Wine is one of the largest wine company worldwide, they have strong client base in different regions, especially in Asia, their Branding-led market strategy is extremely successful, in China Penfolds Wine is the symbol of status, people send Penfolds as gift to show our prestige. This approach would reasonably further extend sales growth into FY18, and the following years if successful.
- **Multi-regional growing and sourcing:** the company has around 60 vineries locating in four different region including Australia, California, NZ, Italy and France. This allows the company to diversified the risk if any bad weather or disaster happened in a particular region. It is allowed to supply the best quality of grapes to different winery based on the company's production demand.
- **Price segment strategy:** Divided company's wine into three different categories, this allowed the company to targets deferent client level
- **Strong Brand Portfolio and continuously expansion:** Over the years the company has invested in building a strong portfolio, including ANZ, US portfolio, and Treasury wine is going to release French Portfolio, French category is very established globally and regarded as a quality trust-mark, particularly in North Asia.
- **Effective marketing strategy:** Optimising a competitive & efficient Route-To-Market; Building strategic and sustainable customer partnerships; Outstanding portfolio and brand building activity driving category growth;
- **Price setting power:** the company is one of the dominant company in wine market and it has its own matured supply chain, therefore the company has strong pricing power based on their products and market demands.

Weaknesses:

- **Over-supply of commercial:** The effective marketing strategy lead the tight market on premium wine. To guarantee the sales revenue of commercial wine, the company set conditional sales contract with distributors. People must buy their commercial wine in order to have Penfolds wine. This decision leads to many inventories of commercial wine unsalable in the store.

Opportunities:

- **Significant increase of wine demand in Asia:** Wine has infiltrated the lifestyle across Asia that results from the growing in middle class. From young professionals to the corporate world, to the wealthy elite, women and more;
- **Free Trade Agreement:** Australia Government sign the Free Trade Agreement ¹with China may benefit the wine import to China with lower cost (effectively from Dec 2015);
- **High entry barrier:** the entry barrier is relatively high; the initial investment is high and there are several dominant company that sharing the wine market.
- **US tax cuts has indirect benefit to the company's net profit:** Tax reform policy of U.S reduced the company tax to 22%, this will increase the Net Profit of the company's US market by paying lower tax.

Threats:

- **Competitor: strong competition within the existing market share, two largest competitor's E&J Gallo Winery and Constellation Brand**

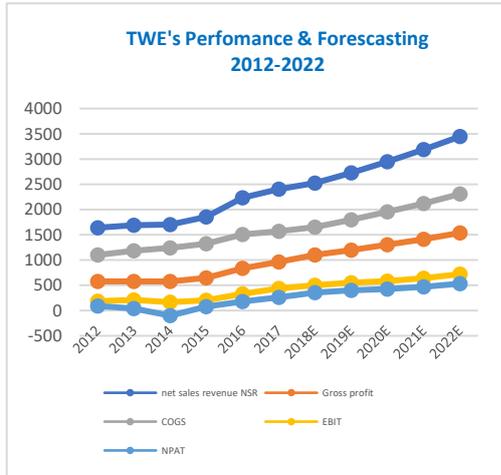
| | TWE | Gallo² | Constellation (Fortune 500) |
|------------------------------|--|--|---|
| Business model | -Grape-growing and Sourcing -Wine production -Wine Marketing, -sales & distribution -Vineyards, winery | -Grape growing -Wine and Spirits Production | -produce beer, wine & spirits -market beer, wine & spirits |
| Products | Diffraction of product portfolio: -commercial wine -Masstige wine -Luxury wine | 90 wine Brands | Beer, Wine, Spirits (vodka, tequila Whiskey) |
| Supplier | -TWE owned/leased vineyards -Grower contracts -3 rd party produced wine | -Grape growing -Wine and spirits making -Wineries: California & Washington | - Beer: owed & leased breweries and distilleries - Wine: purchasing grapes from 3 rd party & Holding Vineyard in US, NZ, Italy - Spirits: 3 rd party |
| Target region(market) | ANZ, Europe, Asia, Americas | US, UK, Australia | US, Mexico, NZ, Italy, Canada |
| Target client | -Commercial: \$5-10 -Masstige: \$10-20 -Luxury: >\$20 | Predominantly focused on fortified wines | Multi-category supplier of beverage alcohol |
| Listing info. | \$17.77AUD Mkt cap: A\$12.62b PE ratio: 40.86 Eps: 0.66 | Family owned | NYSE ³ , \$229.65/share, mkt cap: US\$43.95b, PE ratio: 28.69 eps 22.21, |
| Comparative Adv | Branding Diversification of sourced grapes | 1/3 clients have insured for 20 years or more | Diversified products |

¹ <http://dfat.gov.au/trade/agreements/in-force/chafta/Pages/australia-china-fta.aspx>

² <http://www.gallo.com/>

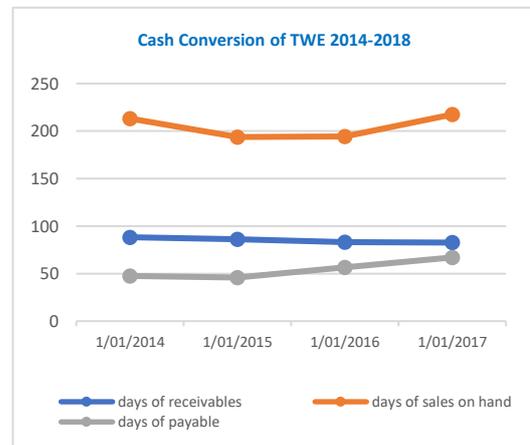
³ <https://au.finance.yahoo.com/quote/stz?ltr=1>

the percentage change of total revenue, which is more than double from approximately \$259m to \$532m from 2017 to 2022.

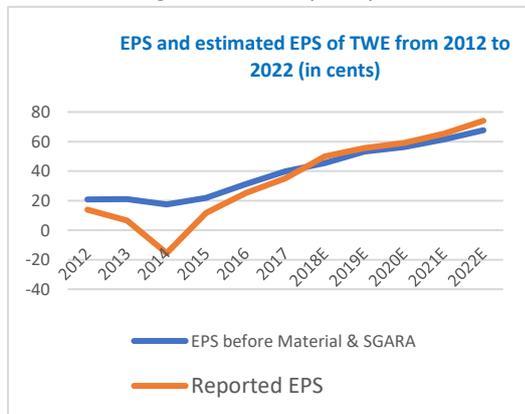


As stated in graph the sales volume of Asia is around 10%, and the sales revenue is 16%, but the EBIT contribution is 30% that is three times more than the sales volume. This numbers indicating the sales margin in Asia is relatively much higher than other regions. In order to test the key factors that drives the revenue, the percentage change of sales revenue and percentage change of sales volume be compared. It shows higher percentage change in sales revenue between 2013 to 2016, but the two ratios become closer in 2017. This indicating the sales margin may relatively decreasing among the period 2016 to 2017, and the higher sales margin in Asia maybe offset from other regions.

TWE experienced high growth for past couple years, the sales revenue growth relatively high compare with the initial years when it separated from Foster's Group, especially in Asia market. The concern of the supply of wine to meet the market demand is raised. The graph of cash conversion shows the effectiveness of inventory and cash management of TWE. The days of sales on hand increased slightly indicating there is no inventory shortage problem. And the days of receivables decreased from 88 to 82 days and the days of payable increased from around 47 to 67 days respectively shows the company's recycle is becoming more healthier. The company hold cash longer that allows the company to have more opportunities to invest or to run the business.



The graph od EPS shows the trend of EPS change from 2012 to 2022. Reported EPS refers to the EPS released by the company and it is calculated by Net Income divided the average number of outstanding shares during the year. However the numerator of EPS before Material and SGARA is different, it is the Net profit before Material & SGARA. Due to wine manufacture industry is high sensitive to government policy, weather and other unexpected factors. And the production is highly related to forecasting future demand. Therefore the two EPS may have significant difference. In 2014, the over-production resulted from over estimation of US demand leded the company experienced huge Material & SGARA loss, this drives the EPS to negative 15.57cents. Among forested period, assume there is no significant disaster, the Material & SGARA are all at reasonable average level(exclude the significant value), the Reported EPS and EPS before Material and SGARA are dumped more than doubled from 35 cents and 39 cents to 74 cents and 67 cents respectively.





| Performance(Millions) | 2016A | 2017A | 2018E | 2019E | 2020E | 2021E |
|-------------------------|--------|--------|----------|----------|----------|----------|
| Revenue | 2232.6 | 2401.7 | 2,521.79 | 2,726.53 | 2,947.90 | 3,187.25 |
| (+/-) % | 20.21 | 7.57 | 5.00 | 8.12 | 8.12 | 8.12 |
| EBIT | 333.50 | 439.40 | 500.67 | 553.66 | 583.49 | 639.72 |
| (+/-) % | 61.74 | 31.75 | 13.94 | 10.58 | 5.39 | 9.64 |
| NI | 179.40 | 259.10 | 358.40 | 398.79 | 424.89 | 469.76 |
| (+/-) % | 1.31 | 0.44 | 0.38 | 0.11 | 0.07 | 0.11 |
| EPS(Cents) | 25 | 35 | 50 | 55 | 59 | 65 |
| Dividends(Cents) | 20 | 26 | 26 | 26 | 26 | 0.26 |

| Ratios Indicator | 2016A | 2017A | 2018E | 2019E | 2020E | 2021E |
|----------------------------|-------|-------|-------|-------|-------|-------|
| Operating Margin(%) | 15.32 | 18.95 | 24.11 | 27.74 | 29.42 | 31.01 |
| Gross Margin | 31.72 | 32.82 | 35.63 | 38.11 | 40.98 | 42.30 |
| ROE | 6.21 | 8.13 | 8.79 | 9.81 | 9.77 | 9.93 |
| ROIC | 4.90 | 6.52 | 7.00 | 7.95 | 8.00 | 8.24 |
| ROA | 4.2 | 5.56 | 6.01 | 6.78 | 6.80 | 6.99 |
| EV/EBITDA | 11.70 | 9.20 | 8.47 | 8.08 | 8.08 | 7.99 |
| P/E | 39.46 | 38.87 | 34.43 | 30.94 | 29.04 | 26.27 |
| P/B | 1.98 | 2.79 | 3.33 | 3.33 | 3.33 | 3.33 |