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A Forensic Analysis of Failed Continuous Disclosure in Action

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Abstract

The ASX listing rules and various provisions of the Corporations Act require that listed corporations keep capital markets informed (subject to carve out exceptions) of any information that a reasonable person would expect to have a material impact on the price or value of its securities. An effective continuous disclosure regime represents a key element of a framework for facilitating informed markets. As such, evidence on the extent to which the continuous disclosure system is functioning is of significance to the regulatory and investment communities alike. This paper questions whether the Australian continuous disclosure regime is working and being enforced at an appropriate level, by forensically reviewing the affairs of listed wine producer Evans & Tate limited during that firm's ill fated 2005 financial year. It is argued that while that firm did indeed continuously disclose financial and non financial information as required, much of the content of that disclosure was misleading. Despite this, no regulatory action has been taken against the firm or its directors. It is therefore concluded that there may be serious deficiencies in the operation of Australia's continuous disclosure framework, particularly in relation to the nature of regulatory responses to apparent breaches of the system.

Keywords

Corporate Governance, Continuous Disclosure, Financial Statement Analysis, Regulation

1. Introduction

Dawn in Perth on the morning of June 28 2005 came at 7.18am. The overnight temperature had dropped to a low of 3.5 degrees and as the sun came up, a cold wind blew from the north. Susan Symons, company secretary of listed wine producer Evans & Tate Ltd was already on her way to the office. It was to be an eventful day. That morning, at 7.52am, she sent a fax transmission to the Australian Stock Exchange requesting that a trading halt be imposed over the company's securities, pending a material announcement to the market.

In the days leading up to the announcement, the company's share price had suffered a severe battering. While each ordinary share had been priced at a little over a dollar during the first two months of the year[1], a creeping decline in sentiment saw the market value of each ordinary equity security fall to around 70 cents, where it hovered from late April until the 22nd of June. On that day, the company's share price closed sharply down at 60 cents, after rumours began circulating that administrators had been called into the company[2]. Despite strenuous denials from the company, the rout continued. By June 27, the closing share price was just 31 cents[3].

On June 29, the much awaited Evans & Tate shareholder update was broadcast to the market. It contained a bombshell. Despite a raft of previous statements to the contrary[4], the company now believed that it would report a loss for the year ended 30 June 2005. However, the company also announced its intention to declare a final dividend on both the company's ordinary and preference shares, somewhat lessening the sting of the news that a loss would be incurred for the year's trading. Indeed, the market reaction to the company's June 29 shareholder announcement was clear, swift and positive. The price of the company's ordinary shares leapt to 40 cents by the close of trade that day, and then to 51 cents the next day[5].

Only one and a half months later, on the morning of August 16, the company released a further shareholder update to the market. This time the news was far worse than it had been at the end of June. The projected loss had ballooned to the extent that there would not be sufficient retained earnings to pay dividends on either the company's preference or ordinary shares. By the end of that day, almost 20% had been wiped off the value of the ordinary shares[6].

These events did not transpire in an institutional void, but rather, against a background of considerable regulation and legal duty – in particular, the requirements of the ASX continuous disclosure regime[7], the statutory duties requiring care, diligence and good faith by company directors embedded in the *Corporations Act*[8] and the prohibition on misleading and deceptive conduct contained in the *Trade Practices Act*[9]. Further, they occurred under circumstances in which there can be no doubt that the company, through its directors and officers, knew that the information it released on June 29 and August 16[10] was likely to have a material impact on the market price of its securities and was likely to be relied upon by market participants in informing the pricing and investing process.

This paper brings the events described above into perspective by examining them within the context of what a reasonable director should have known about the financial situation of the company by June 29 2005, with implications for what a reasonable director should have said about the company's state of affairs and prospects at that point in time. The remainder of the article proceeds as follows. Section 2 provides a background on Evans & Tate and the evolution of its business over time. Section 3 contains an overview of the Australian wine industry in its international context, while section 4 draws on the material contained in sections 2 and 3 in a bid to reflect on the degree to which the above mentioned statements to the market by the company could be viewed as reasonable, in all the circumstances. Finally, section 5 contains the paper's conclusions.

2. The Evans & Tate Story

The Evans & Tate business was established by John Evans, Jan Evans, John Tate and Toni Tate[11] in 1971 with a small land holding in the Perth Hills. Within a short period of time the winegrowing potential of the then nascent Margaret River region was recognised by the founders and by 1974 the company had expanded to include operations at Redbrook, situated within the Margaret River district[12]. In the years that followed, the company successfully established a number of key brands which still remain an important element of the business[13].

Though the Evans name precedes the Tate name in the company's title, the destiny of the company has for the greater part of its lifespan rested with the Tate family, the Evans interests exiting the business in 1983[14]. This dominance was cemented firmly into place in 1987 when Franklin Tate, son of founders John and Toni, joined the company[15]. At that point, the business was a minnow, with annual sales of just \$700,000[16]. By 1992, with the business growing rapidly, Franklin Tate was elevated to the role of Managing Director. By 1995, annual sales had reached \$5 million then doubled again to \$10 million by 1998[17].

Though the years to 1998 had seen the transformation of the company from minnow to substantial commercial enterprise, the following year represented a watershed in the organisation's history. By 1999 the company had swallowed Margaret River rival Selwyn Wines, owned 260 hectares of prime Margaret River vineyards[18], two fully equipped wineries[19] and was achieving annual sales of $12 million. Most significantly, Chief Executive and Chairman Franklin Tate determined that the time was ripe to transform the family business into a listed public company.

This was achieved through the execution of a successful, fully subscribed initial public offering which closed in late December 1999, pursuant to which the Tate family sold 42% of their holdings and the company raised a total of $26 million. At the close of the first day of trading, IPO participants had achieved stagging profits in the order of 20%, and the freshly listed company enjoyed a market capitalisation of slightly more than $50 million.

Prior to the initial public offering and acquisition of the Selwyn wine business, Evans & Tate could be best characterised as a vertically integrated[20] boutique producer of premium, super premium and ultra premium branded bottled wine (with greatest emphasis on super premium products)[21]. However, material change was close at hand. Over the course of the next four years, the company metastised into an organism vastly different in scale and emphasis to that which had been profiled to investors in the 1999 IPO.

This change began with the Selwyn acquisition, which Evans & Tate rationalised as a key plank of its strategy to develop a meaningful non branded wine operation[22]. This business differed fundamentally to that which the company had previously developed, in that its central economic tenet revolved around volume, not margin. The Selwyn acquisition also resulted in a vineyard management business being bolted onto the pre existing wine making business, creating a service revenue stream to accompany the company's product based revenue streams[23].

A further change to the business mix came with the company's decision to acquire the entities which undertook the distribution of much of its production in key markets. Thus Evans & Tate acquired U.S distributor Scott St. Portfolio[24], European distributor Australian Wineries UK[25] and finally Australian distributor WineSource[26]. No data published by the company provides insight into the contribution of this group of businesses as a standalone segment to the overall profit or loss of the Evans & Tate group. However, since these businesses are essentially predicated on assisting the company to sell its own product, it can be assumed that they play a useful, though auxiliary role in the context of the group overall.

The most fundamental transformation of the Evans & Tate business however, rested on its acquisition of other wine production companies. Two such acquisition transactions were completed after the Selwyn business had been digested. The first involved the acquisition of Oakridge Vineyards Limited in 2001. This deal gave Evans & Tate access to a small winemaking facility[27] and vineyard located within the premium Yarra Valley district of Victoria (and thus a degree of geographic diversification), but was otherwise unremarkable[28].

This lay in stark contrast to the company's acquisition of Cranswick Premium Wines, via a scheme of arrangement completed on 17 March 2003[29]. Cranswick was a volume giant compared to Evans & Tate (even after the incorporation of Selwyn and Oakridge). In the year ending June 30 2002, Cranswick produced over 1.9 million case equivalents and crushed 41,500 tonnes of grapes at its two wineries[30]. Cranswick owned 390 hectares of fully developed vineyards located across sites located mainly in NSW and Victoria[31]. Evans & Tate, by comparison, crushed approximately 7,500 tonnes of grapes and produced approximately 500,000 cases of wine in the same period, and owned developed vineyards less than a quarter of the total size of Cranswick's holdings.

Scale though, was not the chief difference between the two businesses. Indeed, aside from the fact that both organisations produced wine, there were very few points of similarity. Whereas the pre Cranswick Evans & Tate business had defined itself as a dominant player in the very small (though lucrative), highly brand driven Margaret River niche, Cranswick produced downmarket product which appealed to consumers more on price than on any other dimension[32]. Evans & Tate had been a domestic sales success, achieving almost 90% of its sales in Australia[33], while Cranswick was highly export focused and had built up a viable distribution structure in the United Kingdom and Europe[34]. Notably, despite its relatively small size, Evans & Tate had enjoyed measurable financial success[35], whereas Cranswick was a clearly troubled company by the time it was swallowed[36].

Thus from the time it emerged as a listed company to the time it was forced to confess to a loss large enough to wipe out all of its retained earnings, Evans & Tate underwent a journey of significant transformation. This journey however, was not taken in isolation, but in the context of industry wide shifts of tectonic proportions over the same period. It is to these changes that the next section of this paper turns.

3. The Australian Wine Industry in its Global Context

The first vineyard in Australia was planted at Farm Cove in Sydney[37] with vine stock imported to Australia on the first fleet. This experimental planting was not a success, and the vines were soon transplanted further west, to Parramatta, where Governor Phillip established a vineyard covering approximately 3 acres (about 1.2 hectares). He would no doubt have been astonished by the discovery that by the conclusion of 2004, 164,181 hectares of land would be under vine in Australia[38].

Likewise Gregory Blaxland, who had imported vine cuttings he obtained from the Cape of Good Hope during his journey to Australia and planted them at his property in Sydney in 1806, would have been astounded to hear of the future of wine exports from Australia. Blaxland was responsible for the first recorded export of Australian wine, sending approximately 150 litres of fortified red to England in 1822[39]. In 2004, Australian producers exported more than 584 million litres of wine[40], with a total value of almost AUD $2.5 billion.

This enormous expansion of activity meant that by the early years of the new millennium, Australia's wine industry ranked sixth globally when measured in terms of total volume produced and fourth globally in export volumes[41]. This position was not reached via a smooth linear growth process. Indeed, even a cursory review of the history of the Australian wine industry demonstrates that the industry's track record has been characterised by enormous volatility and susceptibility to the effects of boom – bust cycles.

It is little remembered, for example, that between the 1890s and the onset of World War I, Australia was a significant exporter of wine, selling approximately 20% of total production to offshore markets – predominantly Britain. By the 1970s however, a combination of changed international trade regimes and domestic taxation and subsidy support saw the Australian wine industry and its export base wither, the nation becoming a net wine importer[42].

Whereas by 2004, close to 60% of total Australian wine sales were to export markets[43], only around 2% of Australian wine production was exported during the early 1980s[44]. Indeed, such gloom hung over the Australian wine industry by the mid 1980s that the Commonwealth Government funded a vine pull compensation scheme to encourage growers to switch out of grapes and into more profitable agricultural product production[45].

Ironically it was at this time that a number of factors critical to transforming Australia's wine industry into a global facing export juggernaut were moving into alignment. First among these factors was the Australian dollar exchange rate, which after being allowed to float freely from December 1983 onwards, had depreciated significantly by mid 1986[46]. This substantially increased the competitiveness of Australian wine exports.

A second important factor was the restructuring of liquor retailing regulations in the United Kingdom which had taken place in the late 1970s, the major thrust of which was to allow supermarkets to retail alcoholic beverages in store, along with all other merchandise. By the mid 1980s, this had led to an environment in which the four major retail chains[47] accounted for the majority of all retail wine sales in Britain. They in turn looked to producers able to supply quality product within strict cost parameters[48]. Australian producers fit the bill admirably. Further, their competition from other new world producers was limited at the time. Trade in South African wine was severely depressed in consequence of anti apartheid sentiment, and the Chilean and Argentinean industries were not at the time structured to support meaningful export activity[49]. That the mid 1980s also saw several wide scale contamination scares relating to European produced wine[50] cannot have harmed the export prospects of Australian producers to markets such as the United Kingdom[51].

Thus the present day industry, though able to trace its roots to Australia's earliest colonial days, is best seen as a creature which began its emergence in the export resurgence which began in the mid 1980s[52]. The industry's achievements since that time have been hailed as nothing short of spectacularly successful[53]. From having been a net importer of wine during the early 1980s, the industry achieved AUD $200 million in export sales in 1992, AUD $1 billion in 1999 and AUD $2.5 billion in 2004[54]. Whereas the wine industry called in 1996 for the achievement of an Australian wine industry generating AUD $4.5 billion in sales by 2025, this was actually achieved by 2004.

Despite this, publicly available data relating to the wine industry also suggests that by late 2004 (and probably earlier), there were reasons to suspect that severe difficulties lay ahead for the industry as a whole. In essence, the data available by late 2004 clearly suggested a range of pressure points with the potential to destabilise and financially distress significant segments of the Australian wine production industry. Continued imbalance between domestic production and consumption meant increasing reliance on the export sector at a time when close competitor wine producing nations were themselves expanding the ambit of their external orientation. Simultaneously, ongoing rationalisation of the liquor retailing industry would continue to tip bargaining power from the hands of producers into the hands of the controllers of an emerging retailing duopoly, with adverse consequences for producer margins and profitability.

A beginning point for understanding how the data pointed to this scenario is to examine the changing makeup of the Australian wine industry from the late 1990s onwards. There is little subtlety in this data. Viewed from any angle, the historical record bears witness to an enormous explosion of activity within the industry, with 800 new producers entering the industry between 1998 and 2004[55] (see Table 1, below).

Table – 1 Australian Wine Producers by Size[56]

Tonnes Crushed	1998	1999	2000	2001	2002	2003	2004
<20	293	323	337	371	418	485	582
20 – 49	211	235	259	296	331	381	414
50 – 400	161	163	160	162	198	181	185
401 – 10,000	75	92	96	122	128	121	151
10,001 – 20,000	8	11	11	8	11	11	14
>20,000	10	10	9	14	13	11	14
Total >50t	254	276	276	306	350	324	364
All Producers	998	1104	1197	1318	1465	1624	1798

The greatest number of new entrants to the industry during this period are best classified as very small businesses. The data in Table 1 shows that 492 out of the 800 identified new entrants over the period in question crushed less than 50 tonnes of grapes per annum[57]. During the same period, there was comparatively little growth in the number of wineries crushing 20,000 tonnes per annum.

However, this does not mean that the dimensions of the Australian industry's growth were limited to marked increases in the number of firms participating between 1998 and 2004. On the contrary, significant growth is evident on all key parameters pertaining to the scale of the industry. Of these, two of the most important for gauging the journey taken by the Australian wine industry during the period under review are the area of hectares under vine, and, consequent substantially upon that figure, the level of production of wine products achieved in any given year. Data pertaining to these factors is set out in Tables 2, and 3 (respectively), below.

Table 2 – Australian Wine Industry – Plantings & Area Under Vine[58]

	Bearing Vine Area (Ha)	Non Bearing Vine (Ha)	Year's New Bearing Vine Area (Ha)	Total Area Under Vine (Ha)	Year's Plantings (Ha)
1998	78,709	19,279	6,590	98,438	16224
1999	95,301	27,614	16,592	122,915	11646
2000	115,068	31,109	19,767	146,177	6772
2001	130,599	17,590	15,531	148,275	7367
2002	143,373	15,221	12,774	158,594	6566
2003	142,793	14,700	-580	157,492	6338
2004	150,561	13,617	7,768	164,181	5337

Between 1998 and 2004, the total area under vine in Australia grew by 67%, while the area of vines which had reached sufficient maturity to yield commercial crops of wine grapes grew by 91%. In order to achieve growth on this scale, massive plantings were required. Over the period under review, these totalled some 60,250 hectares, not far short of 25 newly planted hectares each day[59].

It is useful to place this pattern of growth into perspective by comparing it to the level of plantings called for under the wine industry's 1995 strategic plan "Strategy 2025"[60]. This document, viewed as an aggressive call to action at the time of its publication called for the achievement of an AUD $4.5 billion wine industry in Australia by 2025. According to the strategy, this would require sustained plantings of approximately 1500 hectares, to a total of approximately 40,000 new hectares under vine.

As events transpired, more than 40,000 new hectares were planted within five years of the release of the wine industry's strategy, more than a decade and a half earlier than had been envisaged. That this rapid increase in hectares under vine should also have translated into substantial increases in the quantity of grapes available for crushing can hardly be viewed as surprising. Recall that by 2004, the area of crop bearing vineyards in Australia had expanded by 91% from the 1998 total. Over the same period, the annual grape crush expanded by 96.5%, while the volume of wine produced expanded from approximately 695 million litres to 1.43 billion litres – an expansion of 105%.

That the growth rate in tonnes crushed and litres of wine produced outstripped the growth in land under vine between 1998 and 2004 suggests that much of the new planting was located in higher yielding grape growing areas[61]. Thus between 1998 and 2004, the Australian wine industry was transformed not only because a far greater amount of land was deployed for the purpose of growing grapes to be used for the production of wine, but also, it seems, because much of the new land put under vine produced yields[62] that were higher than previous yield norms across the industry. This suggests a higher focus on lower quality grapes, something which would inevitably reflect in the quality of the end wine product. These trends are evident in the data set out in Table 3, below.

Table 3 – Australian Wine Industry – Crush, Production, Yield and Concentration[63]

	Crush (Tonnes)	Litres Produced	Yield (litres per tonne)	Production Share (>20k Tonnes Crushed)	No. Producers (> 20k Tonnes Crushed)
1998	975,669	695,239,000	713	70.25%	10
1999	1,125,840	811,390,000	721	69.89%	10
2000	1,145,238	824,346,000	720	67.7%	9
2001	1,423,951	1,052,918,000	739	75.28%	14
2002	1,605,846	1,195,168,000	744	74.43%	13
2003	1,398,528	1,059,390,000	758	72.18%	11
2004	1,917,238	1,424,189,000	743	73.31%	14

Though production of wine in Australia leapt by 105% between 1998 and 2005, growth in domestic consumption lagged far behind, rising by only 23% over the same period of time. Balanced against the relatively weak fortunes of the domestic wine sales market however, was the explosive export growth achieved by Australian producers, which totalled some 204% between 1998 and 2004. This radically changed the nature of the local industry from one which had been primarily inward focused, to one whose fortunes rested predominantly on export performance. As Tables 4 and 5 (below) show, not far off 60% of all sales of Australian produced wine in 2004 were achieved in markets outside Australia, a level of export intensity not far off double what it had been in 1998.

The data also reflects the overwhelming trouble the Australian wine industry would have encountered had it not been for its capacity to aggressively find new export markets – and expand those where a presence had already been built. Indeed, the available data makes it plain that success in export markets was not merely a desirable outcome for the Australian wine industry, but rather, a factor necessary to avert financial disaster. Despite this imperative, combined growth in domestic and export sales was insufficient to keep pace with the growth in quantities of wine being produced, leading to rising inventory levels. This problem had become so profound by late 2004, that the Australian Bureau of Statistics estimated that Australian wine producers were by that stage holding more than 206 million cases of unsold wine stocks[64] - approximately twice the total amount of Australian produced wine sold to both domestic and export markets during 2004.

Table 4 – Australian Wine Production, Sales and Inventories[65]

	Gross Wine Production (Cases)	Domestic Sales (Cases)	Export Sales (Cases)	Total Sales (Cases)	ABS Inventory Estimate (Cases)	Stock / Sales Ratio
1998	82,394,111	37,646,000	21,378,222	59,024,222	100,033,222	1.69
1999	94,571,444	38,816,556	24,016,556	62,833,112	121,064,778	1.93
2000	95,462,889	41,030,111	31,659,444	72,689,555	132,421,222	1.82
2001	119,615,333	42,760,778	37,587,667	80,348,445	152,987,111	1.98
2002	135,596,889	42,914,667	46,488,111	89,402,778	174,504,000	2.16
2003	120,665,000	44,719,889	57,626,889	102,346,778	175,760,333	1.96
2004	163,469,778	46,375,333	64,933,000	111,308,333	206,056,222	2.07

The substantial increase in wine inventories experienced between 1998 and 2004 was not the only matter for concern evident in the available industry data. Over the same period, the average price per litre of wine sold into export markets fell from $5.57 to $4.27 – a decline of approximately 25%[66]. (See Table 5, below).

Table 5 – Domestic / Export Sales Balance and Value per Unit

	Domestic Value %	Export Value %	Domestic Volume %	Export Volume %	Domestic $ per Litre	Export $ per Litre
1998	64%	36%	64%	36%	$4.59	$5.54
1999	60%	40%	62%	38%	$4.61	$4.94
2000	56%	44%	56%	44%	$4.69	$4.82
2001	51%	49%	53%	47%	$4.76	$5.18
2002	48%	52%	48%	52%	$5.04	$5.03
2003	46%	54%	44%	56%	$5.21	$4.67
2004	44%	56%	42%	58%	$4.72	$4.27

In aggregate, this data clearly suggests a troubling prognosis for the industry. Large plantings of vine stock in higher yielding areas produced massive quantities of grapes not suitable for high end product, but rather, for wine products which would ultimately be sold to consumers on a primarily price driven basis. This outcome appears to fly in the face of the industry's earlier aspirations to develop a sustainable footing for the industry in export markets by creating value from "Brand Australia."

Per unit price declines for exported Australian produced wine could therefore be partly explained with reference to signs of apparent product quality declines, combined with a high rate of increase in supply availability. Yet these two factors alone are insufficient to explain the position in which the Australian wine industry stood by the end of 2004. Other material phenomena were also at play.

To understand the nature of the forces impacting on the Australian wine industry by 2004, it is necessary to contemplate developments in other wine producing countries – especially those vying for the same key target markets which Australian producers had penetrated so successfully from the mid 1980s onwards, other "new world" producers, including the United States, Argentina, Chile, South Africa and New Zealand. (See Tables 6, 7 and 8 for data on wine production in these countries).

Table 6 – Ex Australia New World Hectares Under Vine[67]

	1999	2000	2001	2002	2003	2004
Argentina	208,000	209,000	205,000	208,000	221,000	235,000
USA	201,000	223,000	223,000	243,000	250,000	250,000
South Africa	116,000	118,000	118,000	120,383	124,008	124,749
Chile	95,000	104,000	104,000	104,000	109,000	111,000
New Zealand	11,000	14,000	15,000	17,000	17,700	18,266
Total	631,000	668,000	665,000	692,383	721,708	739,015

Table 7 – Ex Australia New World Tonnes Crushed[68]

	1999	2000	2001	2002	2003	2004
Argentina	2,356,440	2,116,500	2,072,676	2,122,000	2,230,000	2,900,000
USA	2,617,000	3,310,000	3,000,000	3,300,000	2,863,000	2,774,000
South Africa	1,173,000	1,098,000	977,400	1,013,000	1,158,000	1,228,000
Chile	666,120	917,000	814,900	803,300	900,000	990,000
New Zealand	79,700	80,000	71,000	118,700	76,400	166,000
Total	6,892,260	7,521,500	6,935,976	7,357,000	7,227,400	8.058,000

Table 8 – Ex Australia New World Case Equivalents Production '000s[69]

	1999	2000	2001	2002	2003	2004
Argentina	176,533	139,311	175,944	141,055	147,000	166,666
USA	211,666	258,888	213,333	225,555	226,888	222,222
South Africa	88,533	72,211	71,900	79,877	98,366	103,100
Chile	53,411	71,322	62,866	62,477	74,222	66,666
New Zealand	6,668	6,688	5,922	9,666	6,111	13,333
Total	536,811	548,420	529,965	518,630	552,587	571,987

The data in Tables 6 through 8 make it evident that the trajectory traced by Australia's close competitor wine producing nations was substantially similar to the Australian experience between the late 1990s and 2004 – that is, the area of hectares under grape vines, the quantum of wine grapes crushed and the volume of wine produced by these nations all grew, just as they had in Australia. Yet it was these same nations which were fighting for share of the same key markets as those into which Australian producers were attempting to place their products. Further, while new world producers (including Australia) ramped up production, global demand for wine remained essentially flat, and a considerable global surplus of wine stocks had emerged. The data in Table 9 (below) shows the magnitude of this problem at a global level. It suggests that in 2004 alone, wine producers throughout the world produced almost 576 million case equivalents of wine more than was consumed. In the same year, non Australian new world wine nations produced almost 572 million case equivalents. This means that had the United States, Argentina, Chile, South Africa and New Zealand produced no wine at all in 2004, the world would still have produced more wine than was consumed in that period[70].

Table 9 - World Wine Production & Consumption '000s of Case Equivalents[71]

	1999	2000	2001	2002	2003	2004
Global Production	3,122,655	3,110,867	2,960,700	2,898,867	2,910,000	3,104,444
Global Consumption	2,524,777	2,501,011	2,516,256	2,531,456	2,552,222	2,528,889
Global Surplus	597,878	609,856	444,444	367,411	357,778	575,555
Ex Australia New World Production	536,811	548,420	529,965	518,630	552,587	571,987
Difference	61,067	61,436	(85,521)	(151,219)	(194,809)	3,568

By 2004 then, if not earlier, the available data demonstrated clearly that production of wine in excess of demand was not a uniquely Australian phenomenon, but rather, a global one. Yet even the data set out above does not fully encapsulate the magnitude of the challenge faced by Australian wine producers by the conclusion of 2004. Not only were they under threat in key export markets, but the entire fabric of the domestic wine market was being reconstituted, as a consequence of a large scale consolidation of the liquor retailing industry.

The Australian retail industry is dominated by two very large corporate groups, Woolworths and Coles. Together, these firms control approximately 80% of the Australian grocery market. Their combined sales revenue for 2004 totalled slightly over AUD $60 billion[72]. On the other hand, the Australian Bureau of Statistics estimates that the total value of domestic wine sales in Australia during 2004 was approximately AUD $2 billion[73]. This means that the nation's two leading retailers generate annual turnover of around $30 for every $1 in domestic sales generated by Australian wine producers. This renders them giants relative even to the largest wine producers.

Until recently, this would have been of relatively little consequence to firms involved in the production of wine, because despite the dominance of Woolworths and Coles in traditional grocery retailing, they had relatively little presence in other sectors of the retail industry – for example fuel and liquor. However, due to constrained opportunities for growth in the segments of the retail industry in which they had already achieved dominance, both firms have embarked on growth strategies revolving around the addition of meaningful presence in the fuel and liquor retailing sectors. While by 2004 these strategies were incomplete, they had already resulted in a substantial reconfiguration of the liquor retailing trade in Australia[74], with the two majors acquiring approximately 45% market share between them, with aims to substantially further this[75].

The reality this brought to wine producers was stark. The basic operating model employed by both Coles and Woolworths is to achieve low prices by using scale to achieve leverage over producers. This means that considerable pressure is brought to bear to force would be suppliers to these behemoths to provide a range of rebates and other payments in return for the benefit of shelf space in high turnover sites[76]. The end result is even greater compression of producer margins and reduced financial viability for Australian wine producers, including Evans & Tate, to which the paper returns in section 4, below.

4. Impact of Industry Conditions on Evans & Tate

In its first full financial year subsequent to listing on the ASX, Evans & Tate reported earnings after tax of AUD $2.376 million on gross revenues of AUD $19.718 million. Thereafter, as discussed in Section 2, the company grew rapidly and in the financial year ending 30 June 2004, reported gross revenue of AUD $101.643 million[77] and after tax earnings of AUD $7.624 million. The flow of positive financial news emanating from the company continued throughout the first half of the 2004 – 05 financial year. As at 31 December 2004, Evans & Tate reported increased profits relative to the corresponding period in the previous financial year[78], total retained profits of AUD $14.254 million[79] and declared an interim dividend of 2.25 cents per share[80], up from the previous year's interim dividend of 2.0 cents per share.

Good news stories continued to radiate from the company as it embarked on the second half of the 2004-05 year. In late February, CEO and Executive Chairman Franklin Tate stated that the company's first half results had ensured that the company had a "continuing solid foundation on which to build for increased profit growth for the full 2004 / 05 year."[81] Though no particular profit number guidance was stipulated by the company at the time this statement was made, it would seem reasonable to expect that the expectation was for a figure measurably in excess of the previous year's full year profit of approximately AUD $7.7 million. At the same time, Mr Tate was reported as having suggested that grape oversupply problems in the global wine industry had been "pretty well sorted out."[82]

By April 1[83], Evans & Tate was still loudly pronouncing that its position and that of the industry generally was best seen as robust. Company Executive Chairman Franklin Tate asserted in a media interview that "…the notion that the industry has too much intake is overdone to hell….while there are some pockets where supply has eclipsed demand, I think the reaction has been way out of whack."[84] Approximately one week later, competitor McGuigan Simeon announced a profit warning to market, citing severe margin compression in key parts of its business, while a research publication circulated by Macquarie Bank claimed that bulk wine prices for certain key varietals had fallen to approximately 85 cents per litre[85] and that in consequence, it was likely that many producers would be forced to sell inventories below cost of production. Still Mr Tate remained resolute, claiming that Evans & Tate remained on track for full year profit growth[86].

By early May, with the completion of the 2005 vintage, positive financial news continued to dominate the company's communications to financial markets. The annual vintage report, released on May 3, quoted Chairman Franklin Tate stating that sales of the company's products in both Australia and Europe had continued to grow at greater than industry averages and that the company was operating strongly[87]. A further trading update released to the ASX on May 19 did nothing to contradict any earlier statements relating to the financial performance and position of the company, and continued to emphasise the strong sales growth achieved in the year to date[88]. Remarkably, even as pressure mounted on the company as a result of intensifying speculation that its relationship with its bankers was strained and that administrators had been appointed to the firm, Chairman Franklin Tate was strident in his rejection of the notion that Evans & Tate might be under financial threat. In an interview granted to The West Australian on June 22, Mr Tate claimed that he was "round eyed[89]" by industry speculation on the health of the company. While admitting his desire (and that of fellow directors) to see some reduction in debt and inventory levels, he dispelled any suggestion of financial difficulty saying, "we don't even have the symptoms so how can we get the disease….I'm puzzled as to where this sort of stuff comes from."[90]

Puzzled or not, only a week later, Company Secretary Sue Symons found herself at Evans & Tate head office early on a blustery winter's morning faxing a request to the Australian Stock Exchange requesting that a temporary halt be placed on trading in the company's securities. On the next day, June 29, the market learned the reason why. A loss was to be incurred, but not so significant in magnitude to threaten the capacity of the company to declare dividends in respect of its preference and ordinary shares[91]. Given that balance sheet published as at 31 December 2004 showed retained earnings of approximately AUD $14.25 million, and that in the financial year ended 30 June 2005 the company paid (in cash) dividends to a total value of approximately AUD $4 million[92], it stands to reason that the magnitude of the loss expected to be reported by the company as at the re-commencement of trading on June 29 could have been no more than approximately AUD $10 million. Indeed, the company's own estimate on June 29 placed the expected loss within the range of AUD $4.8 – 7.5 million, after allowing for inventory write downs in the range of AUD $8 - $10 million and intangible write downs of AUD $4.3 million[93].

History records that as events transpired, the company ultimately wrote off approximately AUD $40 million in inventories, almost AUD $7 million in intangibles and raised provisions to the tune of AUD $7 million. The precise value of the sum of these adjustments was in fact AUD $53.255 million. This is striking for two key reasons. First, that it should follow so hard on the heels of a series of strident statements that the company was in sound financial health. Second, in making claims about its financial health, the company had consistently promoted the view that full year earnings for 2005 would be higher than those reported for the 2004 financial year. Yet an inspection of the financial statements shows that reported before tax earnings for the 2005 year amounted to a loss of AUD $49.783 million, which, after subtracting the adjustments noted above would only have translated into a before tax profit of approximately AUD $3.5 million (as against the previous year's AUD $7.71 million)[94].

The stark contrast between the nature of the claims made by the company in relation to its financial circumstances up to an including June 29 and those which emerged from August 16 until the filing of the final financial accounts for the 2005 financial year raises serious questions about the degree to which the directors of the company who caused such communications to transpire could reasonably have believed[95] their content. Though it is outside the scope of this paper to provide in depth commentary in relation to the legal consequences of making statements which could reasonably be expected to have a material impact on security prices of the decision to acquire or dispose of securities when there was no reasonable basis for belief in the statements in question, one thing seems particularly obvious. The capacity of the company to operate profitably rested heavily on the performance and value of two key asset classes – inventories and intangibles.

Together, these items dominated the Evans & Tate balance sheet, representing approximately 65% of total assets in both 2004 and 2005[96]. Yet under the types of industry conditions outlined in Section 3, both were potentially highly vulnerable to value impairments which, even if relatively modest in magnitude, could severely dent profits or (as happened in this case) result in reported losses. To illustrate the magnitude of this risk, assume that the after tax earnings of the company for the year ended June 30 2005 would have been at least as large in magnitude as they had been in the previous financial year, but for the impact of "one off adjustments", say, AUD $8 million.

Recall that the company's total retained earnings as at 31 December 2004 had stood at AUD $14.125 million. Consequently, after tax "one off" events with a magnitude of approximately $22 million would bring the company to the point where its retained earnings were exhausted, and its capacity to pay dividends removed. Assuming all such "one off" write down events to be deductible for taxation purposes[97], the before tax value of "one off" write downs necessary to negate current period earnings and exhaust pre-existing retained earnings would therefore have stood in the range of AUD $32 million – approximately 17.5% of the pre-write down valuation assigned to the inventories and intangible assets controlled by Evans & Tate as at June 30 2005.

In assessing the reasonableness of the company's statements as to its financial affairs – and in particular its assertions and intimations prior to June 29 that it expected to deliver larger earnings in 2005 than it had in 2004, and on June 29 that notwithstanding an expected loss, the company still intended to declare dividends on its preference and ordinary shares, a key analytical benchmark would appear to be the extent to which the company's earnings pronouncements gelled with contemporaneously available evidence pertaining to the potential valuation vulnerability of the two key asset classes in question.

Self evidently, this is a difficult matter for enquiry and judgement, but at least some publicly available evidence assists in placing the matter in perspective. One means of assessing the vulnerability of the company's inventory assets to downwards valuation shocks is to examine the gross profit margins earned by the company on each case of wine sold over time. Higher per case gross margins achieved in the marketplace suggest a greater buffer against the need to engage in write downs against inventory balances. As the data set out in Table 10 suggests however, the prices commanded for each case equivalent sold by Evans & Tate declined substantially and consistently in the period after the company went public, from $144 per case equivalent ($12 per bottle) to only $58 per case equivalent (a mere $4.83 per bottle) in 2005. Over the same period gross margins declined from 52% to 32%. Even in the absence of other indicators, this is hardly a state of affairs which would engender confidence in the financial sustainability of the business, a matter with direct implications for the value of its underlying asset base.

Table 10 – Wine Sales Revenue, Costs and Gross Margin

	Sales $	Sales – Cases	COGS	Revenue $ Per Case	COGS $ Per Case	Gross Margin Per Case %
1999	12,226,000	86,000	5,868,000	$142	$68	52%
2000	19,501,000	135,000	9,867,000	$144	$73	49%
2001	23,136,000	234,000	12,293,000	$99	$53	47%
2002	27,136,000	283,000	14,468,000	$96	$51	47%
2003	47,259,000	671,000	29,173,000	$70	$43	38%
2004	72,960,000	1,200,000	42,194,000	$61	$35	42%
2005	86,094,000	1,476,000	58,367,000	$58	$40	32%

Further, as the data in Table 11 indicates, in the period after the company's IPO, inventory holdings increased substantially, particularly in the wake of the Cranswick acquisition. Reflecting on the history of the Evans & Tate business[98], the pattern of the data relating to the company's inventory holdings and turnover period is peculiar. Prior to the Cranswick acquisition in 2003, the company's business was dominated by the production of super premium branded bottled wine, while afterwards, bulk wine and lower end bottled product represented by far the dominant segment of the company's business. Yet the average inventory holding period in the years prior to the Cranswick acquisition was measurably lower than that recorded afterwards, even though it would seem reasonable to expect quicker stock turn in a business dominated by lower quality product[99] than one in which high end product represented the largest of the firm's output categories. Taken together, the data suggests that Evans & Tate had significant inventory management problems from at least the time of the Cranswick acquisition, and that these were not resolved, even as market conditions steadily worsened.

Table 11 – Evans & Tate Inventory Holdings and Turnover

	Ending Inventory $	COGS $	Inventory Days	Equivalent Years
1999	7,921,000	5,868,000	493	1.35
2000	13,143,000	9,867,000	486	1.33
2001	19,418,000	12,293,000	577	1.58
2002	30,390,000	14,468,000	767	2.10
2003	54,942,000	29,173,000	687	1.88
2004	80,663,000	42,194,000	698	1.91
2005	105,180,000[100]	58,367,000	657	1.80

Further, close competitors within the wine industry had publicly acknowledged the extent of their difficulties with inventories in the period leading up to the sequence of events the subject of this paper. In the financial year ending September 30 2004, Lion Nathan recorded writedowns in the order of $75 million in relation to its wine businesses, because they were underperforming other business segments so noticeably[101]. Orlando Wyndham, owner of the successful Jacob's Creek brand recorded inventory write downs of $28 million during 2004[102], Fosters Group had engaged in writedowns to the value of more than $400 million in its 2004 financial year, largely driven by falling inventory values[103], Xanadu wines had failed[104] and MgGuigan Simeon found it appropriate to issue profit warnings, citing harsh trading conditions[105]. Yet for the longest time, Evans & Tate purported to be navigating the tempest unscathed.

The hard reality was that a combination of unfavourable exchange rates, intensifying international competition, slack domestic demand and a fundamental reconfiguration of the power balance between wine producers and retailers (in favour of the retailers and ultimately, consumers) were all factors present in the operating environment faced by the company during and in the lead up to the period under consideration in this paper. These factors must be understood to have had significance not only for the valuation of the company's inventory, but also for its intangibles base.

It seems axiomatic to suggest that the value of a brand must be impaired in circumstances where the capacity of an organisation to generate positive profit margins in consequence of harnessing the brand for the purposes of driving sales activity is obviously diminishing. Stronger still does the same intuition render the same conclusion in relation to goodwill balances, which had ballooned in the wake of the sequence of flawed acquisition transactions discussed above. Yet here too Evans & Tate remained implacable. In the throes of a perfect storm, the firm's management does not seem to have been capable of countenancing the fact or the magnitude of the problems faced by their organisation and of shaping the appropriate reaction.

5. Conclusions

The analysis mapped out in sections 3 and 4 above suggests the adoption of a course of action, on the part of Evans & Tate, which when viewed dispassionately and in the light of evidence which had been in the public domain contemporaneously with a variety of the company's statements during the second half of the 2005 financial year, seems to suggest an astonishing degree of wilful blindness as to the true state of the firm and its markets.

The record shows that the company made a series of communications with capital markets during the period most intensely scrutinised for the purposes of this paper – and in that sense, may have given the appearance of continuing to inform the investment community as to its state of affairs. Yet the content and timbre of those communications proved to be so far at odds with a reality confronted by the firm's investor base only a few short months later as to beggar belief. Far from providing an accurate guide as to the firm's state of affairs and immediate prospects, it seems arguable that the information released by the firm in this crucial period drove the opposite result.

This in turn begs the troubling question, is it fair to look only to the disclosures which took place between February and late June 2005 in this sceptical light – or could the same spotlight of enquiry be turned onto the (audited) annual and semi annual accounts which preceded this period? It surely beggars belief to suggest that, in a manner reminiscent of Saul's transformation to Paul in the immediate wake of his epiphany on the road to Damascus, a great wave of value impairment struck the firm and profoundly changed its affairs in the few short weeks between late June and early August 2005.

The better view, as set out in the arguments marshalled in the earlier sections of this paper, is that the rot had well and truly set in at Evans & Tate by the time it consummated the Cranswick acquisition, but in ascribing the sanguine valuations which were consistently attached to key items such as inventory and intangibles in the years immediately thereafter, the preparers and attestors to the firm's financial statements in effect engaged in what amounted to strident disavowal of the notion that there was anything at all problematic about the firm's affairs. With great respect to these individuals, it does not require the perfectly crystallised vision afforded by hindsight to understand that this position lacked any reasonable foundation.

It goes without saying that the apparent lacuna between the firm's underlying operational and financial reality and the image of the organisation promulgated in its various financial reports and additional information releases is deeply troubling. On reflection however, the shadow cast by this episode ought to be placed in the context of a much more perfidious matter – the utter silence in relation to this episode on the part of relevant regulatory, standard setting and professional bodies.

Good governance, in the end analysis, is the product not so much of the existence of layer upon layer of regulation coupled to edifices built high with arcane technical rules and provisions. It flows, instead, from the recognition and defence of principal. Thus, while the analysis set out in this paper could be taken as an isolated forensic review of a particular instance (or set of instances) of asset misevaluation, its contribution is more readily understood when set against other recently marshalled evidence on substantial deviations, in financial statements and associated disclosures, from the ideal of presenting the hard economic substratum of firms to which they relate[106].

Tacitus, writing on the subject of the great fire of Rome, reported that Nero stood on a private balcony a safe distance from the conflagration and extemporised verses comparing what he saw before him to the fall of Troy, whilst accompanying his oration with a lyre. In light of the growing body of evidence suggesting that there are matters of fundamental principal about which we should have great concern (of which this paper represents but one exemplar), one cannot help but wonder what his impression of contemporary trends in the regulation of financial reporting and continuous disclosure would be were he here to witness them.

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[1] Yielding a total market value of equity of approximately AUD $92 million.

[2] F Leyden, (2005), "Wine Debt 'no issue' Evans & Tate Says Revenue on Track", *The Australian*, 22 June 2005, p. 31.

[3] The company also had some 31,170,455 convertible preference shares (known as WInES) outstanding as at 31/12/2004. (Evans & Tate Half Yearly Report Half Year Ended 31/12/2004, p.8). These were hybrid instruments with a face value of $1.00 each an non cumulative franked dividend rights of 7.75% per annum. The price of these securities exhibited even greater volatility than the ordinary shares. On June 27 2005, the closing price recorded for these instruments was 29.5 cents, a somewhat anomalous result given the improved rights attaching to WInES when compared against those attaching to ordinary shares in the company.

[4] These will be discussed in greater detail below.

[5] Similarly, the price of the WInES securities increased from 29.5 cents on June 27 to 55 cents by close of trade on June 29, and 56 cents on June 30.

[6] The value of the WInES securities fell by 40% on that day.

[7] As embedded within Chapter 3 of the ASX Listing Rules.

[8] In particular, S. 180 and S. 181.

[9] S. 52.

[10] The company itself flagged both announcements as "material" when it released them to the ASX.

[11] Evans & Tate Prospectus, 1999, p.1.

[12] Presentation by Phillip Osborne, Evans & Tate Chief Operating Officer to Evans & Tate Annual General Meeting, 30 November 2004.

[13] These included: "Redbrook", "Gnangara" and the "Evans & Tate Margaret River" range.

[14] Evans & Tate Prospectus, 1999, p.1.

[15] His initial appointment as was sales and marketing manager.

[16] Evans & Tate Annual Report 2001, p.4.

[17] Presentation by Franklin Tate, Evans & Tate Chairman and Chief Executive Officer to Evans & Tate Annual General Meeting, 6 November 2003.

[18] Approximately 80 Hectares of this total was under vine by the conclusion of 1999.

[19] These were: The Selwyn Winery – acquired in 1999 and a new purpose built winery built on the Lionel's vineyard site in 1999. The two facilities were located approximately 1 km from each other.

[20] That is, the company owned its own vineyards and winery and had on site access to bottling and packaging. Further, the company had developed a reasonable distribution and sales capability.

[21] These were, the ultra premium ($30 - $50 per bottle) Redbrook range, the super premium ($15 - $30 per bottle) Evans & Tate Margaret River range and the premium ($10 - $15 per bottle) Gnangara range.

[22] No cogent rationalisation for this "strategy" was ever stated within the prospectus.

[23] The viticultural services business represented approximately 3% of revenue in 2001, 8.5% of revenue in 2002, 5% of revenue in 2003, 5.5% of revenue in 2004 and approximately 5% of revenue in 2005 (all dates referring to financial year ends, not calendar year ends). Overall, this business does not represent a material element of the overall activity portfolio of the Evans & Tate group, and nor is the success or failure of the group (as configured) likely to turn on the performance of this element of the enterprise.

[24] L Gettler, (2002), "Wine Group Buys Taste of U.S Market", *The Age*, 14 March 2002, p. 3. The consideration paid was approximately AUD $625,000 in a mix of Evans & Tate shares and cash.

[25] A 49% share of the equity of this company was acquired when Evans & Tate took control of Cranswick Premium Wines in 2003. Subsequently, in 2004, Evans & Tate arranged to acquire the remaining equity in this business for reported consideration of AUD $2 million. See – L Gettler, (2004), "Evans & Tate Tightens Grip on UK Distribution", *The Age*, 27 March 2004, p.2.

[26] This transaction also took place in 2004, costing initial cash consideration of AUD $11 million with the possibility of additional payments to the vendors totalling no more than AUD $3.34 million contingent on the financial performance of the business in the years ending 30 June 2005 and 30 June 2006. As at the time of writing, a further $1.2 million dollars was payable to the vendors of the business under this variable consideration arrangement – see; Evans & Tate Limited, Running Sheet for AGM, 30 November 2005.

[27] Approximately 18 hectares in total of vineyards.

[28] The key assets of Oakridge were an 18 Hectare Vineyard, a modern purpose built winery capable of crushing 1100 tonnes of grapes per annum and the Oakridge Estate brand name. In the year of the acquisition, Oakridge produced approximately 54,000 cases of wine. By way of contrast, Evans & Tate produced more than 500,000 case equivalents in the same period. At the time of the acquisition, Evans & Tate's market capitalisation stood at approximately AUD $50 million, while the total value of consideration payable in respect of the Oakridge acquisition was in the range of $AUD 4 million. See – Scheme Booklet for the Scheme of Arrangement between Oakridge Vineyards Limited and Evans & Tate Limited, August 2001.

[29] See – Evans & Tate Media Release: Completion of Schemes of Arrangement, 20 March 2003.

[30] One winery was located in Mildura, the other in Griffith.

[31] See; Explanatory Statement for Schemes of Arrangement between Cranswick Premium Wines Limited in relation to the Proposed Merger with Evans & Tate Limited, December 2002, p. 44.

[32] Its most successful product, the "Barramundi" range – principally an export brand, was selling more than one million cases per annum by the time of the acquisition. This range was priced in the sub AUD $10 per bottle segment of the market. See; S Evans, (2002), "Cash Lubricates Tate, Cranswick Wine Merger", *Australian Financial Review*, 27 September 2002, p. 54.

[33] L Gettler, (2002), "Evans & Tate Merger Fails to Excite", *The Age*, 15 June 2002, p.3.

[34] J McCulloch, (2002), "Evans & Tate Chairman is a Family Man", *Perth Sunday Times*, 23 June 2002, p. 47.

[35] Evans & Tate reported after tax earnings of $701,000 on a revenue base of $12.3 million (net profit margin 5.7%) in 1999, and $2.925 million in after tax earnings on a revenue base of $25.9 million (net profit margin 11.3%) in 2002 – the financial year immediately prior to the Cranswick acquisition.

[36] In 1998, Cranswick reported total revenues of approximately $22 million, and an operating profit after tax of $3 million (net profit margin (14.2%). By 2001, having grown revenues to $56 million, Cranswick's annual after tax profit remained stuck at $3 million (net profit margin 5.3%). For the year ended 30 June 2002, the final full financial year prior to being acquired, the company reported a loss of $23 million, after being forced to write down the value of its inventories and certain of its land and intangible assets.

[37] Farm Cove is the site of the present day Sydney Botanical Gardens.

[38] ABS Cat 1329.0 2004, Australian Wine and Grape Industry, p.3.

[39] England still remains a major export destination. Later, in 1828, Blaxland was the Gold Ceres Medal for his wine by the Royal Society for the Arts in London.

[40] ABS Cat 1329.0 2004, Australian Wine and Grape Industry,

[41] See; G Dutruc-Rosset, (2003), *The State of Vitiviniculture in the World and the Statistical Information in 2001*, Office International de la Vigne et du Vin, Paris. According to this report, Australia was responsible for 3.8% of global wine production (measured in litres produced), ranking behind France with 20.2%, Italy with 18.9%, Spain with 11.5%, the USA with 7.3%, Argentina with 6.0% and China, with 4.1%. However, measured at the same point in time, only France, Italy and Spain exported more wine than Australia.

[42] K Anderson, (2001), "The Globalisation (and Regionalisation) of Wine, *CIES Discussion Paper 125*, Adelaide University, Adelaide.
[43] ABS Cat 1329.0 2004, Australian Wine and Grape Industry, p. 3.
[44] ABS Cat 1329.0 1998, Australian Wine and Grape Industry, p. 30.
[45] R. Osmond & K. Anderson, (1998), *Trends and Cycles in the Australian Wine Industry – 1850 to 2000*, Centre for International Economic Studies, Adelaide University.
[46] A Blundell-Wignall, J Fahrer & A Heath, (1993), "Major Influences on the Australian Dollar Exchange Rate", Reserve Bank of Australia 1993 Conference – *The Exchange Rate, International Trade and the Balance of Payments*, July 1993, Sydney.
[47] Sainsbury's, Marks & Spencer, Waitrose and Tesco.
[48] T Unwin, (1991), *Wine and the Vine: An Historical Geography of Viticulture and the Wine Trade*, Routledge, London.
[49] K Anderson, (2001), "The Globalisation (and Regionalisation) of Wine", *Centre for International Economic Studies Discussion Paper 125*, Adelaide University, Adelaide.
[50] These ranged from concerns relating to contamination flowing from the Chernobyl disaster to scandals involving illegal additives in Italian wines.
[51] B Rankine, (1996), *Evolution of the Modern Australian Wine Industry: A Personal Appraisal*, Ryan Publications, Adelaide.
[52] The Winemakers' Federation of Australia dates the commencement of Australia's new wine era to 1984, when the highly influential UK Masters of Wine visited Australia to examine the local wine industry and subsequently reported enthusiastically about what they had discovered and the potential of the industry. See; Winemakers' Federation of Australia (2000), *The Marketing Decade – Setting the Australian Wine Marketing Agenda 2000 – 2010*, p.3.
[53] K Anderson, (2000), "Lessons for Other Industries From Australia's Booming Wine Industries", *Centre for International Economic Studies Policy Discussion Paper 25*, Adelaide University, Adelaide.
[54] See; Winemakers' Federation of Australia (2000), *The Marketing Decade – Setting the Australian Wine Marketing Agenda 2000 – 2010*, pp.4 – 6, and; ABS Cat 1329.0 2004, Australian Wine and Grape Industry, p. 3.
[55] This equates to approximately one new winery in Australia every 3 days for the entire period between 1998 and 2004 (inclusive).
[56] Source – Winetitles (Various Years), *Australian and New Zealand Wine Industry Directory*, Adelaide, Winetitles.
[57] Assuming a yield of 700 litres per tonne of grapes crushed, this translates into maximum production of less than 4000 cases per annum for these businesses. By way of contrast, Orlando Wyndam's "Jacob's Creek" branded wine now accounts for sales of more than 7 million cases per annum, and Casella's "Yellowtail" brand sells more than 10 million cases per annum – see; S Evans, (2005), "What's Wrong With Australian Wine?", *Australian Financial Review*, 10 December 2005, p. 22.
[58] Source – ABS Cat. 1329.0 Australian Wine and Grape Industry, 1998 – 2004.
[59] This in turn equates to roughly 46 (American) football fields. Thus the wine industry added approximately 46 football fields worth of vineyards every day, for a total of seven years. Looked at another way, between 1998 and 2004, Australian wine producers added an area of vines equivalent to three times the entire New Zealand industry area under vine as at 2004.
[60] Australian Wine Foundation, (1995), *Strategy 2025: The Australian Wine Industry*, Adelaide: Winemakers' Federation of Australia for the Australian Wine Foundation.
[61] This likely means a high intensity of plantings in warm east coast inland locations using irrigation. Districts in which substantial additional plantings have taken place include the Riverina district and the Riverland district.
[62] As measured by tonnes of grapes per hectare and litres of wine per tonne of grapes crushed.
[63] Source: ABS Cat 1329.0, various years.
[64] It is generally thought that ABS inventory figures actually understate industry inventories, though the magnitude of the error term is not known. To understand the nature of the problem, examine the ABS ending inventory estimates for 2003 and 2004. In case equivalent terms, these were, 175,760,333 and 206,056,222 in 2003 and 2004 respectively. The net increase in industry wide inventories implied by comparing the difference between these two figures is 30,295,889 cases. Compare this against the production and sales data for 2004, also set out in Table 4. This suggests that 163,469,778 case equivalents of wine were produced in 2004 and that through a combination of export and domestic sales. 111,308,333 cases were sold. The difference between estimated production and estimated sales according to this data is 52,161,445, which is the run up in inventories inferred by comparing the sales and production data. The ABS uses different survey instruments to gather data about production, sales

and year end inventories – so it is natural that it will not be possible to reconcile the results of the two different approaches to estimating changes in inventory. However, the size of the differentials evident in the calculations above strongly suggest that the year end inventory data published by the ABS materially understates inventories. During the conduct of the research for this paper, this proposition was put to the ABS officer responsible for the compilation of the inventory data. His response to this proposition was that the ABS is aware of the problem and agrees that the year end inventory data understates the actual industry position.

[65] Source, ABS Cat 1329.0, various years.

[66] It is estimated that for 2005, the revenue per litre of wine exported from Australia dropped still further to $4.06 – see; S Evans, (2005), "What's Wrong with Australian Wine?", *Australian Financial Review*, 10 December 2005, p.22.

[67] Source – Office International de la Vigne et du Vin (OIV), various years, *The State of Vitiviniculture in the World*, OIV, Paris.

[68] Source – Office International de la Vigne et du Vin (OIV), various years, *The State of Vitiviniculture in the World*, OIV, Paris.

[69] Source – Office International de la Vigne et du Vin (OIV), various years, *The State of Vitiviniculture in the World*, OIV, Paris.

[70] This is a very crude way of looking at the problem because it does not take account of quality and style differentials which exist between different wine producing nations. However, as a basic means of communicating the magnitude of the global surplus problem, even this crude measure is useful.

[71] Source – Office International de la Vigne et du Vin (OIV), various years, *The State of Vitiviniculture in the World*, OIV, Paris.

[72] See, Woolworths Limited Annual Report, 2004; Coles Myer Limited Annual Report 2004. Total sales revenue for Woolworths for the 2004 financial year was AUD $ 27.9 billion. For Coles the figures was AUD $32.2 billion over the same period.

[73] ABS Cat 1329.0, 2004, p.3.

[74] For example, in 1999, Woolworths controlled a total of 287 liquor retailing outlets. By June 2004, this had grown to 679 outlets spread across every state of Australia. See; Woolworths Annual Report, 1999, Woolworths Annual Report, 2004.

[75] E Jones, (2005), "Liquor Retailing and the Woolworths / Coles Juggernaut", *Australian Journal of Political Economy*, Vol 55, pp. 24 – 47.

[76] These rebates are said to typically include: 4% rebate on wholesale product price for access to shelf space, 4% of wholesale for promotional activities, minus 1% for hypothetical breakages and loss, minus 2.5% for trade debts to be settled within normal commercial payment periods.

[77] 515% of the amount reported for the year ending 30 June 2000.

[78] Reported earnings for the 6 months ending 31 December 2004 were AUD $2.102 million as against AUD $2.055 million for the 6 months ending 31 December 2003.

[79] Up from $13.445 million as at 30 June 2004. See Evans & Tate Ltd, Half Yearly Report for Half Year Ended 31 December 2004.

[80] The amount was fully franked.

[81] AAP Newswire, 21 February 2005, "Evans & Tate Expects Increased Full Year Profit Growth.'

[82] AAP Newswire, 21 Feburary 2005, "Evans & Tate OK on Foster's Bid." Given the data presented in section 3 of this paper, this seems a miraculous assertion.

[83] Readers may draw their own conclusions as to the significance or lack thereof of the timing of this pronouncement.

[84] AAP Newswire 1 April 2005, "Australian Winemaker Hopes to Dodge Takeover Flak".

[85] Down from approximately $1.50 per litre at the same point the previous year.

[86] J Freed, (2005), "Flood of Plonk Hits McGuigan Earnings", *The Sydney Morning Herald*, 9 April 2005, p. 46.

[87] Evans & Tate Market Announcement, "Wine Group Outperforms Industry", May 3, 2005.

[88] Evans & Tate Market Announcement, "Trading Update", May 19, 2005.

[89] It would seem that this is an expression of astonishment.

[90] J Sprague, (2005), "E&T Rejects Talk of Trouble", *The West Australian*, 22 June 2005.

[91] See the discussion in Part 1 of the paper for greater detail on this point.

[92] See Evans & Tate Annual Report 2004-05, p.32.

[93] See – Evans & Tate Limited, Shareholder Update, 28 June 2005.

[94] Evans & Tate Annual Report, 2004-05, p.30.

[95] The extent to which the statements made were subjectively honest is not likely to be a highly relevant matter in cases such as these; see; *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191.

[96] Total reported assets as at 30 June 2004 amounted to AUD $215.408 million. Inventories represented AUD $82.548 million – or 38.3% of total assets, and Intangibles represented AUD $54.627 million or 25.4% of total assets. Total reported assets as at 30 June 2005 sat at AUD 215.8 million. However, this represented the position after write downs to inventory of AUD $39.249 million and to intangibles of $AUD 6.956 million. Reversing these adjustments sees total assets of AUD $262.006 million, inventories of AUD $105.180 million (40%) and intangibles of AUD $66.326 million (25%). If the calculation proceeds without backing out the 2005 year end write downs to inventories and intangibles, these two asset classes still represent almost 60% of total reported assets as at 30 June 2005.

[97] This is a generous assumption. It is unlikely that the write downs against intangible assets would have resulted in allowable deductions against assessable income.

[98] As outlined in Section 2 of the paper.

[99] Super premium wines may require lengthy cellaring and maturation processes, whereas premium wines and bulk wines are generally brought to market younger and after far less intricate production processes.

[100] This is not the reported final year inventory figure, but rather, the reported figure with inventory adjustments and write downs written back to allow year to year comparability.

[101] Lion Nathan Annual Report 2004.

[102] T Bawden, (2004), "Hopes of Sales Lift Despite Wine Glut", *The Adelaide Advertiser*, 4 June 2004, p.79.

[103] Reuters News Wire, 8 June 2004, "Fosters Takes Writedown on Wine Arm".

[104] J Sprague, (2005), "Auditors Cast Doubt on Xanadu",

[105] K Andrusiak, (2005), "McGuigan Drops $110m as Grape Glut and Rising Dollar Hit Hard", *The Australian*, 9 April 2005, p. 33.

[106] See for example, T Carlin, G Ford & N Finch, (2006), "Magic Pudding or Regulatory Arbitrageur's Friend? The Use of Hybrid Debt Equity Securities by Australian Listed Corporations", AFAANZ Annual Meeting, Wellington, July 2006.