

# first the GFC

## What next for wineries?

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**T**he Australian wine industry has been severely impacted by the global financial crisis (GFC) over the past 18 months. We have seen a severe tightening of bank credit

which has flowed right through our economy, consumers have reduced spending, and our currency has fluctuated in a wide range.

Then, on 30 October 2008 the Federal Government confirmed what was already widely predicted: Australia is to have a Carbon Pollution Reduction Scheme, dubbed the 'CPR Scheme' by the Canberra boffins. It could be argued that, after the GFC, the heart of the wine industry was in need of CPR! But this proposed CPR? Let us consider what is in store.

There has been a succession of Government releases on CPR from white papers to green papers to vigorous debate from all sides of politics. While we appear to still be some way from agreement as to how the CPR Scheme will be implemented, it is generally conceded by all but a very small minority that carbon gas emissions must be reduced. And this is not just an Australian phenomenon. Europe has had a scheme in place for over four years, the change of president in the USA has also seen a change in that country's Federal Government policy to now favour an emissions trading scheme, and there have been the first rumblings from China that they will also be going down this path, brought on no doubt by the policy changes in Washington.

Australia has signed the Kyoto Protocol, which legally commits us to a reduction in our carbon emissions. We have no choice but to act. There is therefore little doubt that we are to have some form of emissions trading scheme. Research conducted by MGI Business Growth

Advisors and our carbon management partners clearly concludes that, while the proposed CPR Scheme will initially require carbon emissions permits to be purchased by about the 1,000 largest companies in the country, the flow-on affect will be felt in varying degrees by every manufacturer and every consumer in the country.

It is proposed that the largest carbon emitters will be required to either substantially reduce carbon emissions, or buy permits to emit. The carbon emission limits above which permits will be required are to be progressively lowered over time, which in turn will see the cost of permits increasing as more and more businesses are caught in the net. These costs will be passed on to the customers of the businesses.

For the wine industry the greatest impact is most likely to be in the increased cost of energy, particularly electricity as electricity generation has already been marked as one of the largest carbon emitters. The impact will vary depending on the source of your electricity. At the upper end of the cost scale will be those customers acquiring electricity from producers who use brown coal as their fuel source. Victoria falls very clearly into this category. Electricity generated from hydro, wind, solar and gas sources produces less carbon emissions resulting in lower permit costs to be passed on to consumers. Tasmania is likely to see only minimal increases in electricity costs because of its hydro generated power. Electricity produced in other wine growing areas will generally result in lower cost

increases than in Victoria, but more than those in Tasmania.

Wine is very much a global product and so wine producers in low carbon energy production environments, including California and New Zealand, will be at a distinct advantage compared to their Australian competitors. If you are competing with producers from these regions it is imperative that you critically analyse your energy costs before you are put at a disadvantage by the CPR Scheme.

While the final costs of permits have not yet been set, it is currently proposed that for the first year of operation from 1 July 2011 the cost of carbon permits will be capped at \$10 per tonne of emissions. The price will then be set by market forces. The MGI Carbon Management Team believes that this cost may be as high as \$40 per tonne. It has further estimated that electricity costs will increase by between 20% and 40% once the scheme is fully implemented, the variables being the cost of permits and the manner in which the electricity is generated.

Diesel and petrol prices will not be impacted for the first few years because the Government has proposed that it will reduce its tax on petrol and diesel to compensate for the increase in costs

# and now CPR

resulting from the CPR Scheme. The good news is therefore that transport costs within Australia are not likely to be greatly impacted in the first years of the scheme. But they will eventually.

Many of the other components used in wine production will also increase in cost as increased energy costs are passed down the line. For example, glass bottles will cost more because of the substantial energy used both in initial glass production and in melting recycled glass. It is therefore no coincidence that Wolf Blass has recently launched a new range of wines in plastic bottles. Almost all goods and services used in the wine production and distribution chain will be affected to some degree.

What does all this mean for wine producers?

The future survival of your winery may well depend on how you deal with the low carbon future.

You need to start planning today to deal with the inevitable increased costs.

One of the costs likely to be most heavily impacted will be electricity, which is a substantial cost in wineries. You should seriously consider having an energy audit of your winery to determine how you can reduce electricity consumption and costs. Inefficient refrigeration or insulation can

substantially increase consumption. Older plant may be energy inefficient and need upgrades or replacement. You could consider installing solar panels to produce your own electricity. And you should certainly review your electricity supply contracts to ensure that you are able to take advantage of off-peak tariffs, particularly during peak consumption periods such as vintage.

There are a number of experts who can assist you in reviewing your electricity consumption and costs. Your first port of call should be your accountants, who should have direct access to these services.

Reducing your energy consumption is good business practice, regardless of whether there is a GFC or a CPR Scheme, or both.

You should urgently initiate dialogue with your significant suppliers to get indications from them as to how they are going to manage the emissions trading scheme cost increases and how they plan to mitigate them. You may well have to consider alternative suppliers to keep cost increases to a minimum.

A thorough review of all your production processes would also be a useful part of the preparation for the CPR Scheme.

Federal and State Governments can provide significant funding to assist you in tackling climate change. Like many government schemes the challenge is to actually determine what funding is available for your business.

Federal funding is generally being delivered through Ausindustry (Department of Innovation) via a scheme known as Green Business Australia, which has several funding areas including the following that are most relevant to wineries:

- *Climate Ready* assists innovators to develop new technologies, products or processes that reduce carbon emissions or water usage. Ausindustry has already announced grants under this scheme to two wineries. Funding is limited and

therefore the sooner you are able to apply the more likely you are to get it.

- *Re-Tooling for Climate Change* is designed to help manufacturing companies including wineries, reduce the environmental impact of their businesses. Unlike past R&D grants this scheme actually funds the cost of plant as well as other costs and can therefore prove very valuable to manufacturers.

There are also various State Government schemes that generally are not as attractive as the Federal schemes, but nonetheless are worthy of consideration. These do vary from State to State.

In addition there is also the existing Federal Research and Development Scheme, which is administered via the *Income Tax Assessment Act* and which assists manufacturers improve production, processes and the like. The Federal Government announced in the May Budget that this scheme is to be substantially improved from 2010, but has yet to provide any further details.

Once again your accountants can provide you with valuable advice and assistance in successfully accessing these various grant schemes. Put them to work to assist you to strengthen and grow your business.

Unfortunately the combined effect of the GFC and the CPR will result in the failure of wineries. It is not too late for you to take the required action to ensure that you do not join the failures. The survivors will be around to pick up business as the weak fail and the world economy turns around.

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