

CPA Common Final Examination

BOARD OF EXAMINERS' REPORT

PART B — The Day 1 Report

September 2018 and September 2019 Examinations

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See Part A for full report on Day 2 and Day 3 simulations and marking guides.

THE BOARD OF EXAMINERS' REPORT ON THE SEPTEMBER 2019 COMMON FINAL EXAMINATION

OBJECTIVES OF THE REPORT

The objective of this report is to explain the Common Final Examination (CFE) process and to assist the profession in improving the performance of candidates on the CFE.

The report sets out the responsibilities of the Board of Examiners, the methods used for guide setting and marking the CFE, and the results of the marking process. The report also includes recommendations to candidates from the Board of Examiners.

The September 2019 CFE Report is presented in two parts: Part A is the Day 2 and Day 3 Report and Part B is the Day 1 report.

The appendices provide more detailed information on the design, guide setting, and marking of the CFE, as well as the board's expectations of candidates on the simulations. Readers are cautioned that the marking guides were developed for the entry-level candidate and that, therefore, all the complexities of a real-life situation may not be fully reflected in the content. The CFE report is not an authoritative source of GAAP.

Since the objective of this report is to explain the standard CFE process and to assist the profession in improving future candidate performance, this report is focused on the normal marking process. The Board of Examiners has also issued a separate document that summarizes the marking process and additional steps taken to evaluate candidates' responses due to disruptions involving the September 2019 Common Final Examination. *A Summary of the Board of Examiner's Report, 2019 Common Final Examination*, can be found on the CPA Canada website¹.

RESPONSIBILITIES OF THE BOARD OF EXAMINERS

The Board of Examiners (BOE or the board) comprises a chair, a vice-chair, and sixteen members appointed by the provincial bodies.

The board's responsibilities, as set out in its terms of reference, include the following:

- Setting the CFE in accordance with the *CPA Competency Map* (the *Map*) and other directions from the Professional Education Management Committee;
- Submitting the CFE and the marking guides to the provincial bodies for review;
- Marking the candidates' responses and recommending to the provincial bodies the pass or fail standing that should be given to each candidate; and
- Reporting annually on the CFE to various CPA committees and the provincial bodies, in such form and detail and at such time as is satisfactory to them.

¹ <https://www.cpacanada.ca/en/members-area/profession-news/2019/september/cfe-exam-2019>

The chair is responsible for the supervision of the evaluation process. A CFE subcommittee, made up of 10 members of the board, is actively involved in the preparation of the CFE simulations, the preliminary marking guides, and the setting of the initial passing profile. Selected members of that subcommittee participate in the Preliminary Evaluation Centre where the marking guides are tested against candidate responses and finalized, and in the start-up of the marking centre. The chair and vice-chair provide oversight throughout the entire marking process. The full board is responsible for determining the passing standard.

THE CFE

Preparation and Structure of the CFE

The board staff works in conjunction with authors to ensure that simulations presented to the board achieve the overall intent and design objectives set by the board, while adhering to the competencies and the proficiency levels specified in the *Map*.

The full board provides guidance as to the content and nature of simulations to be included on the examination. It also reviews and refines these simulations to make up the three-paper evaluation set.

Nature of the Simulations

The CFE comprises a set of simulations that are both essential and effective in evaluating the candidates' readiness to enter the profession:

Day 1 – The first paper is a four-hour examination consisting of a single simulation that is linked to the Capstone 1 group case. There are two versions of the linked cases. Version 1 is linked to the most current Capstone case and is written by first time writers and by repeat writers who chose to attempt the new case rather than Version 2 of the previous Capstone case. Version 2 is written by repeat writers and candidates who deferred and are writing Version 2 as their first attempt.

Day 2 – The second paper is a five-hour case, with four different roles and requirements. Additional information tailored to each role is provided in four separate appendices.

Day 3 – The third paper, is a four-hour paper, consisting of three multi-competency area simulations.

Assessment Opportunities

The board applies competency-based marking procedures that enable it to decide which candidates demonstrate readiness to enter the profession.

Assessment Opportunities are designed to answer the question, "What would a competent CPA do in these circumstances?" To attain a pass standing, candidates must address the issues in the simulations that are considered significant.

Appendix A contains a comprehensive description of the evaluation process.

Marking Guides

Marking centre leaders and assistant leaders provide valuable input during the testing and setting of the marking guides, before live marking begins. The board chair, the vice-chair, selected board member(s) and senior evaluations staff hold meetings with the leaders and their assistants during both the guide-setting and the marking processes. See **Appendices B to F** for the HEVW Day 1 simulations and related capstone case, HEVW marking guides, and HEVW sample responses. **Appendix G** contains the marking results by assessment opportunity, and **Appendix H** contains the BOE comments. A copy of the Day 1 V1 (Marmani), Day 2 and Day 3 simulations can be found in **Part A** of the CFE Report. The marking guide and detailed BOE commentary for the Marmani Day 1 simulation will not be published until version 2 is written on the September 2020 CFE.

Day 1 – The marking guide is designed to assess the candidate on the stages of the CPA Way: 1) situational analysis; 2) analysis of the major issues; 3) conclusions and advice; and 4) communication. Based on these four summative assessments, the candidate's response is then holistically judged to be either a passing or a failing response.

Day 2 and Day 3 – Marking guides are prepared for each simulation. Besides identifying the Assessment Opportunities, each marking guide includes carefully defined levels of performance to assist markers in evaluating a candidate's competence relative to the expectations set out by the board when developing the passing profile for a competent CPA.

Five categories of performance are given for each Assessment Opportunity. The candidate's performance must be ranked in one of the five categories:

- Not Addressed
- Nominal Competence
- Reaching Competence
- Competent
- Competent with Distinction

Setting the Passing Standard

The board chair and vice-chair participate in the monitoring of live marking. Near the completion of the marking process, the CFE subcommittee satisfies itself that the markers applied the marking guides as intended by the board.

In determining which candidates pass the CFE, a candidate is judged in relation to the board's pre-established expectations of an entry-level chartered professional accountant. Any changes to the initial profile that were made throughout guide-setting and the marking centre are ratified by the full board. In setting the passing profile, the board considers the following:

- The competency area requirements described in the *Map*
- The level of difficulty of each simulation
- The level of difficulty of each Assessment Opportunity
- The design and application of the marking guides
- Comments from leaders and assistant leaders regarding any marking difficulties encountered or any time constraints noted
- Possible ambiguity of wording or of translation
- Input on critical decision factors from an independent board of three CPAs who review the fair pass package

The Decision Model

The purpose of the CFE is to assess whether candidates possess the competencies required of an entry-level CPA through a written evaluation that is common to all CPAs. Each day of the CFE is unique and is designed specifically to assess different skills:

- Day 1 is linked to the Capstone 1 group case work. It assesses the candidates' ability to demonstrate professional skills. It is independent from Day 2 and Day 3.
- Day 2 is the **depth** test. It assesses technical **depth** in one of four unique roles (that reflect the four CPA elective choices) and provides **depth** opportunities in the common core competency areas of Financial Reporting and/or Management Accounting. Candidates pre-select one role and respond from that role's perspective.
- Day 3 supplements the **depth** test in the common core areas of Financial Reporting and/or Management Accounting. It is also the **breadth** test for all common core competency areas.

Candidates must pass all three days in order to qualify for entry to the profession. Those seeking licensure must obtain depth in Financial Reporting and in the Assurance Role.

Day 1

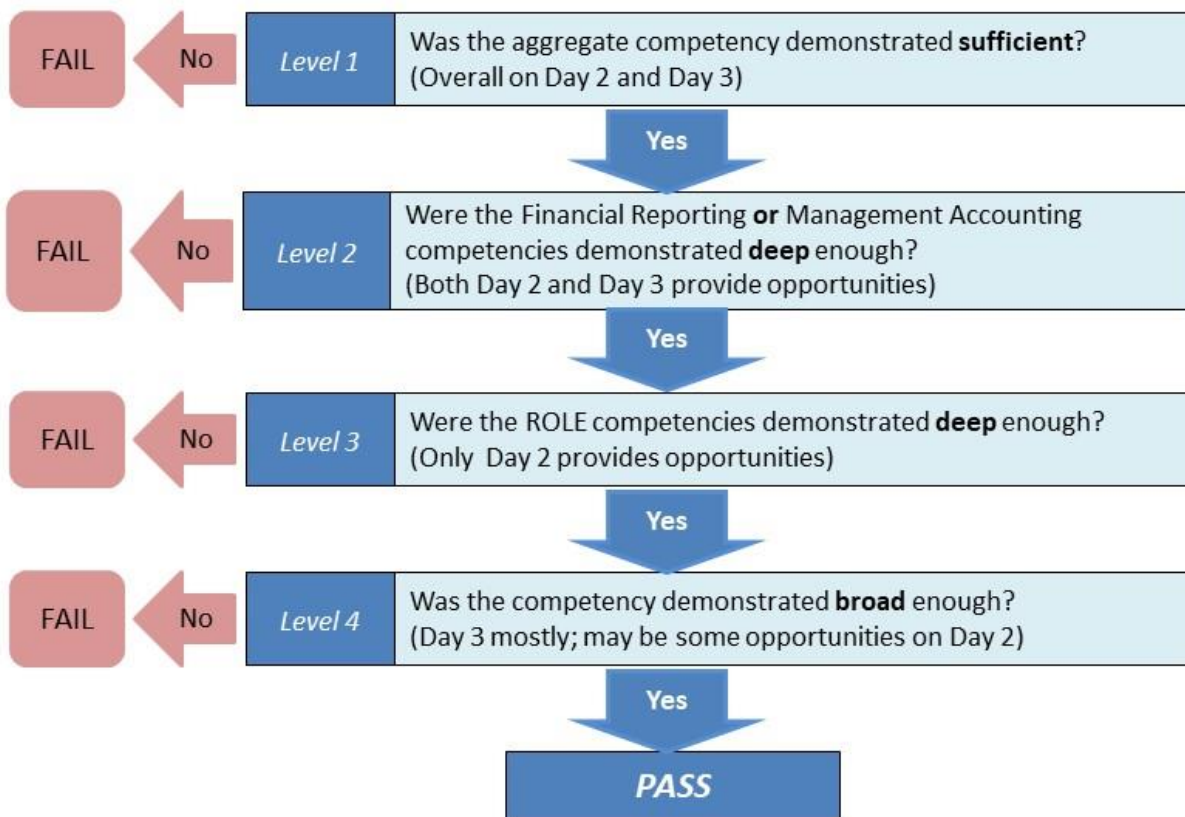
Day 1 is assessed independently from Day 2 and Day 3. A pass or fail decision is made based on a holistic assessment of the candidates' performance in applying the CPA Way to demonstrate essential professional skills.

Day 2 and Day 3

The decision model used by the board is presented in Exhibit I. Four key decision points, or levels, are applied in reaching a pass or fail decision, as follows:

1. The response must be **sufficient**; i.e., the candidate must demonstrate competence in the Assessment Opportunities presented on Day 2 and Day 3 (Level 1).
2. The response must demonstrate **depth** in the common core area of Financial Accounting or Management Accounting (Level 2).
3. The response must demonstrate **depth** in the pre-selected elective role (Level 3).
4. The response must demonstrate **breadth** across all competency areas of the *Map*, at a core level, by not having avoided a particular technical competency area (Level 4).

EXHIBIT I
DAY 2 AND 3 PASS/FAIL ASSESSMENT MODEL



Approving the Results

The CFE subcommittee reviews and approves the marking results for each simulation. Day 1 is assessed separately from Day 2 and Day 3.

Day 1 – The CFE subcommittee discusses the profiles for both the marginally passing and marginally failing candidates to confirm that the board's pre-established passing profile has been appropriately applied by the markers.

Day 2 and Day 3 – As part of the development process, the CFE subcommittee sets preliminary requirements for the three levels (tests of depth and breadth) being assessed on the Day 2 and Day 3 simulations. After the marking is completed, the board reviews and finalizes those requirements. The board establishes the Level 1 (sufficiency) requirement for the combined Day 2 and Day 3 simulations.

During the approval process, the board continues to consider whether the results could be affected by any inconsistency in the evaluation or the board's processes.

Reporting

In reaching its decision, the board determines which candidates pass on a national basis only, without regard to provincial origin or language. Similarly, the detailed comments are based on analyses of the performance of all candidates.

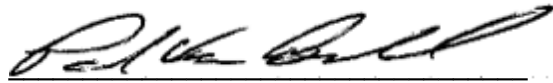
The board reports the following information by candidate number:

- Overall pass/fail standing and pass/fail standing for each of Day 1 and of Day 2 and Day 3 combined.
- A pass/fail standing for Day 1.
- A pass/fail standing for Level 1, Sufficiency. A decile ranking is provided for failing candidates.
- A pass/fail standing for Level 2, Depth in Financial Reporting and/or Management Accounting.
- A pass/fail standing for Level 3, Depth in Role.
- A pass/fail standing for Level 4, Breadth in all technical competency areas.

Thank You

All board members wish to express their warm and sincere appreciation for the outstanding energy, support, and commitment of the small group of Board of Examiners staff members whose dedication and talent contributed in large measure to the achievement of our objectives and the fulfilment of our responsibilities.

We also wish to acknowledge the contributions made by the provincial reviewers, markers, authors, translators, and editors. The commitment, energy, and skill demonstrated by all the markers were outstanding, resulting in the sound application of marking procedures and producing an appropriate evaluation of the candidates. Everyone's commitment to the quality and fairness of the process is appreciated.



Paul Van Bakel, CPA, CA
Chair
Board of Examiners



D. Jordan Oakley, CPA, CA
Vice Chair
Board of Examiners

A MESSAGE TO CANDIDATES

To attain a pass standing, candidates needed to achieve a “Pass” on Day 1 and on Day 2 and Day 3 combined to demonstrate sufficient competence in all areas, plus meet the two depth standards and the breadth standards.

INTRODUCTION

The September 2019 CFE Report, Part A and Part B combined, present detailed information on all candidates' performance for all the examination cases, except for the Day 1 linked case, Marmani Version 1. Commentary on the performance of candidates on Marmani Version 1 is provided in a summary format only, since detailed commentary on Marmani will only be provided after Version 2 is written in September 2020. The simulations, marking guides, marking results, and Board of Examiners' comments on the rest of the examination are found in Part A of the CFE Report. Information on Day 1 (HEVW Version 1 and Version 2) can be found in this document, Part B of the CFE Report.

The intent of this message from the BOE is to draw attention to the most common detracting characteristics observed in candidates' responses to the September 2019 CFE in order to help candidates improve their performance on future CFEs. The comments are based on feedback of the marking teams who marked the entire candidate population. The BOE's comments on the September 2019 CFE are limited to the broad themes noted by the markers. Those seeking the more detailed, AO by AO commentary on candidates' performance should refer to the BOE's comments in Appendix F of Part A or Appendix H of Part B of the CFE Report.

There were significant challenges faced by many of the candidates at the September 2019 CFE writing centres. More detail on the nature of the issues encountered and the steps that the BOE took to ensure that the responses were evaluated fairly can be found in the *Summary of the Board of Examiners' Report* issued in January 2020. The BOE is impressed by the resilience of candidates who wrote the CFE in September 2019. They demonstrated the true qualities of a CPA and performed to the best of their ability when presented with unexpected events. The BOE commends candidates for responding to the simulations thoughtfully and professionally, despite the challenges they faced.

Nature of the CFE

The design of the CFE is such that each day of the examination allows candidates to demonstrate a different skill set. Day 1 allows candidates to demonstrate their high-level professional skills, such as critical analysis, decision-making, and professional judgment, as well as communication. Day 2 allows candidates to demonstrate their technical competence in the common Financial Reporting and Management Accounting competencies and in their chosen role, which ties to one of the four elective areas. Day 2 typically, but not always, directs candidates to the work to be done and is not designed to be time constrained, allowing candidates to demonstrate depth. Day 3 allows candidates to demonstrate depth in the common Financial Reporting and Management Accounting competencies and provides multiple opportunities to demonstrate breadth in all the core technical competency areas. Day 3 is less directive and more integrative than Day 2. It is also time constrained, requiring candidates to prioritize their time per issue.

Strengths and Weaknesses

Time Management

The Day 1 portion of the CFE allowed ample time to read the case and consider the issues. Both the V1 and V2 cases required time to integrate the various parts of the case to be able to identify the underlying strategic issues. The board was pleased by the fact that the majority of candidates appeared to manage their time well on both Day 1 cases and left themselves sufficient time to consider the interrelationships between the issues and draw appropriate, integrative, conclusions.

On both V1 and V2, the Board noted that some candidates chose not to provide a situational analysis at all, proceeding immediately to their issue analysis. These candidates sometimes failed to discuss relevant considerations and trends in their analysis of the issues. Candidates are encouraged to take the time to perform a situational analysis, as it is an important step in assessing the critical changes. In the BOE's view, and as evidenced in some responses, there is a risk of missing key elements when skipping the situational analysis entirely.

The Day 2/Day 3 portion of the 2019 CFE required candidates to manage their time carefully. The Board saw evidence of time management issues on both Day 2 and Day 3.

On Day 2, many candidates spent a disproportionate amount of time addressing the common AOs compared to the role AOs. The teams noted several rushed and very short responses in the role section compared to the common section. The number of pages spent on the role AOs was sometimes as much as two-thirds less, suggesting that some candidates spent too much time on the six common AOs, and ran out of time on their role AOs. This was commonly seen in the Day 2 Finance, Taxation and Performance Management role responses. The BOE believes this was related to the fact that, for the first time on the CFE, the six common AOs contained an equal number of Management Accounting and Financial Reporting AOs and that candidates could easily spend excessive time on the quantitative Management Accounting AOs if they failed to balance and manage their time per AO properly.

Candidates are reminded that there needs to be a balance between the time spent on the common AOs, and the role AOs and that spending too much time on any one AO can hurt performance on another AO. Candidates should bear in mind that when the BOE designs the Day 2 case, it anticipates candidates spending more time on the role AOs than on the common AOs, as they are needed for the depth in role test, which is only on Day 2. In this case, it was important to manage the amount of time spent on the common AOs, to ensure sufficient time remained to address the seven role AOs in sufficient depth.

The Board noted a higher number of candidates skipping or hardly addressing AOs on Day 3 in 2019 than in 2018, which resulted in a higher percentage of Not Addressed (NA) and Nominal Competence (NC). The Board noted that in some cases, the AOs that were skipped on Case 1 and Case 2 were often those that were rated more difficult, suggesting that pressed for time, candidates chose to address the easier AOs first. The AO that was most often skipped was the Assurance AO on Day 3, Case 3 (Tiny). This may have been a conscious choice on the part of the candidates, due to being time constrained, as there was also evidence of rushed or brief responses on one or two AOs on that same simulation. Day 3, Case 1 (SGF) was the longest of the three simulations and had eight AOs to address within the allotted 90 minutes, requiring strong time management skills. If candidates went over the suggested time on Case 1, they would have had difficulty making that time up since Day 3 is designed overall to be time constrained. The higher percentage of NA and NC suggests to the Board that candidates still need to improve their time management skills. The Board continues to encourage candidates to attempt all of the AOs because the CFE has not only depth and breadth tests but also a sufficiency score, which is impacted by skipping issues. The Board also notes, again, that it is important to use the suggested times as a guide to help manage the time spent per AO.

Lack of Support/Generic Discussions

A deficiency that was raised by the board in the 2018 *Message to Candidates* was also apparent in the 2019 responses, across all three days. Some candidates continue to list case facts, typically in point form, without elaborating on why these facts are relevant to their discussion or explaining the relationship to the point being argued. Typically, these candidates were able to sort the case facts into a list of pros, and cons for a decision like AO#4 (Second Optometrist) on Day 3, Simulation 2, but failed to explain why they were categorized as such from a strategic/governance perspective. Similarly, they listed the facts in different categories as part of Day 3, Simulation 3, AO#5 (SWOT), without further explanation. On Day 2, Taxation, AO#11 (Employee Residence), candidates listed the case facts under headings, sometimes under “arguments for resident / arguments for non-resident” and sometimes under “primary tie / secondary tie” but provided little or no explanation as to whether those facts indicated that Amber would be resident or not, or why.

Candidates must ensure that they answer the questions “Why?” or “So what?” when they make any point using case facts. Simply repeating case facts without any further explanation, even if it is in a logical format, is insufficient. The Board is interested in understanding a candidate’s logic and is looking for evidence of the analysis and professional judgment that has been applied in reaching a conclusion.

The Board also noted that some candidates drew conclusions on an analysis that failed to integrate the case facts, resulting in a superficial and generic analysis of the issues and unsupported conclusions. On Day 2, PM role, AO#13 (Departmental Performance Evaluation) some candidates' discussion of the current 360-degree performance evaluation system provided a list of indicators or objectives that were entirely generic. For example, for the Research and Development department, although Elcar's development team works on a direct material (battery) and not on the finished product (car), they recommended performance indicators such as "number of new products developed." Day 2, Taxation, AO#10 (CEO Compensation), is an example of where candidates provided unsupported conclusions, using a "yes/no" or "taxable/ not taxable" list without further explanation. As was noted in 2018, candidates are again reminded that a competent response on the CFE requires supported arguments and defensible positions that are case specific.

There were instances where candidates copied information from the *Handbook* but did not apply that information to the case facts. These "stand-alone" cut and pastes, frequently seen on Day 3, Case 1, AO#6 (NPO Contributions), and Day 3, Case 3, AO#3 (Grant), did not add value to a candidate's response. This is because the role of the CPA is to advise clients on the application of standards. Simply providing the standard is not sufficient. The BOE is interested in seeing the application of the accounting principles, as evidence of understanding by the candidate of the decision-making elements that were considered. The BOE finds more value in a discussion of the fundamental underlying accounting principles than with a cut and paste of the *Handbook* that has no supporting explanation. Candidates are reminded that the *Handbook* is a resource tool to be used to help explain their position and not a stand-alone component of a competent response.

Irrelevant Discussions/ Misinterpretation of the Required

Similar to prior years, there were instances of candidates providing irrelevant discussions, misreading or misinterpreting the requireds. The BOE intentionally reduced the level of direction to some of the issues, which may have resulted in some candidates having more difficulty identifying the correct issue and relevant case facts to discuss on this examination.

On Day 1, Version 2 some candidates thought the heirloom vegetable business was an issue to be analyzed in depth rather than seeing that it was a clue to the broader governance issue. A discussion of expanding the vegetable growing was not intended as a stand-alone strategic decision as there were few case facts presented to analyze and a significant amount of time should not have been spent on this issue.

On Day 2 and Day 3, some candidates tried to find a home for new standards or changes in legislation that did not have a place in the case. For example, in the Day 2, Taxation role, class 14.1 discussions were attempted. And, on Day 3, candidates often tried to discuss the IFRS new lease standard instead of the ASPE lease discussion that was requested on Simulation 1, AO#7 even though the case was clearly in an ASPE context.

The following are some examples of where candidates misinterpreted the requirements. On Day 2, Common AO#3 (Reporting Improvements), some candidates provided a variance analysis of the existing report instead of commenting on ways to improve the reporting. On Day 2, Assurance role, AO#11 (Provincial Grant), some candidates provided special reporting options for the provincial grant agreement. Denise did not ask for this to be provided, and in fact had explicitly stated that she wanted procedures related to an audit report on compliance with an agreement. Therefore, candidates who chose to discuss the various options, such as a Section 9100 report or a review on compliance with agreement, spent time discussing a topic that provided very little value.

Also on Day 2, Assurance role, AO#13 (Environmentally Responsible Actions) some candidates seemed to have misinterpreted the required and/or their role entirely for this AO, taking on an internal role rather than the role of an external auditor and discussed measures that could be implemented to ensure that Elcar meets the statements, others discussed how Elcar could demonstrate that they have met these statements, and some suggested changes to the statements so that Elcar could more easily meet them. These discussions did not address the required. On Day 2, PM role, AO#7 (Comparison of Actual Performance to 2016 Proposal), some candidates mistakenly performed a financial analysis to determine whether Elcar had performed well during this period. Others mistakenly analyzed whether the plan itself was realistic, not realizing that it was historical, having been presented to NHC three years ago. Others revisited the original plan in order to improve it retroactively, which was not what was requested. On Day 3, Simulation 2, AO#3 (KPIs), rather than provide KPIs and valid metrics to assess the performance of VEC, some candidates provided actual-to-budget variance analysis or key success factors.

The Board believes it is an essential CPA skill to be able to analyze and integrate the information presented to identify what is and isn't relevant to the issues raised in the case. Candidates are reminded to read the required carefully, and to take the necessary time, and use their judgment to decide whether a discussion is pertinent to the issues at hand or to their role.

Blending Technical Knowledge and Enabling Skills

Most candidates were able to demonstrate an appropriate level of technical knowledge throughout Day 2 and Day 3 of the CFE. However, they performed better on the more straight-forward and routine issues presented, with some candidates avoiding the more difficult issues.

The BOE consciously includes more challenging and unique topics, like the artwork in the Assurance role, the cash flow projection and cost-cutting in the Performance Management role, the cryptocurrency in the Taxation role, and the NPO contributions on Day 3, Simulation 1, in order to present situations for candidates to demonstrate judgment, and their ability to draw on first principles to work through an issue where there is no clear guidance, or an issue they have never seen before. Although there is no doubt that success on the CFE requires a strong foundation of technical knowledge to clearly demonstrate competence, the ability to handle new and difficult issues is critical. With technical knowledge changing at a faster and faster pace, it is important for candidates to be able to draw on first principles, explore alternatives, and use their professional judgment and common sense to tackle the issues presented. The BOE will continue to present new and challenging topics on the CFE and encourages candidates to use their enabling skill set to respond to the issues.

Day 1

Comments Specific to Day 1 (Marmani, Version 1)

Most candidates dedicated the first section of their response to a situational analysis. Most used their situational analysis later in their response, making links back to the work they did while analyzing the specific issues or within their conclusions. Some candidates chose not to provide a situational analysis and proceeded directly to their issue analysis and as a result missed key elements in their discussion of the issues.

There were three major issues that candidates were expected to analyze from both a strategic and operational perspective: 1) sell or expand Adaptive 2) expand Athleisure into online sales, and 3) hire Matthew and his team to manage the Athleisure Division. There was one additional, minor issue, the sales team compensation issue, that candidates should have also discussed, but in less depth. Candidates were expected to provide an in-depth, qualitative discussion of each of the major issues while also showing an acceptable level of numeracy skill in their discussion of these issues. Candidates were also expected to identify the management time constraint and consider how it affected each decision, and how each decision would affect Marmani on a more holistic level.

Overall, most candidates did a good job of analyzing the issues to be addressed that were presented in the case. There were three main differentiating factors that separated strong candidates from weak candidates in terms of their analysis. First, strong candidates tended to provide balanced discussions for each issue analyzed whereas weak candidates tended to lean toward either just the pros or just the cons of each issue. Second, strong candidates provided the implications of the case facts that they included within their analysis. Weak candidates tended to simply list case facts without providing the “so what?” Third, strong candidates highlighted and discussed the qualitative points that were most critical to the decision at hand, such as, for example, the management time constraint. Strong candidates recognized this critical issue and assessed how each decision would affect the constraint.

Most candidates concluded that it was not realistic for Marmani to expand either Adaptive or Athleisure, let alone both, if the company did not hire additional management. Most candidates recognized that Matthew and his team were not a good fit for Marmani and therefore recommended against hiring Matthew and his potential management team. Many candidates recommended an alternate approach, expanding both divisions, since both expansions aligned with the company's mission and vision and appeared to be lucrative, and hiring additional management to alleviate the burden on the current team.

Most candidates approached their response in a coherent and organized fashion. Only a few candidates struggled to effectively communicate their ideas. These candidates tended to use poor sentence structure, confusing syntax and an unorganized response approach.

Additional Day 2 and Day 3 Comments

None provided. See Appendix F of Part A and Appendix H of Part B of the CFE Report for more detailed commentary.

APPENDIX A

**EXAMINATION DESIGN, MARKING GUIDE DEVELOPMENT, AND MARKING
OF THE COMMON FINAL EXAMINATION**

CFE Design

Day 1 is one four-hour case that is linked to the Capstone 1 case, which is worked on in groups for eight weeks prior to the CFE. When writing the Day 1 case, candidates are allowed access to their Capstone 1 case but not their group's answer or any sample response. The Day 1 case is designed to assess the enabling (professional) skills. Candidates are directed to *not* perform any detailed technical analysis, but rather to target a “board room and senior management” level of discussion, with high-level analytics. There are two versions of the Day 1 case. Candidates preselect the version they will write.

Day 2 is one four-hour case that candidates are given five hours in which to respond. The extra hour gives candidates time to filter and find the information that they need to answer *their* role requirements from within the common information presented. Day 2 is designed to assess the technical competencies in **depth** (Level 2 and Level 3). Candidates pre-select a role (Assurance, Finance, Taxation, or Performance Management). All candidates work with the same case — it has a common section and four sets of appendices containing additional information applicable to each of the four unique roles. The required tasks, regardless of the role, are clearly directed, unless there is an undirected/enabling issue in the case that the board expects candidates to identify on their own. Day 2 evaluates the competencies listed in the *CPA Competency Map* mostly in the elective area and in common Financial Reporting and/or Management Accounting areas in **depth**. The role **depth** test (Level 2) may also include coverage of other competency areas from the common core.

Day 3 is a four-hour examination containing a mix of small cases (60 to 90 minutes each) that evaluate the common core competencies only. The Day 3 cases provide additional opportunities for **depth** in Financial Reporting and Management Accounting and all the **breadth** opportunities for all the technical competency areas. Cases are time constrained, and they are designed to cover different competency areas within each case. A higher level of integration and judgment is required on Day 3 of the CFE than in the core modules, although the technical competencies are tested at the common core level of expectation.

The assessment opportunities on the Day 2 case are given mark values such that each of Day 2 and Day 3 are weighted equally.

The Development of Marking Guides and the Provincial Review Centre

Approximately three months prior to the Common Final Examination booklets being published, provincial reviewers meet to examine the simulations and the preliminary marking guides. The provincial reviewers' comments are then considered by the board when it finalizes the examination set and again when the senior markers review the marking guides in the context of actual responses.

The September 2019 CFE Marking Centre

From the marker applications received, approximately 280 individuals were chosen to participate in the September 2019 CFE marking centre. The criteria for selection included marking experience, motivation, academic achievement, work experience, personal references, and regional representation. The marking was supervised by the CPA Canada Evaluations and International Assessment full-time board staff (6 staff).

The Day 1 Marmani Version 1 linked case was marked by a team of 30 people in Montreal from October 9 to October 22, 2019. The Day 1 HEVW Version 2 linked case was marked remotely by a five- member team from September 25 to October 17, 2019. [See the September 2018 Board of Examiners' Report for details on the Day 1 HEVW Version 1 marking centre.]

The Day 2 Common assessment opportunities were marked by a separate team from the role teams. Day 2 Common was marked in Montreal by a team of 61 people from October 8 to 22, 2019. Day 2 Assurance was marked by a team of 54 people in Montreal from October 8 to October 22, 2019. Day 2 Performance Management was marked by a team of 20 people in Montreal from October 9 to October 20, 2019. The other two Day 2 roles (Taxation and Finance) were marked by a total of 13 people, remotely, from September 27 to October 7, 2019, immediately following the preliminary evaluation centre.

All three Day 3 cases were marked remotely from October 11 to October 28, 2019. The Day 3 simulations were marked by a total of 97 people.

Before the marking centre, the members of the CFE subcommittee, staff, leaders, and assistant leaders attended a five or six-day preliminary evaluation centre (PEC). Participants reviewed the marking guides, applied them to randomly selected candidate responses, and made necessary revisions to the marking guidelines, taking into account the written comments on the marking guides received from provincial reviewers.

At the beginning of the marking centre, the leaders and assistant leaders presented the marking guides to their teams, while staff, the BOE chair, the vice-chair and select BOE members supervised. The teams undertook a two-phase test-marking procedure prior to actual marking. Phase one consisted of marking guide familiarization, during which markers applied the marking guide to copies of candidates' responses and collectively reviewed their results. Phase one thus ensured that all markers understood the issues in the marking guide and the basis on which to apply each expectation level. Phase two consisted of an expanded test marking of several responses to establish marker congruence.

After the training and test-marking phases, and only when marker congruence was achieved, live marking commenced. All teams, for all days, had a leader, and anywhere from one to six assistant leaders, and had both French-speaking and English-speaking markers. Each team had one or more markers who marked in both languages.

The board strives for the highest possible marking consistency and quality control. Leaders and assistant leaders therefore devoted much of their time to cross-marking and other monitoring activities. Markers' statistics were reviewed to ensure that marking remained consistent throughout the centre. Based on analysis of the statistics, leaders reviewed and, if necessary, re-marked papers to ensure that the assessment opportunities were marked fairly for all candidates. Bilingual markers marked papers in both languages, and their results were compared to ensure that the marking was consistent in both languages.

Borderline Marking (Day 1)

Each candidate's paper was marked once. All candidates' responses that were assessed as clear fail, marginal fail, and marginal pass were marked a second time by the team leader, an assistant team leader or a senior marker. Clear pass results were also audited to ensure accuracy of marking.

Double Marking (Day 2)

Each candidate's Day 2 paper was marked independently by two different markers. If the two initial markings differed on any assessment opportunity, an arbitrator (the leader, the assistant leader, or a senior marker) compared the two initial markings and determined the final result.

As an added measure to ensure that markers were consistently applying the marking guide, a two-day rule exists that results in the second round of marking not beginning until two days have elapsed since the first marking. Adherence to this rule ensures that any movement in the application of the marking guides due to marker interpretations during the first two days of live marking are stabilized before the second marking and arbitration procedures begin.

Borderline Marking (Day 3)

Day 3 was marked using a borderline model. All Day 3 responses were marked once and then the Day 2 and Day 3 results were combined. All failing candidates who passed the Day 2 role test, had their Day 3 response marked a second time by an independent marker, and any differences between the first and second markings were arbitrated by a leader or senior marker.

Subsequent Review of Results and Request for Performance Analysis

Failing candidates may apply for a review and remarking of their examination results and/or a performance analysis for either Day 1, or Day 2 and Day 3, or for all three days.

Review and Remarking Approach

Great care is exercised in the original marking and tabulating of the papers and results. The following review and marking procedures are applied to all three papers constituting the Common Final Examination.

Under the supervision of the chair of the Board of Examiners, as well as CPA Canada Evaluations and International Assessment staff, the responses are reviewed by the leaders and assistant leaders who did the original marking. The leaders and assistant leaders read the responses and compare them to the marking guides used at the marking centre. In reviewing candidates' results, two aspects are considered. First, it must be determined that the basis of marking the papers has been consistent with that accorded other candidates who wrote the examination. Second, all responses reviewed are subjected to a careful check to ensure the markers have indicated that consideration has been given to all material submitted by the candidate.

The results are then tabulated and the decision made regarding whether any candidates have been treated unfairly and should be granted a pass on the examination.

The review and remarking results are then forwarded to the provincial bodies for notification of the candidates.

APPENDIX B

**CAPSTONE 1
HEVW BACKGROUND CASE**

Capstone 1

Heartbreak Estates Vineyard & Winery Ltd. — Case

(All dollars are Canadian dollars unless specifically stated otherwise.)

It is February 1, 2018, and you are employed as a CPA with Bennett & Robertson LLP (BR), a local CPA firm in Picton, Ontario, offering a full range of accounting, tax, audit and advisory services to clients. Jean Bennett, a founding partner of BR, is Heartbreak Estates Vineyard & Winery Ltd.'s (HEVW) adviser. You are part of the team assigned to prepare a report for the owners of HEVW.

HEVW's two owners, Andrew and Geneviève (Jenny) Heartwood, recently engaged BR because the company's accounting and regulatory reporting was overwhelming Jenny. After discussions with Jean, the Heartwoods now realize they need advice from professionals to facilitate the growth of HEVW into a medium-sized vineyard and winery. Andrew and Jenny want BR to complete a strategic analysis and provide recommendations related to planting the remainder of their acreage and building an on-site winery and tasting room. The results of this analysis will be included in their business plan. A decision must also be made on the distribution channel and price for their wine, keeping in mind their goal of becoming a premium estate winery. As well, an educational institute has approached HEVW about a strategic partnership, and BR must analyze this potential opportunity. HEVW's business plan will be presented to prospective investors, lenders and strategic partners, and will need to include draft pro forma financial statements reflecting the recommendations. There are also many financing, tax planning and operational issues that Andrew and Jenny would like BR to address.

The following information has been compiled for the engagement team to review and analyze. Andrew has also compiled a list of terms used by the wine industry (Appendix XI).

Heartbreak Estates Vineyard & Winery Ltd.

HEVW is a privately held vineyard located in Prince Edward County, Ontario. Currently, one-quarter of its land is planted and produces premium grapes, which are made into wine at a nearby winery. HEVW's 2016 "First Heartbreak" Pinot Noir won the Gold Pinot Noir Award at the 2017 Ontario Wine Awards. Andrew also received the Young Winemaker Medal. The Heartwoods are seeking to expand the vineyard and establish a winery and tasting room because of a deep love of the vineyard, winemaking and wine.

Industry information

Consumer preferences

Wine consumption in Canada is growing three times faster than globally, and total domestic per-capita wine consumption is approximately 15 litres per year.¹ Industry statistics show that current consumption trends are favourable for the domestic wine market, especially for producers of premium wines. There is also a growing interest in organically grown grapes.

Wine accounted for 15.8% of the total volume of alcohol sales in Canada in 2014/2015 (up from 12.4% in 2005/2006),² with 59% of Canadians preferring red wine (consumption of red wine has grown by 6.8% since 2014³).

Premium wines tend to be made from grape varieties recognized by the Vintners Quality Alliance (VQA) and are grown following sustainable growing practices. The grapes are handled gently throughout the harvest and winemaking process, usually under the direction of a winemaker known for making quality and award-winning wine. Most premium wines are featured in fine restaurants, which prefer to carry at least one red and one white wine from a premium brand. These wines are able to command a higher price, which is also paramount for branding.

Vitis vinifera (common grape vine) is native to the Mediterranean and southwestern Asia, and produces both red and white grapes that contain high amounts of sugar and tartaric and malic acids, making them excellent grapes for premium winemakers. Until the late 1980s, the Canadian wine grape industry was based on hybrid varieties. Recently, however, there has been a conversion of plantings to the *Vitis vinifera* varieties. The most popular white *Vitis vinifera* varieties in Canada are Chardonnay, Pinot Blanc, Pinot Gris, Riesling and Vidal. The most popular red *Vitis vinifera* varieties in Canada are Cabernet Franc, Cabernet Sauvignon, Marechal Foch, Merlot and Pinot Noir.

Market demographics

Adults of drinking age can be divided into three broad generations: baby boomers (boomers), generation X (gen-Xers) and millennials. Each generation has unique preferences and buying habits.

The growth in the premium wine market can be attributed to the aging boomers, who, in or nearing retirement, have accumulated significant wealth over their lifetime and can afford to spend money on luxury items such as premium wine. Wine is the preferred dinner beverage for this demographic, and their consumption of premium wine is expected to increase for a number of years.

¹ <http://www.cbc.ca/news/business/per-capita-canadian-wine-consumption-now-15-litres-a-year-1.1412093>

² <http://www.statcan.gc.ca/daily-quotidien/160510/cg-b002-eng.htm>

³ <https://www.thestar.com/business/2015/02/17/canada-among-the-worlds-top-consumers-of-imported-wine.html>

Millennials, born between 1980 and 2000, are driving a changing landscape for the wine industry and, by 2020, will represent one in three adults.⁴ Millennials represent the largest cohort in the workforce at 37% in 2014.⁵

The following are some important facts⁶ about the attitudes of the millennial generation:

- 89% expressed a stronger likelihood they would buy from companies that supported solutions to specific social issues.
- Millennials account for more than \$1 trillion in consumer spending in the United States.
- 87.5% of millennials disagreed with the statement that “money is the best measure of success,” compared to approximately 78% of the total population.
- 63% of millennials want their employer to contribute to social or ethical causes they feel are important. About half of older gen-Xers and boomers felt the same.
- 64% of millennials would rather make \$40,000/year at a job they love than \$100,000/year at a job they think is boring.
- 19% of millennials agreed with the statement, “most people can be trusted.” This compares to 31% of gen-Xers and 40% of boomers.
- 83% of millennials agreed with the statement, “there is too much power concentrated in the hands of a few big companies” — more than all other generations.
- The average investor aged 21 to 36 has 52% of their savings in cash, compared to 23% for other age groups.

When it comes to wine, millennials have different preferences than gen-Xers and boomers:

- Millennials do not pay attention to expert wine reviews. They place more value in wine recommendations from their peers.
- Millennials value the stories behind the wines and the opportunity to experience a personal connection with the vineyard.
- Millennials look for quality, but at a reasonable price, as they have less money to spend.
- Millennials prefer to drink wine with friends in an informal setting and are more likely to buy wine by the glass than a bottle in a restaurant.

⁴ www.brookings.edu/.../11-facts-about-the-millennial-generation

⁵ <http://www.canadianbusiness.com/innovation/the-millennial-majority-workforce/>

⁶ www.brookings.edu/.../11-facts-about-the-millennial-generation

- Millennials are technologically savvy, environmentally engaged and eager for stories about the things they love.⁷
- Both boomers and millennials prefer red wine over white.⁸
- Recently, millennials have been showing an interest in red blends as well as Riesling, Chardonnay, Cabernet Sauvignon and Pinot Noir.⁹ Riesling, Chardonnay and Pinot Noir have shown increasing popularity through Liquor Control Board of Ontario (LCBO) sales.¹⁰

Results from a survey of wine-drinking millennials¹¹ showed the following:

- 86% buy a bottle or glass of wine they've never tried before at least two to three times a month.
- 22% subscribe to a print wine magazine, newsletter or other publication.
- 85% have met someone after work for a glass of wine at least once in the past month.
- 43% have visited four or more winery tasting rooms in the past 12 months.
- 61% have commented on wine on Facebook or read the wine comments of others on Facebook in the past month.
- 72% have posted a photo on Facebook, Instagram, Pinterest or other social media platform showing wine they enjoyed in the past month.

Wine on tap is becoming more popular, and millennials in particular are flocking to restaurants offering good-quality wine on tap. They are also open to wine in different packaging types. Boxed wine is more accepted by the younger demographic, with almost half saying boxed wine is just as good as bottled wine.¹²

Tourism and the wine industry

Each year, wine-related tourism welcomes more than three million visitors to Canada, indirectly generating more than \$1.2 billion annually in tourism revenue and employment.¹³ Chinese tourists play a key role, numbering over 440,000 visitors and spending more than \$1 billion annually. Chinese tourists prefer high-end wine products.¹⁴ There is still an over-reliance on domestic visitors, however, and Canada competes with California, France, Australia and New Zealand, which are well-recognized wine regions. Yet Canada does enjoy a competitive advantage in wine

⁷ <https://www.wsj.com/articles/how-millennials-are-changing-wine-1446748945>

⁸ Ibid.

⁹ <http://marketwatchmag.com/millennials-and-wine-december-2015/>

¹⁰ https://wgao.ca/wp-content/uploads/2016/03/Shari_MogkEdwards_Presentation.pdf

¹¹ <https://www.wsj.com/articles/how-millennials-are-changing-wine-1446748945>

¹² <https://www.specialtyfood.com/news/article/wine-tap-popular-among-millennials/>

¹³ <http://www.canadianvintners.com/2013/03/05/canadian-wine-and-grape-industry-contributes-6-8-billion-in-economic-impact-to-canadian-economy/>

¹⁴ http://tiac.travel/Library/TIAC_Publications/vintner_report_2015_FINAL.pdf

tourism, including well-marked wine routes, free online wine route planners, top restaurants located in and around wineries, and wine festivals and events.¹⁵

Direct sales at the vineyard are critical to a winery's success.¹⁶ Tourists appreciate hearing the story behind the wine and they like to feel a relationship with the winemaker. Vineyard tours attract visitors and are key to driving increased wine sales, enhancing brand awareness and helping to differentiate between each wineries' products.

When building a winery, incorporating elements that will encourage tourism, such as safe viewing of the production processes and wine production, will yield more visitors. In addition to wine quality, elements that encourage tourism include:¹⁷

- a sufficient number of knowledgeable, friendly staff on hand during business hours
- exterior attractiveness (such as architecture, car parking facilities and signposting)
- ambience (such as interior design, furnishing, decoration, equipment, order and cleanliness)
- merchandise articles and brochures

Many Canadian wineries already incorporate these elements into their operations; as such, they must seek ways to differentiate themselves, such as offering unique culinary experiences, cooking courses and special events.¹⁸ Some best practices related to wine tourism include:¹⁹

- wine roads/routes
- wine community partnerships
- special wine events and festivals
- experiential wine programs
- linking wine production to regional tourism
- unique partnerships (such as with golf courses and spas)
- wine villages
- focus on art and architecture
- food and wine pairing
- green tourism/ecotourism

¹⁵ Ibid.

¹⁶ http://academyofwinebusiness.com/wp-content/uploads/2014/07/TE03_Ratz_Juliane.pdf

¹⁷ McDonnell, A. and Hall, C. M., "A framework for the evaluation of winery servicescapes: A New Zealand case" (2008), available at: http://www.pasosonline.org/Publicados/6208special/PS0208_7.pdf (accessed 28 November 2008).

¹⁸ Hashimoto, A. and Telfer, D.J., "Positioning an Emerging Wine Route in the Niagara Region: Understanding the Wine Tourism Market and its Implications for Marketing" (2003), in Hall, C.M. (Eds.), *Wine, Food and Tourism Marketing*, Haworth Pr Inc., New York, pp. 61-76.

¹⁹ <https://lizthachmw.com/2013/12/06/12-best-practices-in-global-wine-tourism/>

- unique wine tours (such as wine and kayaking)
- social media for wine tourism

Having a social media presence has become critical to promote wine tourism. Higher brand awareness, increased tourism and greater sales can be supported by social media. If effective, social media can create a positive brand conversation that entices consumers to visit winery locations or the winery website.²⁰

Legal and regulatory environment

Vineyards are regulated by the Ontario Farm Products Marketing Act. The majority of grape growers in Ontario belong to the Grape Growers of Ontario, which advocates on their behalf. The Vintners Quality Alliance Ontario administers and enforces the Vintners Quality Alliance Act (VQA Act), which sets the framework by which standards for the production of VQA wine and appellations for wine-growing regions are established. Vineyards seeking organic certification may also need to comply with federal Organic Product Regulations and Standards.

The wine industry is highly regulated as the LCBO controls the sale and distribution of all liquor for the province of Ontario. The LCBO sells liquor through its own retail stores and website. The Alcohol and Gaming Commission of Ontario (AGCO) grants licences for the sale of liquor at non-LCBO locations, which include independent winery retail stores, restaurants and wineries.

The sale of wine is heavily taxed via several different levies and fees:²¹

- Bottle deposit: A refundable bottle deposit of \$0.20 is charged to the consumer on each bottle of wine.
- HST: Wine is taxable for HST purposes, and is charged on the basic selling price, excluding the bottle deposit.
- AGCO fees: The AGCO charges the following taxes²² on the sale of wine:
 - Basic tax: 6.1% of basic selling price — this is not charged when wine is sold in the LCBO stores
 - Environmental tax: \$0.0893 per unit (bottle) sold
 - Volume tax: \$0.29 per litre of wine
 - Excise tax: the federal government charges excise tax on alcohol, including wine, but wine made from 100% Canadian agricultural products is exempt

Because of the regulations in place, wineries can't get grapes at the price and quality

²⁰ <http://www.winebusiness.com/news/?go=getArticle&dataid=96151>

²¹ <https://hellolcbo.com/ci/fattach/get/93163/0/session/L2F2LzEvdGltZS8xNDk2NzcxNjM5L3NpZC9lbC1rRnNrbg==/filename/Pricing+Examples+April+2017.pdf>

²² <http://www.fin.gov.on.ca/en/tax/bwt/>

they want and, as a result, are usually vertically integrated. Estate wineries would prefer to invest in marketing their product, but instead, they invest in vineyards to ensure they produce quality grapes below the current pricing model for wholesale grapes.

The net revenue of wineries is also significantly impacted by its distribution channel(s):

LCBO retail stores

The LCBO has over 650 retail stores and more than 210 agency stores in Ontario that sell beer, wine and spirits. In order to have a product listed for sale through the LCBO, a business (or agent acting on behalf of the business) must apply to the LCBO through a comprehensive, multi-phase application process, and products are accepted based on identified needs, consumer trends, sales and marketing plans, and product differentiation, among other criteria.²³

When products are accepted and sold via the LCBO, they are subject to a prescribed markup on the basic price net of taxes and a wine levy (which the LCBO charges in addition to the taxes and fees described earlier). The LCBO has been increasing the markup by 2% each year over the past several years (Appendix VI).

Liquor sales licences

The AGCO grants a variety of licences to sell liquor, and these licences can be divided into two main categories: licensees and winery retail. The application process takes between 10 to 12 weeks, but may take longer if risks are identified requiring further investigation. Applicants are required to detail specific information about their premises and business, as well as personal and financial information. Applications require a completed municipal information form as well as an agency letter of approval from the local fire, building and health departments. Applicants will undergo licensing inspections and may be required to hold a public hearing.

Licensees: A licensee, such as a restaurant or independent retail store, purchases wine at a 10% discount, calculated on the basic price. These wine sales are subject to the same taxes and levies as wine sold via the LCBO, with the exception of the LCBO markup and the wine levy. The licensee can set its own price to sell the wine to the consumer.

Winery retail: Wineries are permitted to sell wine they make themselves at an on-site retail store, and, by law, must sell the wine for the same price as at an LCBO store. This category also includes wine bottled under licences for other wineries, and direct sales such as wine mailing clubs. These wine sales are also subject to the same taxes and levies as those sold by other licensees, but are not subject to the 10% discount.

²³ <http://www.doingbusinesswithlcbo.com/tro/Forms-Documents/pmpp/files/assets/downloads/publication.pdf>

Soil and climate

Choosing a vineyard site on a south-facing slope contributes to good air drainage, allows for the greatest exposure to the sun, as sunlight is absorbed through the vine leaves and is converted to sugar, and avoids frost.

There are certain regions in Canada that enjoy a climate that is ideal for growing grapes. One such region is the Niagara Escarpment, where the ground warms up in the spring and cool air is drawn inland from Lake Ontario. This cool air delays bud bursts on the vines, which prevents potential damage from late spring frosts.²⁴ Other regions with climates ideal for grape growing are those with lands in close proximity to a large body of water, where the water has a moderating effect on the air temperatures.

Canadian grape farmers face an added challenge when dealing with Mother Nature, and unseasonably cold Canadian winters have been known to destroy crops. For example, in 2014, a polar vortex wreaked havoc on the vineyards in southern Ontario, with the Merlot and Sauvignon Blanc grape varieties suffering very low bud survival rates. After the incident, some southern Ontario farmers decided to replace their Merlot with hardier grape varieties.

Canadian grape farmers have implemented techniques to protect the vines when the temperature falls below –23 degrees Celsius. Some vineyards in Ontario's wine regions have built bonfires throughout the vineyards, rented helicopters to fly over the vines or purchased large wind machines to keep the cold air away from the vines. Hardy cool-climate grapes include Cabernet Franc, Cabernet Sauvignon, Chardonnay, Gamay, Gewurztraminer, Merlot, Riesling, Sauvignon Blanc, Syrah, Pinot Blanc and Pinot Noir. The appropriate cool climates for growing grapes for wine are characterized by a long period of growth and sunshine with little cloud cover.

In addition to the damage inflicted by cold weather, hot and wet weather can also destroy crops. Hot weather can cause grapes to dry out and become overripe. In the spring, heavy rains can knock blooms off the vines. At harvest time, excess water resulting from wet weather can cause the grapes to swell and burst, and mildew can spread among the vines.

Even a perfect growing season can cause overproduction and the quality of the wine may suffer. It is standard practice for growers to trim off excess grape bunches to ensure that the remaining grapes ripen to become more flavourful and complex. A smaller yield is often preferred if the goal is to produce a premium wine, which will hopefully yield a higher value when the time comes to sell the bottled wine.

Company background and operations

Andrew attended university in Burgundy, France, to continue his studies as a grape grower and winemaker. There, he gained a deep passion for the famed dry, red wine

²⁴ <http://escarpment.org/travel/highlights/wineries/index.php>

of the region, Pinot Noir. It is also where he met his wife, Jenny, who was born in Burgundy and grew up on an estate winery. Shortly after meeting, Andrew and Jenny started making plans to establish their own vineyard in Canada. Andrew knew that the soil where his family operated a vineyard did not have the right conditions to grow Pinot Noir, and his research led him to the newest wine region in Ontario, Prince Edward County.

Andrew and Jenny purchased 40 acres of land in 2012. The land is located on a rolling south-facing stony hillside in the northwestern corner of Hillier, a community in Prince Edward County that borders the main road tourists use to travel to other wineries as well as to Sandbanks Provincial Park, which enjoys over 750,000 visitors per year. The hill on which the land is located attracts the sun and appears to repel rain and frost. This particular plot of land has fairly fertile clay with limestone gravel, and Andrew and Jenny have found it to be very similar to the soil in Burgundy. The morning fog gives way to moderate temperatures during the day, enabling the fruit to stay relatively cool during the prime growing season and allowing for maximum time on the vine with optimal flavour development. The vineyard is just over a kilometre from Lake Ontario and enjoys the moderating effects of the breezes from the warmth of the lake.

Andrew and Jenny married and began the vineyard while living in a rundown farmhouse situated on an additional quarter-acre of land, adjacent to their vineyard. Andrew and Jenny purchased the farmhouse and the quarter-acre of land for \$25,000 from the farmer who previously owned the vineyard. In the spring of 2013, Andrew planted Pinot Noir rootstock on 10 acres, leasing back the remaining 30 acres to the farmer who sold them the land, for \$75 per acre per year. Andrew oversees the vineyard and Jenny handles all administration.

The first Pinot Noir grapes were harvested in the fall of 2015 and the wine was released for sale in the fall of 2016. While establishing HEVW's vineyard and to generate income, Andrew has been the resident winemaker at County Winery (CW), a neighbouring and well-established Prince Edward County winery.

Currently, HEVW is operating as a "virtual" winery at CW — HEVW's grapes are pressed into wine and the wine is aged in barrels for approximately 12 months, at which time it is bottled, under licence at CW, and released for sale. HEVW pays CW for all winery services, including bottling costs, when the grapes are pressed.

50% of HEVW's wine has been sold at CW's retail store for a 10% commission on the gross retail selling price, but the wine is not offered at the CW tasting bar. 40% of the wine is sold through a wine club HEVW established under CW's licence. Both the wine sold by CW and the wine sold through the wine club are classified as "winery retail" for LCBO and taxation purposes. The remaining 10% of HEVW's wine is sold to a few local restaurants that support Prince Edward County wines. The restaurants are all licensees with the AGCO.

Demand has been good and HEVW has been selling all of the wine it bottles within the year it is released for sale. CW currently has excess bottling capacity of 40,000 bottles annually, which HEVW can use. CW will sell up to 3,000 cases of HEVW wine from its retail store, but this could be reduced at any time, as CW's priority is selling its own wines.

Andrew and Jenny have invested a great deal in their vineyard, financially, physically and emotionally. They know that small wineries don't typically generate large profits and they don't expect to be handsomely rewarded in this business. Andrew and Jenny want their business to provide a reasonable margin and to be a rewarding future for their family, with target revenues of no less than \$2,000,000 but no more than \$5,000,000. Working capital will be required to sustain the business while the future vineyards reach 100% production, which will take another five to six years. Jenny has suggested that this may mean exploring other revenue opportunities in the interim to supplement the sales revenue of the wine produced from the current Pinot Noir vineyard.

Vision statement

Grow the finest grapes, let them shine in the finest wine and attract all types of people from all places to see where the magic happens at our vineyards in Prince Edward County, Canada.

Mission statement

Our **vineyards** will grow premium *vinifera* grapes, and we will use hand labour and sustainable farming methods to care for the grapes to the point of harvest.

Our **winery** will produce premium wines, which are the best expression of our unique terroir, with minimal intervention and minimal impact on the environment.

Our **wines** will please the most discerning wine lover's palette, and we will introduce fine wine to an entirely new wine loving demographic.

Our **business** will provide a satisfactory profit to enable the owners to focus on this business with sufficient returns to fund future growth goals.

Company structure

HEVW is a limited company owned equally by Andrew and Jenny, who incorporated the company for a nominal value. While there is no formal Board of Directors, Andrew's father, John Heartwood, acts as the couple's industry adviser.

Management team

Andrew is from a fourth-generation family of farmers in Niagara-on-the-Lake who converted their 250 acres of farmland to vineyards over a 15-year period from 1978 to 1993. Throughout this period, new winemakers moved to the region, believing that southern Ontario was ideally suited to grow the same varieties of grapes that are grown in Europe.

Andrew spent many years as a child, alongside his two brothers, helping to plant and tend the vines. The family sells their grapes to established winemakers in the Niagara region. The name of their vineyard has been featured on the label of premium VQA wines from several reputable wineries over the years. They are well known for their Chardonnay and Cabernet Sauvignon grapes, but they also grow several other varieties. They attempted to grow Pinot Noir, but after several failed attempts, Andrew's father replaced the vines with more hardy *Vitis vinifera* and hybrid vines.

After graduating from Brock University in 2008 with an undergraduate degree in oenology and viticulture, Andrew expressed an interest in pursuing winemaking and in growing high-quality grapes. His father, John, supported him and funded his education in France, where Andrew earned a master's degree in vineyard and winery management from the Université de Burgundy. Throughout his studies, Andrew gained hands-on experience learning about the inner workings of a winery. He knew the experience would be invaluable and he learned to clean and repair almost every pump, conveyor, tank and other piece of equipment used in a winery.

Jenny grew up as the daughter of a small vineyard owner and resident winemaker in Burgundy. She studied history at the Université de Burgundy. Jenny was actively engaged in managing the small family vineyard operation before marrying Andrew and immigrating to Canada.

Financing

Andrew borrowed \$750,000 from his father against his interest in the family vineyard in Niagara-on-the-Lake. The borrowed monies were used to fund the purchase of the 40 acres of land and the immediate development of 10 acres. The 250-acre vineyard in Niagara-on-the-Lake was recently appraised at \$70,000 per acre. John owns 50% and each of his three sons have a one-sixth ownership interest.

John told Andrew that he would not charge interest on this loan until the Pinot Noir grape vines were at 100% productivity, which occurred in 2017. Interest is charged at a rate of 6% while the loan is outstanding. Andrew has agreed to forego any claim to dividends on the family vineyard while the loan is outstanding.

Andrew can borrow against his remaining interest in the family vineyard from his father to finance expansion, but only if he can demonstrate that HEVW can repay the loan over 15 years and that HEVW will show profitability within five years. Andrew has the

option to sell his interest in the family vineyard outright, but he is legally obliged to sell it to family members. Andrew's brothers have young families and it is unlikely that they have the cash flow to purchase his interest.

Risk management

There are many risks associated both with the growing of grapes and with winemaking. On the growing side, the risks involved include grape variety selection, grape quality, grape prices, weather, disease, water, pests and funding the long vineyard establishment period, among others. On the winery side, the risks include market uncertainties, changing consumer preferences, the regulatory environment, the political climate, taxes, competition from the large wineries, continued industry consolidation and funding the long manufacturing cycle.

The AgriStability, AgriInvest, AgriInsurance and AgriRecovery programs²⁵ have been established in Ontario to help grape growers address these various risks and uncertainties. The details of these programs are as follows:

- **AgriStability:** Producers receive relief payments if current-year margins fall below 70% of a calculated previous-year average.
- **AgriInvest:** Producers make an annual deposit of 1% of their operations' allowable net sales for the program year into a special account and receive a matching government contribution.
- **AgriInsurance:** Producers pay a premium in advance, and payments are triggered when there is a decline in production for the year.
- **AgriRecovery:** This program fills the gaps when the other programs cannot respond quickly to a weather or disease disaster that may impact only a small geographic area of the province. There are intentionally no established calculations so each situation can be assessed individually (for example, drought, flooding, catastrophic crop disease).

Meeting dialogue

Jean recently met with Andrew, Jenny and John on January 26, 2018. Andrew provided the team with additional background information on the wine region, Pinot Noir and winemaking (Appendix I). Jean obtained the draft financial statements from Jenny (Appendix II) and located industry metrics to use in the analysis of results (Appendix III). Jean also assembled additional information for the team based on information from Andrew and Jenny and BR resources on vineyard expansion (Appendix IV), winery development (Appendix V), distribution channels and pricing (Appendix VI), a pricing calculator (Appendix VII) and a strategic partnership with Niagara College (Appendix VIII).

²⁵ <https://www.bdo.ca/getattachment/ca06a088-08a9-4a0d-b1df-403feb1c63a3/attachment.aspx/>

Jean: Thank you for taking the time to meet with me today. I want to give my team clear direction regarding what you require of us so I hope that you don't mind that I am recording our conversation.

Andrew/Jenny/John (in unison): No problem.

Jean: We have received the additional background information you sent us, along with your financial statements for the past six years. We will review this information and provide you with comments. The industry metrics we have found will be useful as a benchmarking tool.

Andrew: Thank you, Jean.

Jean: I know that you've also requested that we present a strategy document that will enable you to develop a clear direction for the future of the company. To confirm, you would like us to prepare the draft pro forma financial statements, for 2018 and into the future, to complete your business and financing plans, which you will then share with your father and brothers and with other potential lenders, investors and strategic partners. The pro formas and financial projections we prepare will incorporate our recommendations.

Andrew: That's correct.

Jean: Thank you for your confirmation Andrew. I will need to obtain some more information to assist us with this project.

Andrew: Right now, our vines are at full production of our Pinot Noir grapes, and we have a little over 2,000 cases of wine to sell in 2018 that we produced in 2017.

Jenny: Our award-winning "First Heartbreak" wine is selling quickly. I don't think we will have a problem selling these wines through our wine club or CW's retail store.

John: Andrew plans to bring the vineyard to full production by planting 25 of the remaining 30 acres over the next five to seven years. The remaining five acres are earmarked for an on-site winery. We would like advice from BR on what to plant. I'd like to recommend grape varieties that I know have a high yield and a proven market, but Andrew correctly pointed out that what we plant depends upon a variety of factors, some of which are geographical.

Andrew: We need to select the grape varieties that complement our Pinot Noir. I have heard from other winemakers in the area that the Pinot Gris is a top seller and a hardy variety, but I am open to suggestions on the appropriate mix. Also, when it comes time for harvesting, I don't want all of the grapes ready at the same time. We aren't a large vineyard and our labour is limited.

Jenny: The decision should also relate back to the research we have conducted on the industry demographics, consumer preferences and price. Andrew is so focused on the quality of the grapes and wine that he forgets we need to sell it!

John: The yield will differ by grape variety and we have good industry data to use.

Andrew: We all have different viewpoints and would like BR to perform an analysis and provide a recommendation on product mix. I am also interested in the decision criteria that you use to determine the product mix. As well, I would like to know the annual expected yield by grape variety based on the recommended product mix and a five-year forecast of the total costs associated with the vineyard establishment and ongoing operations. To aid in the financial projections, I have provided the actual costs for establishing and operating the first 10 acres of Pinot Noir, and you should use this to estimate the costs for planting the additional 25 acres, regardless of the grape varieties recommended.

Jenny: I think we should plant all 25 acres immediately since it takes so long to get to 100% yield, but Andrew has some other ideas.

Andrew: The additional lease income has been helpful. I believe that we can continue leasing out any portion of the land that we decide not to plant at the same rate per acre to the farmer who previously owned the land. My passion is for Pinot Noir grapes, and while I don't want to plant more Pinot Noir immediately, perhaps some portion of the land should be reserved for future planting. All winemakers in the county are closely watching those vineyards and wineries that have been successful with Pinot Noir. In the Canadian wine market, this could be a niche for Prince Edward County and HEVW.

John: No matter what is decided, there is an additional way HEVW can add to the grape value. Andrew hasn't used pesticides on the current 10 acres of Pinot Noir and he uses only the organic farming methods that I taught him. As much as we can, we rely on crop residues and manure to maintain the soil quality, supply nutrients to the plants and control weeds, insects and other pests. There is an opportunity to market HEVW grapes as "organic" and to charge a premium.

Andrew: We know that the farmer who has been leasing our remaining land does use agricultural toxins (pesticides, herbicides, fungicides and chemical fertilizers) on his crops and he refuses to discontinue this practice that he has always used. We haven't pushed the issue as we need the lease money. He has been kind enough to spray on still days, which minimizes the impact on our Pinot Noir. We won't use pesticides on the new vineyards we plant.

Jenny: We will keep the history of the pesticide use confidential, as we can't afford to wait the three years it normally takes for the pesticide residue to dissipate from the soil in order to start planting vines that would be organic. While I don't see any problems with this, perhaps BR can identify any potential concerns.

John: Andrew and Jenny have done well with the Pinot Noir and I think they should continue to concentrate on the vineyard and put the winery development on hold. It is a big investment for a young couple. Wine could still be made at CW so I don't understand the immediate need for expansion. I'm sure the cost to process grapes at our own winery would be comparable to the amount we are paying CW.

Andrew: A winery will provide added income for our future. BR can complete an analysis of the costs related to processing grapes using our own winery versus outsourcing, and any other factors we should consider in making this decision. I understand my father's concerns, and we need to ensure that the winery is the right size. I've obtained information about how much it would cost for each of the components of our new gravity-fed winery, but I would like the BR team to estimate the square footage we would require, assuming we proceed with the winery, based on the expected yield of the recommended product mix. I'd like to see an estimate prepared of the winery investment and then incorporate the required investment into the financial forecasts. Neither Jenny nor I know how we should show this investment in our financial statements or how it might be treated for tax purposes.

Jenny: I also think we should consider leasing any excess winery capacity to other current and future virtual wineries in Prince Edward County, if we don't produce enough grapes initially. We have seen from leasing the land to the farmer that additional revenue sources are beneficial. My father-in-law's vineyard may even provide a source of grapes while waiting for our new vineyards to reach maturity.

John: Andrew is right; should the winery be built, it needs to be small and hopefully there won't be an excess capacity issue. I have offered Andrew and Jenny some additional financing by borrowing against Andrew's remaining interest in my vineyard. I don't want to risk my retirement and I am interested in seeing the final business plan.

Andrew: I'm concerned where we will get the cash flow needed to fund this potential expansion and would like you to provide an analysis of our financing options. Jenny researched an alternative financing option that I'd like you to include in your assessment (Appendix IX). It would be nice to keep my share of the family vineyard as a sort of insurance policy or, if we are successful, a source of future financing for further expansion.

We would also like your team to determine how much money is needed each year over five years to establish the remaining vineyards and construct the winery and tasting room, outlining all of the operational and financial assumptions. The analysis should include projected capital asset purchases, revenue, operating costs, selling and administrative costs and cash flows.

I can continue my role as CW's winemaker until such a time as our new vineyards reach 75% production. Jenny currently earns \$45,000 per year as a bartender in Picton, but will quit that job when we start building the winery. We rely on her income to help pay our personal expenses as we are trying not to take much out of the business.

If there are funding programs we could apply for, we would like to hear about them as they would help fund operating or capital requirements. For example, one of our neighbours received \$40,000 a couple of years ago. I have heard of the Marketing and Vineyard Improvement Program. I am not sure if this program still exists or if there are others and, unfortunately, I don't have time to do the research.

Jenny: We also need a plan for how much we should sell in each of our different markets. I have done some research on pricing, and our Pinot Noir will be our premium wine. Some of the local wineries, including CW, hire an agent to sell their wines to licensees. We want to know if this is the direction we should take or if we should hire someone full or part time to represent our winery.²⁶

John: I think HEVW should distribute through the LCBO. Our vineyard supplies some large wineries and I understand that the LCBO takes care of all the marketing and distribution. The LCBO would allow Andrew and Jenny to concentrate on growing quality grapes and making more award-winning wine.

Jean: The net revenue varies dramatically by distribution channel. We will evaluate each of the options and explain why any channels may be ruled out. To help with this analysis, our firm has developed a pricing calculator and it has been updated with the 2018 rates. I had one of our tax experts check the fees, taxes and calculations, and it works correctly.

Jenny: That sounds great! In addition to advice on how much of our wine should be distributed through each channel, I would also like help with our strategic pricing decision as I need to know what price to list each type of wine at, keeping in mind that our goal is to establish a premium brand. Operationally, I would like the BR team to suggest some marketing ideas appropriate for the size of HEVW.

Jean: We will provide you with analyses of these issues.

Andrew: At the 2017 Ontario Wine Awards, I became reacquainted with a former university classmate, Grant Bailey, whose winemaking career has included winery work overseas. Grant is currently a winemaker instructor at Niagara College (NC). A few years ago, NC acquired a 40-acre vineyard and winery in Niagara-on-the-Lake and it became a teaching winery and satellite campus of NC.

John: The addition of a teaching winery has increased awareness of our wine region. We have benefited from the advertising NC does for its winery. I've heard that NC is investigating the possibility of marketing through the LCBO.

Andrew: Since the acquisition, Grant has been teaching several courses in addition to overseeing the vineyard and wine production. Under Grant's leadership, NC has received numerous industry awards for its ice wine, which is now marketed across the

²⁶ <http://www.noahwinegroup.com/#!the-wine-agent/tm6exbe>

world. NC is looking to establish a second teaching winery to be part of its Canadian Food and Wine Institute in another Ontario wine region and has approached us with a proposal.

Jenny: While I don't think Andrew ever imagined being an instructor, the marketing benefits would be fantastic. I also see the potential for other revenue generating opportunities through the strategic partnership.

John: How is Andrew going to concentrate on his vineyard if he is teaching and working at CW? I'm not sure I would want inexperienced students tending my grapes.

Andrew: It is something to consider as it could allow me to concentrate on our vineyards and winery instead of working at CW; I don't think I could do both. I have a passion for grapes and wine that I would love to share and, having learned through hands-on experience, I would like to provide that same opportunity for other students. There may also be an opportunity to create new jobs in our local area, which is good for the community. Financially, the opportunity provides us with access to some financing, and the free student labour could reduce ongoing labour costs for the vineyard by 70%. There is a set curriculum so students will have some background before they start tending the vines.

John: The monitoring stations make me nervous. I don't think you want to tell the whole industry your formula for growing prize-winning grapes. You'll lose your competitive advantage.

Andrew: The monitoring makes sense to me. I was thinking of volunteering this information anyways, since there is a lack of data for the Prince Edward County wine region. We have been lucky so far but the alerts would be helpful.

Jenny: We will also be local heroes if the university can get us broadband Internet service in the region. We would like BR to provide us with an analysis on this proposal. As you can see, we are conflicted on whether we should proceed.

Jean: BR will be able to prepare an analysis of the NC proposal for you. As well, thank you for the information on all of the strategic issues; our team will work with the information you have provided and do some additional research before we provide our findings to you.

Andrew: Given all the strategic changes and new direction that HEVW will be embarking on, it would be useful if BR could summarize how my, and Jenny's roles will change, and whether we need to consider hiring any additional staff to help us with these roles.

Jean: We can provide this summary. The next thing I would like to discuss is the accounting, tax and risk management side of the business. Am I correct in my assumption that you use Excel to record all of your vineyard and winery transactions?

Jenny: Yes, I use a spreadsheet to record all of the vineyard and winery transactions. It is getting harder and harder to keep things organized now that we are bottling wine and receiving payments from CW. I would like some advice as to how I can better manage the accounting side of the business without spending a lot of money.

Jean: It sounds like you need some accounting software. We will identify your needs, develop some criteria to evaluate various accounting software packages and provide you with a recommendation.

Jenny: Excellent. With regard to taxes, I have filed my personal taxes including employment income only for my bartending job, but we haven't filed taxes for the company because we have accumulated losses. We have included Andrew's job at CW in HEVW's income so I have not filed a personal tax return for him. We are withdrawing \$2,500 from the company each month to help pay for our personal expenses and make repairs to the old farmhouse.

We have an HST number but I have not filed an HST return yet because our input tax credits are higher than the HST we have collected. Are there any issues with this?

Andrew: We will also need some help with tax planning given your understanding of our future goals. As you can see, we are expensing our winery supplies. I read an article stating that estate wineries such as ours can be considered farms and are able to use the cash basis of accounting,²⁷ so we currently record our expenses when paid and record income when it is received. We would like your input on that decision, as I don't want to get into trouble with the Canada Revenue Agency and would like to do what is best from an accounting standpoint. How does this impact our company and investments that we have made? Jenny mentioned there may be special accounting rules related to growing and processing grapes, but we don't know what the proper accounting is and could use some help.

As well, please let us know any other significant tax issues that we should be aware of, based on your knowledge of us and our business.

Jenny: I know that once we open the winery there will be certain licensing and regulatory requirements we will need to comply with, but I'm not sure on the details of what is involved. I would like BR to prepare a summary of the licensing and inspection requirements under the AGCO and the LCBO audit requirements. I have found the following resources to get your team started:
http://www.agco.on.ca/en/whatwedo/licence_apply.aspx and
<http://www.lcbo.com/content/lcbo/en/corporate-pages/about.html#.WO4tAoWcGhd>. As well, I know the NC proposal requires a review engagement. I'm not sure what this entails. Could you provide me with some relevant details specific to our situation?

²⁷ <http://www.mnp.ca/en/posts/is-winemaking-farming>; <http://fbc.ca/knowledge-centre/farmers-benefit-cash-method-accounting>

John: I believe it would be helpful for me if HEVW had some sort of performance management system linked to the key success factors in the industry. While I am comfortable offering Andrew and Jenny advice on vineyard operations, Jenny has spoken of further agritourism facilities and events. If we were able to track some key metrics, it could offer them both an outside perspective.

Jenny: I will need some guidance on what to track and in what format. As well, Andrew and I currently manage operations and make all decisions, and we rely on John to provide us with business advice. I have heard that other organizations have a more formal governance structure and was wondering if you could provide some analysis and advice related to this.

Andrew: We will be facing significant risks through the vineyard expansion. Jean, could your team identify these risks and address how to prevent or manage them in your report? As well, we have heard that a few neighbours have participated in some risk management programs offered to the industry. We would like to know which of these, if any, we should enrol in. The costs should be incorporated into the financial plans and pro forma financial statements.

Jean: BR can advise on all financial and regulatory reporting requirements. I'll have the team suggest a framework for performance management and what key metrics should be tracked. We will develop a risk management plan for the vineyard as part of our report. We will also prepare the pro forma statements that you require for your business plan, incorporating all of our recommendations, both strategic and operational.

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Appendix I
Additional background information
Per discussion with Andrew Heartwood

Prince Edward County wine region

Prince Edward County is an island community located east of Toronto and south of Belleville, with the Bay of Quinte to the north and Lake Ontario to the south. It encompasses 1,000 square kilometres, with over 500 kilometres of shoreline, beautiful beaches and limestone-rich soil. It is the newest VQA-designated viticulture area in Ontario. The scenery and close proximity to large centres make it a favourable tourist destination. Twelve new restaurants serving wine have applied for AGCO licences and plan to open in the area within the next few years.

The soils, although fertile, are difficult to farm because of their stoniness. The broken limestone bedrock creates excellent drainage in the spring and absorbs water throughout the growing season. In this location, the vines tend to grow deeper during the hot summer months. The result is a lower yield of grapes with more concentrated flavours. The vines also yield less fruit because they are pruned to allow only the healthiest to benefit from the shorter growing season.

Since Prince Edward County is the newest viticulture area in Ontario, the price for land is less expensive than in Niagara-on-the-Lake. As a result, many hobby farmers are now establishing vineyards in Prince Edward County.

Pinot Noir

Prince Edward County lends itself to growing Pinot Noir, and many vineyards in the county are planting this grape with the hopes of capitalizing on its growing popularity. In Oregon, 82% of the vineyards grow Pinot Noir grapes. The price of this variety is much higher than others and has exceeded \$2,400 per ton.

Pinot Noir acquired the name “the heartbreak grape” for its fickle nature in the vineyard. It typically does better in cooler climates, but cool climates can also be challenging. The Pinot Noir grapes have very thin skin. This makes them sensitive to fluctuations in temperature and, if they are exposed to too much sun, they can be sunburned. Their thin skin also makes Pinot Noir grapes susceptible to rot, fungus and mildew because of their tight, disease-prone clusters. Because of this, Pinot Noir has a propensity to produce lower yields than other grape varieties. Growers such as HEVW typically hand-pick these grapes.

Winemaking

The grapes are fermented to create wine. Wine can be white, red or pink, and it can be sparkling in all these colours. Fermentation occurs when grape sugar is attacked by yeast. The sugar is converted into alcohol and the grape juice becomes young wine.

Pinot Noir requires careful attention and respect during each phase of the winemaking process. Grapes that have been handled too much can end up making wines that lack flavour and harmony. For these reasons, most Ontario Pinot Noir comes from the estate vineyards of wineries where the winemaker/owner has a passion for the Pinot Noir grape and takes a non-interventionist approach to winemaking.

Pinot Noir grapes should be sorted by hand and the stems gently removed, leaving many grapes uncrushed. The grapes are then placed in a large, open-top fermenter for two to three weeks. Natural yeasts and cultured yeast are normally added to start the fermentation process. During fermentation, the grape skins float to the surface and are punched down several times a day to ensure that the skins have contact with the juice. The free-run wine is then transferred into settling tanks or barrels. The wine is aged 12 to 18 months in oak barrels. This wine requires infrequent racking (transferring into other containers) and it should be monitored and tasted frequently. Secondary fermentation usually occurs naturally in the barrel. The bottling process begins with bottles being placed onto a conveyor. An inert gas, often nitrogen, blows any dust out. Bottles are then filled with 750 millilitres of wine and corked seconds later. The winery labels meeting VQA standards are then applied, and the bottles are packed back into the cases by hand. The bottled wine can be released immediately or aged for six to 12 months before release to further enhance quality. A 750-millilitre bottle of wine contains the juice of 600 to 900 grapes.

If grape growers are able to share in the value-added process of winemaking, they may be more likely to profit financially.

Appendix II
Financial statements

Heartbreak Estates Vineyard & Winery Ltd.
Cash flow statement
For the year ended December 31

	Notes	2012	2013	2014	2015	2016	2017
Opening balance	1	\$ 100	\$ 364,580	\$ 229,860	\$ 199,858	\$ 102,099	\$ 46,694
Receipt of loan	2	750,000					
Loan payments							\$ (75,000)
Plus: HST collected		293	293	293	293	16,055	47,584
Less: HST paid		(44,453)	(18,375)	(7,988)	(15,484)	(26,275)	(30,525)
Purchase of land	3	(307,000)					
+/- net income + depreciation		(34,360)	(116,638)	(22,307)	(82,568)	(45,185)	140,844
Ending cash		\$ 364,580	\$ 229,860	\$ 199,858	\$ 102,099	\$ 46,694	\$ 129,597

Heartbreak Estates Vineyard & Winery Ltd.
Balance sheet
As at December 31

	Notes	2012	2013	2014	2015	2016	2017
Assets							
Cash on hand		\$ 364,580	\$ 229,860	\$ 199,858	\$ 102,099	\$ 46,694	\$ 129,597
Accounts receivable (HST collected net of HST paid)	4	44,160	62,242	69,937	85,128	95,348	78,289
Total current assets		408,740	292,102	269,795	187,227	142,042	207,886
Land	3	307,000	307,000	307,000	307,000	307,000	307,000
Buildings, equipment and other		—	—	—	—	—	—
Total long-term assets		307,000	307,000	307,000	307,000	307,000	307,000
Total assets		\$ 715,740	\$ 599,102	\$ 576,795	\$ 494,227	\$ 449,042	\$ 514,886
Liabilities and equity							
Current portion of long-term debt		—	—	—	—	75,000	75,000
Total current liabilities		—	—	—	—	75,000	75,000
Long-term debt	2	750,000	750,000	750,000	750,000	675,000	600,000
Total liabilities		750,000	750,000	750,000	750,000	750,000	675,000
Equity	1	100	100	100	100	100	100
Retained earnings		(34,360)	(150,998)	(173,305)	(255,873)	(301,058)	(160,214)
Total liabilities and equity		\$ 715,740	\$ 599,102	\$ 576,795	\$ 494,227	\$ 449,042	\$ 514,886

Heartbreak Estates Vineyard & Winery Ltd.
Income statement
For the year ended December 31

	Notes	2012	2013	2014	2015	2016	2017
Net wine sales	5	\$ —	\$ —	\$ —	\$ —	\$ 129,302	\$ 387,925
Commissions paid to CW	6					(8,049)	(24,148)
Lease income	7	2,250	2,250	2,250	2,250	2,250	2,250
Consulting income	8	80,000	80,000	80,000	80,000	80,000	80,000
Total revenues		82,250	82,250	82,250	82,250	203,503	446,027
Vineyard establishment costs	9	(55,450)	(139,750)	(40,970)	(56,260)	(63,400)	—
Vineyard operating costs	9	(2,470)	(10,290)	(12,410)	(14,060)	(12,400)	(65,040)
Fixed land clearing	10	(10,000)	—	—	—	—	—
Fixed production costs — vineyard	11	(15,400)	(15,558)	(15,714)	(15,865)	(16,045)	(16,205)
Variable costs — winery	12	—	—	—	(30,456)	(91,374)	(121,831)
Total cost of goods sold		(83,320)	(165,598)	(69,094)	(116,641)	(183,219)	(203,076)
Gross margin		(1,070)	(83,348)	13,156	(34,391)	20,284	242,951
Expenses							
Principal/manager/office salaries	13	(30,000)	(30,000)	(30,000)	(30,000)	(30,000)	(30,000)
General administrative expenses	14	(3,290)	(3,290)	(3,701)	(4,277)	(12,617)	(31,222)
Selling and marketing expenses	15	—	—	(1,762)	(13,900)	(22,852)	(40,885)
Total expenses		(33,290)	(33,290)	(35,463)	(48,177)	(65,469)	(102,107)
Net income before taxes		\$ (34,360)	\$ (116,638)	\$ (22,307)	\$ (82,568)	\$ (45,185)	\$ 140,844

Note 1 Cash received in purchase of common shares by Jenny and Andrew.

Note 2 Loan from John Heartwood for purchase of land and development of initial 10 acres.

Note 3 Land purchase: 40 acres of developable land at \$7,500/acre + \$7,000 closing costs.

Note 4 HST

HST collected on revenue (total revenue, excluding consulting income)		\$ (293)	\$ (293)	\$ (293)	\$ (293)	\$ (16,055)	\$ (47,584)
HST paid on expenses	Note 4a	9,480	18,375	7,988	15,484	26,275	30,525
HST paid on assets		34,973	—	—	—	—	—
HST (due) refund		44,160	18,082	7,695	15,191	10,220	(17,059)
Cumulative HST (due) refund		\$ 44,160	\$ 62,242	\$ 69,937	\$ 85,128	\$ 95,348	\$ 78,289

Note 4a

HST paid on expenses							
Vineyard establishment costs		\$ (55,450)	\$ (139,750)	\$ (40,970)	\$ (56,260)	\$ (63,400)	\$ —
Vineyard operating costs		(2,470)	(10,290)	(12,410)	(14,060)	(12,400)	(65,040)
Total		(57,920)	(150,040)	(53,380)	(70,320)	(75,800)	(65,040)
Less labour component (15% 2012-2016, 54% 2017 per Appendix IV)		8,688	22,506	8,007	10,548	11,370	35,122
		(49,232)	(127,534)	(45,373)	(59,772)	(64,430)	(29,918)
Variable costs — winery		—	—	—	(30,456)	(91,374)	(121,831)
Fixed land clearing		(10,000)	—	—	—	—	—
Fixed production costs — vineyard		(15,400)	(15,558)	(15,714)	(15,865)	(16,045)	(16,205)
Less property taxes included in production costs — vineyard		5,000	5,039	5,101	5,160	5,203	5,257
General administrative expenses		(3,290)	(3,290)	(3,701)	(4,277)	(12,617)	(31,222)
Selling and marketing expenses		—	—	(1,762)	(13,900)	(22,852)	(40,885)
Expenses subject to HST		(72,922)	(141,343)	(61,449)	(119,110)	(202,115)	(234,804)
HST paid on expenses (13%)		\$ 9,480	\$ 18,375	\$ 7,988	\$ 15,484	\$ 26,275	\$ 30,525

Note 5

Net of fees, taxes and LCBO fees.

			2016	2017	2018
Bottles available for sale (prior year yield, Appendix IV)			6,439	19,318	25,757
	Mix	Net revenue per bottle (see pricing calculator)			
Winery retail (CW)	50%	20.30	\$ 65,356	\$196,078	
Winery retail (wine club)	40%	20.30	52,285	156,862	
Licensees (restaurants)	10%	18.11	<u>11,661</u>	<u>34,985</u>	
			\$129,302	\$387,925	

Note 6

		VQA retail		
Commission paid to CW:	10% of CW sales	\$ 25.00	8,049	24,148

Note 7 Lease income of 30 acres at \$75/acre per year = \$2,250 annually.

Note 8 Consulting income is the fee Andrew charges County Winery for winemaking.

Note 9 Vineyard establishment and ongoing costs per acre (Appendix IV), multiplied by developed acres = 10.

Note 10 Land clearing: \$1,000 per acre for 10 acres.

Note 11 Fixed production costs do not include any component of labour because Andrew provides all supervision. Fixed production costs include such items as property taxes, insurance, utilities, pest removal, and repairs and maintenance. They have increased approximately 1% per year since 2012.

Note 12 Variable costs — winery includes packaging and the bottling fee paid to CW.

			2015	2016	2017
	Per bottle		6,439	19,318	25,757
Glass bottle	0.80				
Cork/screw cap	0.20				
Capsule	0.05				
Labels (back + front)	0.35				
Packaging labour	0.33				
Total packaging cost	\$1.73	\$ 11,139	\$ 33,420	\$ 44,560	
County Winery bottling service	\$3.00	<u>19,317</u>	<u>57,954</u>	<u>77,271</u>	
		\$ 30,456	\$ 91,374	\$ 121,831	

- Note 13 Withdrawn by Jenny and Andrew to cover household expenses: \$2,500 per month.
- Note 14 General and administrative expenses include office expenses and professional fees. They are expected to total approximately 7% of revenues on an ongoing basis.
- Note 15 Selling and marketing includes wine club operations and advertising. These costs are expected to total approximately 10% of revenues on an ongoing basis.

Appendix III
Industry metrics
 Extracts from Deloitte study²⁸

Profitability and financial position

Industry income statement 2015

	Winery size (2015 sales)				
	\$0M–0.5M	\$0.5M–2M	\$2M–5M	\$5M–10M	\$10M+
Net VQA wine sales	73.0%	70.2%	80.2%	73.4%	35.0%
Net non-VQA wine sales	9.5%	7.2%	0.5%	0.8%	60.6%
Grape sales	3.1%	1.7%	2.3%	3.5%	0.1%
Merchandise sales	2.6%	2.7%	2.8%	2.6%	0.9%
Hospitality sales	1.6%	3.0%	1.7%	2.2%	0.5%
On-site food and wine service sales	2.3%	5.9%	4.9%	11.4%	1.5%
Other sales	5.5%	3.9%	1.9%	2.8%	0.6%
Grants and programs	2.4%	5.5%	5.7%	3.2%	0.8%
Total sales	100.0%	100.0%	100.0%	100.0%	100.0%
Raw materials	-21.4%	-18.7%	-26.3%	-18.8%	-25.6%
Labour and packaging	-41.8%	-28.7%	-21.4%	-21.1%	-14.8%
Other direct manufacturing expenses	-13.1%	-9.7%	-8.8%	-13.9%	-11.6%
Total cost of goods sold	-76.3%	-57.1%	-56.6%	-53.8%	-52.0%
Gross margin	23.7%	42.9%	43.4%	46.2%	48.0%
Sales and marketing expenses	-12.4%	-12.7%	-14.7%	-19.8%	-21.4%
Contribution after sales and marketing	11.3%	30.2%	28.7%	26.3%	26.6%
General and administration expenses	-29.9%	-22.5%	-18.4%	-15.6%	-8.6%
EBITDA	-18.6%	7.7%	10.3%	10.7%	18.0%
Depreciation and amortization	-15.1%	-8.5%	-6.2%	-4.2%	-1.6%
EBIT	-33.8%	-0.8%	4.1%	6.5%	16.4%
Interest expense	-7.0%	-3.9%	-3.2%	-2.0%	-1.3%
Interest income	0.0%	0.1%	0.0%	0.9%	0.0%
Other non-operating income	1.3%	0.9%	1.4%	-0.3%	-0.1%
Foreign exchange gain/(loss)	0.0%	0.0%	0.0%	0.0%	0.0%
Inventory write-downs	-1.6%	-1.6%	-2.6%	-0.1%	-0.6%
Profit/(loss) before tax	-41.1%	-5.4%	-0.30%	5.0%	14.5%

Note: Amounts in the above table represent relative percentages of “Total sales”.
 Amounts may not sum to subtotals due to rounding.

²⁸ Ontario Wine and Grape Industry Performance Study 2015. VQA Ontario and Deloitte on behalf of the Ontario wine and grape industry March 2016.
http://www.vqaontario.ca/Library/Documents/2015_Ontario_Wine_and_Grape_Industry_Performance_Study_FINA_L_03232016.pdf

Industry balance sheet 2015

	Winery size (2015 sales)				
	\$0M–0.5M	\$0.5M–2M	\$2M–5M	\$5M–10M	\$10M+
Cash	1.7%	1.9%	0.9%	1.4%	1.4%
Accounts receivable	1.4%	3.6%	6.0%	7.4%	5.7%
Inventory	28.7%	36.3%	31.5%	36.5%	40.5%
Other current assets	1.4%	1.1%	3.1%	2.5%	0.6%
Total current assets	33.2%	42.9%	41.5%	47.8%	48.2%
Land and land improvements	18.4%	13.9%	8.7%	11.5%	5.2%
Vineyards	7.2%	7.2%	8.8%	2.3%	5.1%
Buildings and improvements	25.5%	18.2%	27.5%	26.9%	13.9%
Equipment	12.7%	9.0%	5.9%	7.0%	10.3%
Other fixed assets	1.2%	3.3%	3.9%	1.6%	8.8%
Total net fixed assets	64.9%	51.6%	54.8%	49.3%	43.2%
Purchased goodwill and other intangible assets	0.2%	0.3%	0.2%	0.0%	8.2%
Investments	0.0%	4.6%	0.3%	2.7%	0.1%
Other assets	1.7%	0.7%	3.2%	0.2%	0.3%
Total assets	100.0%	100.0%	100.0%	100.0%	100.0%
Bank indebtedness	5.8%	5.3%	5.1%	10.8%	11.8%
Accounts payable and accrued liabilities	6.1%	5.9%	7.3%	4.2%	6.2%
Other current liabilities	2.8%	16.9%	17.5%	1.8%	2.0%
Total current liabilities	14.8%	28.0%	29.8%	16.8%	20.1%
Long term liabilities	102.8%	64.4%	59.3%	52.6%	32.6%
Total liabilities	117.6%	92.4%	89.1%	69.3%	52.7%
Capital stock	13.9%	24.1%	22.6%	3.3%	21.5%
Retained earnings	-31.5%	-16.4%	-11.7%	27.4%	25.8%
Total equity	-17.6%	7.6%	10.9%	30.7%	47.3%
Total liabilities plus equity	100.0%	100.0%	100.0%	100.0%	100.0%

Note: Amounts in the above table represent relative percentages of “Total assets.”
Amounts may not sum to subtotals due to rounding.

Industry key financial ratios 2015

	Winery size (2015 sales)				
	\$0M–0.5M	\$0.5M–2M	\$2M–5M	\$5M–10M	\$10M+
Solvency ratios					
Current ratio	2.2	1.5	1.4	2.9	2.4
Debt to equity ratio	-6.7	12.1	8.1	2.3	1.1
Debt to tangible assets	1.2	0.9	0.9	0.7	0.6
Efficiency ratios					
Inventory turnover	0.6	0.5	0.7	0.9	1.1
Fixed asset turnover	0.3	0.6	0.7	1.2	1.9

Appendix IV Vineyard expansion

Per discussion with Andrew Heartwood

Vineyard plans

HEVW would like to develop its remaining land using organic viticulture practices — as was done for the current 10 acres of Pinot Noir — and Andrew continues to research new ways to recycle agricultural nutrients. As an estate winery, HEVW must grow its own grapes to produce wine. HEVW intends to plant 25 acres of vineyards and to set aside the remaining five acres to build an on-site winery and tasting room with room for future expansion.

HEVW must decide whether to plant all 25 acres immediately or plant over a longer period of time. HEVW would like to plant additional *Vitis vinifera* vines, or possibly hybrid vines to complement the Pinot Noir in terms of harvest timing, being mindful of what would grow well in Prince Edward County. Andrew would like to continue to meet VQA standards and also establish HEVW as a premium wine producer. BR's recommendation should include what portion of the land should be devoted to each grape variety.

Andrew has narrowed the selection of possible grape varieties that are most suitable for HEVW's land. Options include four red varieties: Cabernet Franc, Cabernet Sauvignon, Pinot Noir and Sirah (also referred to as Shiraz or Syrah), and four white varieties: Sauvignon Blanc, Pinot Gris, Riesling, and/or Chardonnay. Andrew provided the following document that contains some useful information on these varieties: Grape Varieties in Ontario Wine Regions²⁹.

It is a costly undertaking to establish a vineyard to full production because it often takes five years of negative cash flow. Growers will invest approximately \$40,000 to \$50,000 per acre, not including the purchase of the land, before the vineyard reaches full production (see the vineyard establishment costs and ongoing costs below). After planting the vines, it is not until the third season that the vines yield the first fruit and even then it is about 25% of what is expected at full production. In the fourth year, production will be at 75%, and the next year, the vineyard will be at 100% production. The vineyard will produce at that level for about the next 20 years and then will begin to decline, so most growers begin to replace the vines after the 20th year.

Andrew predicts that, given HEVW's growing and harvesting methods, HEVW could obtain a premium price on its Pinot Noir grapes if HEVW sold them through processors rather than using them to produce wine. Andrew would prefer to bottle all of the grapes HEVW grows.

²⁹ <http://www.grapegrowersofontario.com/sites/default/files/OVIP%20Varietal%20Plan%20Handbook.pdf>

Andrew and Jenny can manage the establishment labour for the new vines by hiring part-time labour, and this will account for 15% of the establishment costs. Vineyard operations will also be met by hiring part-time labour, and this will account for 15% of the variable operating costs while the vines are being established, and 54% of variable operating costs once the vines reach 100% production.

Conversion of acres of grapes to cases bottled

	2015	2016	2017	
Acres of Pinot Noir	10	10	10	A
% yield	25%	75%	100%	B
Tons/acre	3	3	3	C
Yield per acre (B × C)	0.75	2.25	3.00	D
Total tons (A × D)	7.50	22.50	30.00	E
Litres (E × 650 litres per tonne of grapes)	4,875	14,625	19,500	F
Litres to bottles (with spillage allowance) (F / 0.75708)	6,439	19,318	25,757	G
Bottles to cases (G / 12)	537	1,610	2,146	

Vineyard establishment costs and ongoing costs for Pinot Noir

	Notes	2012	2013	2014	2015	2016	2017	
		Pre-plant (1/2 year)	Year 1 planting	Year 2	Year 3 (25%)	Year 4 (75%)	Year 5 (100%)	Total
Annual costs (excluding land and clearing)								
Pinot Noir — variable establishment costs/acre	1	5,278	13,360	3,431	4,923	5,637	—	32,629
Pinot Noir — fixed establishment costs/acre	2	267	615	666	703	703	—	2,954
Total establishment costs		5,545	13,975	4,097	5,626	6,340	—	35,583
Pinot Noir — variable operating costs/acre	3	247	1,029	1,241	1,406	1,240	6,504	11,667
Pinot Noir total per acre		5,792	15,004	5,338	7,032	7,580	6,504	47,250

Note 1 Variable establishment costs include trellis installation, land preparation and initial purchase of the vines. 15% relates to extra labour hired in addition to the labour provided by Andrew and Jenny.

Note 2 Fixed establishment costs include permits, soil testing and land preparation, aside from site clearing. 15% relates to extra labour hired in addition to the

labour provided by Andrew and Jenny.

- Note 3 Variable operating costs include ongoing pruning, tying, suckering, harvesting, vine replacement, organic fertilizers, pest control, ground cover, equipment fuel and maintenance. For 2012 to 2016, 15% relates to labour hired in addition to the labour provided by Andrew and Jenny. The Pinot Noir requires significant hand labour compared to machine time. Once 100% yield was achieved, Andrew and Jenny had to hire more part-time labour to tend to the vines and during harvest. In 2017, 54% of the operating cost relates to extra labour in addition to the labour provided by Andrew and Jenny.

Grape Growers of Ontario prices and grape yield statistics by varietal

	Red varietals				White varietals				
	Cabernet Franc	Cabernet Sauvignon	Pinot Noir	Sirah/Shiraz/Syrah	Sauvignon Blanc	Pinot Gris	Riesling	Chardonnay	Note 1
2019 price obtained/tonne	\$1,866.53	\$2,088.14	\$2,272.50	\$2,421.09	\$1,829.05	\$1,856.61	\$1,625.09	\$ 1,657.06	Note 2
2018 price obtained/tonne	\$1,866.53	\$2,088.14	\$2,164.28	\$2,421.09	\$1,829.05	\$1,856.61	\$1,625.09	\$ 1,657.06	
2017 price	\$1,777.65	\$1,988.70	\$2,081.04	\$2,305.80	\$1,741.95	\$1,768.20	\$1,547.70	\$ 1,578.15	

Yield statistics	Cabernet Franc	Cabernet Sauvignon	Pinot Noir	Sirah/Shiraz/Syrah	Sauvignon Blanc	Pinot Gris	Riesling	Chardonnay	
Harvest timing in Prince Edward County	Late	Mid	Early	Late	Mid	Very early	Mid	Mid	
Industry average tonnage yield per acre	4 to 5	3.5 to 5	3 to 4	3.5 to 5	7 to 10	7 to 10	7 to 10	7 to 10	Note 3
HEVW expected tonnage yield per acre	4	3.5	3	3.5	7	7	7	7	Note 4

- Note 1 This is the negotiated price established by the Grape Growers of Ontario. These prices are base prices exclusive of sugar premiums or discounts. While growers contract their grape sales directly with processors, prices must be no less than the minimum set through negotiations between the Grape Growers of Ontario and Ontario's grape processors.
- Note 2 The training and pruning practices adopted by HEVW will result in a higher brix (sugar content), which will yield a 10% premium on the price shown in this chart on each varietal that HEVW plants.
- Note 3 These yields, obtained from the Ontario Ministry of Agriculture, Food and Rural Affairs, reflect the current management practices presently used by growers today. However, there are many different grower practices (such as vine density, training systems, pest management programs and fertilizer rates) because of soil conditions, variety selections, personal grower management decisions and the unique micro climates in Ontario, and these different practices will all impact individual grower yields. See note 2 for HEVW premium pricing.
- Note 4 HEVW will control production to the low end of the yield range to ensure the highest concentration of fruit/flavour. As well, the sustainable farm practices also result in lower yields.

Appendix V Winery development

Per discussion with Andrew Heartwood

HEVW outsources its bottling to CW at a price of \$3 per bottle plus variable packaging costs. This was planned as a temporary measure until HEVW's on-site winery is established. Andrew and Jenny would like advice supported by analysis as to whether they should build the winery now or in a few years, considering the planned vineyard yields and CW's capacity. If HEVW begins planning immediately, the winery can be operating at the beginning of 2020.

The winery will also seek VQA approval for all wines produced. A summary of VQA requirements is provided in Appendix X. HEVW wants to label its wine as "organic" wine, which is wine produced from organically grown grapes. HEVW also wants to be known as a premium winery, which, in part, involves offering a mix of both red and white wines.

Because much of the land is located on a hill, the plan is to place the proposed winery at the top of the hill with four different levels so it can be gravity-fed.³⁰ This will lower utilities and equipment costs as well as reduce the impact on the environment through reduced carbon emissions. Some advantages of a gravity-flow winemaking facility are that it improves the quality of the wine because it is gentler on the grapes and allows the fermentation process to start with whole grapes. A gravity-fed facility also minimizes the environmental impact of the winemaking activities by reducing the use of pumps, motors and fuel in order to move wine between tanks, barrels and bottles.

Andrew and Jenny would like to know how much it would cost to build the winery given the recommendations regarding the vineyards. Jenny envisions a retail space and tasting room to sell their wines, and possibly an additional space for potential events to attract tourists to their location. In order to evaluate funding options, HEVW requires a summary of the amount of funding required each year to establish the proposed premium winery.

Andrew has gathered information on operating costs based on other wineries in the area and through industry studies. He is confident that HEVW can achieve the following cost structure:

- Winery variable costs will approximate 19% of the following year's sales.
- Winery variable costs will include 25% for hired labour.
- Winery fixed production costs will approximate 8% of current-year sales. Andrew's supervision salary will be the only labour component of this cost.

³⁰ <http://blog.winecollective.ca/wp-content/uploads/2013/07/GravityFlowProcess.jpg>

Total investment costs by equipment category and winery size

Andrew has gathered the following industry data on investment costs based on vineyard and winery size:

	Vineyard size (acres)				
	5	10	35	50	70
	Winery size (cases)				
	2,000-4,999	5,000-9,999	10,000-14,999	15,000-19,999	20,000+
	Winery size (square feet)				
Square feet	2,400	6,000	12,000	30,000	40,000
Cost category					
Receiving equipment	10%	11%	9%	7%	6%
Cellar equipment	3%	2%	1%	1%	1%
Material handling equipment	9%	6%	4%	3%	2%
Refrigeration system	6%	6%	7%	7%	7%
Fermentation and storage	9%	9%	7%	8%	8%
Cooperage	9%	17%	22%	23%	22%
Plant, bottling equipment, office and tasting room	53%	49%	50%	52%	54%
Total investment	100%	100%	100%	100%	100%
\$/square foot	\$230	\$135	\$100	\$60	\$60

Appendix VI

Distribution channels and pricing

Prepared by Jenny Heartwood

Along with my full time job in Picton, I assume primary responsibility for the business side of HEVW. This can sometimes be challenging as I don't have a degree in business and English is not my first language. My role encompasses financial and regulatory reporting, paying vendors and employees, marketing and selling the wines we produce, and risk management.

HEVW became of a member of the Wine Council of Ontario to gain access to marketing resources and to better understand the regulatory process with the LCBO. I need assistance in determining the distribution mix and pricing alternatives to establish our wine as a premium brand. Various distribution channels are available to HEVW: selling through the winery and wine club (winery retail), selling to licensees (restaurants) and distributing through the LCBO. Specifically, I would like to see an analysis of profitability by distribution channel and a recommendation of volumes to be marketed by channel. I have determined that the Pinot Noir can be sold for as much as \$32 per bottle, compared to the current price of \$25. I expect that most other white or red varietal wines will sell for about 75% to 80% of the Pinot Noir price, respectively.

In June 2016, the Government of Ontario announced a series of tax increases, or markups, on wine sold at LCBO stores per the following schedule:

	Domestic	International	Differential
June 2015	65.5%	71.5%	6%
June 2016	67.5%	73.5%	6%
June 2017	69.5%	75.5%	6%
June 2018	71.5%	77.5%	6%
June 2019	72.5%	78.5%	6%

The LCBO holds a monopoly on the sale and distribution of liquor in the province and is considered critical for gaining access to the Ontario market. With a few exceptions, the LCBO's large production quotas usually mean only the larger wineries can occupy shelf space, as estate wineries cannot produce in sufficient quantity to qualify. Smaller producers' wines are predominantly found in the smaller vintages section at the LCBO retail outlets.³¹ In addition, to sell wine in the quantities required by the LCBO, wineries typically need to have extensive marketing programs, which can be quite costly.

Grandfathered privileges enable larger wineries to sell wines at more than 300 licensed off-site locations. This originated before the Canada-U.S. Free Trade Agreement (CUFTA) when the LCBO granted licences for independent sale of alcohol at non-LCBO locations. These licences were allowed to remain with the original owners, many of which have grown in size or have purchased the licenses or the wineries from who originally owned them. With the inception of CUFTA, no further off-site retailing licences

³¹ Pelling, Matt and Hira, Andy. *The Ontario Wine Industry: Provincial Policy at a Crossroads* (2012), pp. 14-15.

were granted. The result is that a very few well-established wineries benefit from this grandfathering privilege and, as a result, the marketplace is not a level playing field, impacting competition.³²

Sales through licensees (restaurants) and on-site retail stores enhance winery brands and stimulate sales through the LCBO. Most medium-sized and large wineries strive for sales across all channels. To drive higher LCBO store sales, wineries spend marketing dollars to get priority placement of their products (end aisles, shelf extenders, pods, fridges) or have their wines featured in promotional materials. Such expenditures are at the discretion of individual wineries.

The LCBO has a variety of programs available to aid Canadian wineries in promoting themselves as quality producers. However, most of the associated marketing costs are not provided in the LCBO markups; the LCBO charges extra for this service. In any event, wine sales of Ontario products continue to show higher growth than import wines.

³² Ibid.

**Appendix VII
Pricing calculator**

Pricing calculator for Heartwood Estates Vineyard & Winery

Change to recalculate net revenue to winery based on new prices

Pinot Noir		VQA		
		Winery retail	Licensees	LCBO stores
Bottle size in litres	0.750	0.750	0.750	0.750
VQA retail selling price (same for all channels)	\$25.00	\$25.00	\$25.00	\$25.00
+ Bottle deposit	\$0.20	\$0.20	\$0.20	\$0.20
+ HST 13%	13%	\$2.85	\$2.85	\$2.85
Basic price		\$21.95	\$21.95	\$21.95
Basic price <i>net</i> of 10% licensee discount	10% discount		\$19.75	
Less Alcohol and Gaming Commission of Ontario fees				
- Basic tax: 6.1%	6.1%	\$1.339	\$1.339	
- Environmental tax: \$0.0893 per unit	\$0.0893	\$0.089	\$0.089	\$0.089
- Volume tax: \$0.29 per litre	\$0.2175/bottle	\$0.2175	\$0.2175	\$0.2175
Less LCBO markups				
- LCBO wine levy: \$1.62 per litre				\$1.215
- LCBO markup	71.5%			\$8.52
Net revenue to winery		Net retail per bottle	Net license per bottle	FOB per bottle
		\$20.30	\$18.11	\$11.91
		Net retail case	Net license per case	FOB per case
		\$243.62	\$217.28	\$142.92

Appendix VIII
Strategic partnership with Niagara College
Per discussion with Andrew Heartwood

Niagara College (NC) was established in 1967 and is a leader in applied education and training. NC has several campuses in the Niagara region. NC has intentionally made strategic partnerships with businesses in a variety of forms to provide students with the opportunity for hands-on learning in agriculture, culinary, health services, manufacturing and tourism.

NC commits to sustainable development with the goal of reducing electricity consumption, greenhouse gas emissions, waste generation, water consumption and paper consumption. NC has undertaken several infrastructure projects on its campuses toward these goals including: carbon-neutral buildings following Leadership in Environmental and Energy Design (LEED) building standards, habitat structures for birds and bees, geothermal heat pumps, solar panels and wind turbines.

The Canadian Food and Wine Institute (CFWI) at NC includes a teaching winery, teaching brewery and teaching restaurant. It also offers food and beverage seminars and team-building events as part of its community engagement programs. Significant financial and human resource investment has been made in various applied research and innovation projects that partner with business, industry and communities to provide support for new products. CFWI is able to draw upon all resources at NC including: agriculture and environmental technologies, advanced manufacturing, business and commercialization as well as digital media and web design. Students who complete the two-year winery and viticulture technician program at NC are granted transfer credit to Brock University's viticulture program.

NC's chair of visualization sciences and Brock University have received media recognition for a co-operative VineAlert program. Vineyards have allowed installation of monitors that send weather data to NC. Vineyards also input data on the stage of the grapevine buds and management practices weekly during the dormant season (October to April). The hardiness of the grapevine buds will change throughout the dormant period and varies according to the variety of grapes, site conditions and management practices. Data is analyzed by NC and alerts are sent out to the various wine regions based on the aggregate data. The alerts allow vineyards to take protective measures such as utilizing wind machines or other freeze-avoidance methods to protect the vines. There has been limited information to date on the Prince Edward County wine region because of a lack of broadband Internet. New developments by NC's agricultural technology faculty have adapted the monitors to record soil properties such as moisture and mineral content. Information is transmitted through the Internet to the vineyard owner's computer system or portable device.

Proposal

NC and HEVW will form a strategic partnership to offer on-site courses in viticulture and winemaking. Students will initially be provided with the opportunity for classroom and hands-on learning in the field of viticulture. Further instruction is expected in the areas of winemaking and winery management, as the campus develops. HEVW will become a satellite campus of NC and a second teaching winery. The initiative is supported by donors to the university interested in continued development of the wine regions of Ontario.

Structure

Joint venture or a general partnership. Exact structure and details to be agreed upon by both parties.

Term

The initial term of the agreement will be 10 years, with an additional 10-year renewal option at the agreement of both parties. The first intake of students will be in January 2019.

Niagara College contributions

A. Academic

- NC will supply the curriculum for each course offered at the HEVW campus. The viticulture technician program will include five courses that may run concurrently: Introduction to Grapes and Wines, Introduction to Grape Growing, Vineyard Management, Sustainable Agricultural practices, and Operation and Safety of Vineyard Equipment.
- NC will provide all student administrative support for admission, registration, housing and graduation.
- NC will provide ongoing training to all instructors on innovative teaching methods.
- NC will include HEVW as a member in research and industry initiatives relating to viticulture or winemaking.
- NC will allow HEVW to operating under its LCBO licence.

B. Capital

- Engineering specifications related to classroom space, a greenhouse, an analysis lab and a wastewater treatment system will be provided from the existing teaching vineyard, along with current engineering estimates and suggested construction timelines. Estimates are all based on LEED building standards and certification.

	Estimate	Timing
Classroom space	\$230,000	Now
Greenhouse	\$55,000	Year 2
Analysis lab	\$368,000	Year 3
Wastewater treatment system*	\$160,000	Year 5

*Federal and provincial grants available to reduce cost; exact amount uncertain.

C. Financing

- During 2018, HEVW could issue a five-year, \$3,500,000 face-value unsecured debenture of 6% to NC. The debenture would be priced at issuance to achieve a yield to maturity of 10%. Coupon payments would be made semi-annually on June 30 and December 31, with the first payment due on June 30, 2018. The final payment would be made on December 31, 2022.
- NC will supply letters of support for grant proposals made by HEVW to granting agencies for ongoing operating costs, research and innovation improvements over the term of the agreement.

D. Operations

- An instructional salary of \$32,000 per annum will be paid to Andrew Heartwood for instruction of the one-year Viticulture Technician Program.
- Once the winery is established, an instructional and supervisory salary increased to \$72,000 per annum will be paid to Andrew Heartwood for instruction of the two-year Winery and Viticulture Technician Program.
- NC will compensate an additional instructor to teach the one-year Viticulture Technician Program if there is sufficient enrolment once the winery is established.
- NC will provide additional compensation for instruction and/or facility rental on an event-by-event basis for food and beverage seminars and team-building events as part of its community engagement programs. NC will reimburse all additional costs, such as catering and supplies. These events run after school hours and on the weekends. A sample of these events and their compensation rates from the existing teaching vineyard is detailed below:

Event	Annual number	Instructional rate per event	Rental rate
Food and beverage seminar	10	\$500	\$350
Team-building event	24	\$200	\$350

- Students will complete their practicum by working in the vineyard without compensation. HEVW will hire students for the winery or obtain placements for the students at other local wineries.
- CFWI advertising will include HEVW on the college website and in advertising related to the applicable programs.

- NC will make available a winery facility in an old fruit-packing plant located 35 kilometres from HEVW for wine aging, bottling and storage of finished bottles, until HEVW's winery is operational. The fruit-packing plant is located on the edge of a small town. While the doors lock, there are no security systems in the building.

E. Other

- NC will use its influence to lobby its Internet service provider to bring broadband service to Prince Edward County.
- NC will provide regular communications on provincial and federal government innovation and research grants. NC will also provide support for grant applications on a cost-recovery basis.
- NC will provide access to its commercialization services on a cost-recovery basis: advertising and marketing, international marketing and e-commerce.

Heartbreak Estates Vineyard & Winery contributions

HEVW will:

- provide NC students with access to vineyard and winery operations as specified in the course curriculums
- recognize itself in all promotional material and labels as an “NC teaching winery”
- provide Andrew Heartwood as an instructor in all NC winery and viticulture technician courses for the term of the agreement; instruction will include inputting final grades into the NC registration system
- allow on-site visits and program reviews to ensure academic standards are met
- build classroom space to accommodate up to 60 students, complying with existing NC specifications
- make an ongoing commitment to investment in innovation and technology
- comply with sustainability objectives of NC, which include LEED buildings, no use of herbicides, and a wastewater treatment system
- complete sustainability reports (water usage, for example) as requested by NC
- provide CFWI's research and industry liaison a seat on HEVW's Board of Directors over the term of the agreement
- complete a business plan for the vineyard and winery that includes a mission, vision, background on HEVW, a plan of operations, an industry analysis, a regulatory and competitive analysis, a marketing plan and pro forma financial statements
- allow installation of VineAlert monitors by CFWI's research division, and consent to the regular collection, transmission and publication of data from the monitors via the Internet to NC and to HEVW's computer system or portable devices

- allow access to its vineyard and winery for additional collaborative research with other faculties at NC
- submit annual financial statements following Canadian generally accepted accounting principles (GAAP), with a review engagement report, to NC within 90 days of HEVW's year end

Appendix IX
Alternative financing option for expansion
Per discussion with Jenny Heartwood

HEVW's bank could not offer financing for the winery expansion. Through industry associations, Jenny made contact with Farm Plus Financial (Farm Plus). The company has a long history of winery and vineyard financing in Oregon and California, and has recently partnered with a Canadian financial institution to offer innovative financing solutions to vineyards, orchards and farms in southern Ontario.

Proposal from Farm Plus: Term loan

Farm Plus will grant HEVW term-loan financing to a maximum of \$3,000,000, repayable over a 15-year period, with interest charged and payable annually at a rate of 8%. HEVW has the option to postpone principal payments for a five-year period at the start of the loan. HEVW may make a 15% annual prepayment at any time without penalty.

Terms and conditions:

- first charge against all vineyard and winery assets
- personal guarantee of owners
- annual financial statements complying with Canadian GAAP provided to Farm Plus within 90 days of HEVW's year end

Requirements for financing:

- provide a business plan
- demonstrate market and sales potential
- demonstrate competent management team
- owner must have a financial investment in the winery
- appraisal of the vineyard property

Appendix X

Summary of VQA regulations

Prepared by Andrew Heartwood

The VQA is responsible for setting the standards by which wine is produced from the grapes of respective provinces. The VQA identifies criteria for VQA wine and regulates the use of specified terms, descriptions and designations. Some of the key winemaking standards are as follows:³³

- The VQA limits eligible grape types to *Vitis vinifera* varieties and a few premium hybrids, such as Vidal. Vidal is the raw material for most ice wines.
- The grapes must attain a minimum ripeness level measured by sugar or brix level when harvested. Different categories of wine have different requisite brix levels.
- A wine must contain 85% of a particular grape in order for it to be named for its varietal (grape type), but blending a small amount of a complementary grape variety can increase a wine's complexity without detracting from the principal grape's characteristics.³⁴
- A wine must be 85% from a particular designated viticultural area (DVA) in order for it to carry that DVA's designation. The other 15% can be made from grapes grown elsewhere in Ontario.
- A wine must be 100% from a particular vineyard in order for it to carry that vineyard's designation. The vineyard itself must be within the boundaries of a recognized DVA. On the label, the VQA designation includes both the DVA where the grapes were grown and the name of the vineyard where the wine was made.
- A wine must be 100% from land owned or controlled by a particular winery (which must also be located in the DVA) in order for it to be designated estate-bottled at that winery.
- Wineries must submit their wine to an independent tasting panel for evaluation in order to obtain a VQA designation.

³³ Aspler, Tony and Leslie, Barbara. Canadian Wine for Dummies (2000), Wiley p. 14.

³⁴ <http://www.vqaontario.ca/Regulations/Standards>

Appendix XI Vineyard and winery terminology definitions³⁵

Prepared by Andrew Heartwood

Designated viticultural area (DVA) : An area in which quality vinifera grapes can be consistently grown. There are three DVAs in Ontario as defined in the VQA regulations: Niagara Peninsula, Lake Erie North Shore and Prince Edward County.

Estate winery: A winery that sells wine produced from the same owner's vineyard.

Grape Growers of Ontario (GGO) : A non-profit corporation regulated by the Ontario government through the Ontario Farm Products Marketing Act to represent over 500 registered grape growers and to advocate on their behalf. Wine grape prices are negotiated between the GGO and the Wine Council of Ontario. Prior to 2002, the GGO was called the Ontario Grape Growers' Marketing Board.

Hybrid grapes: Varieties that are the product of crossing two or more *Vitis* species. Hybrid grapes are also referred to as inter-specific crossings or "modern varieties." Some examples are Pinotage, Vidal and Seyval Blanc.

Oenology: The study of wines.

Rootstock: The part of a plant, often an underground part, from which new above-ground growth can be produced. A healthy root or part of a root can be used as a basis in grafting hybrid plants. A hybrid grape vine plant is made up of a graft between the rootstock plant and the budwood plant, known as the scion.³⁶

Terroir: From the French word *terre*, meaning "land," a term that is used to explain how a particular region's climate, soils and aspect (terrain) affect the taste of the wine. Terroir is loosely translated as "a sense of place." The assumption is that the land from which the grapes are grown imparts a unique quality that is specific to that growing site.

Varietal: A wine made from or belonging to a single specified variety of grape.

Vintners Quality Alliance Ontario: Ontario's wine authority, responsible for regulating and setting standards for the production of wine made from Ontario-grown grapes. It establishes and maintains an appellation of origin system that allows consumers to identify wines based on the origin of the grapes they are made from and procedures followed in the winemaking process.

Virtual Winery: A winemaker that purchases grapes from growers and then blends, bottles and sells wine under its own name. A virtual winery uses someone else's facilities to make and label its own wine.

³⁵ <http://www.omafr.gov.on.ca/english/busdev/facts/startingawinery.pdf>

³⁶ <https://www.winefrog.com/definition/171/rootstock>

Viticulture: The study and cultivation of grapevines.

Vitis: A genus of 70 accepted species of vining plants in the flowering plant family *Vitaceae*. It is economically important as the source of grapes, both for direct consumption of the fruit and for fermentation to produce wine.

Vitis vinifera: A species of grape vine native to the Mediterranean region, Europe and southwestern Asia. There are currently between 5,000 and 10,000 varieties of *Vitis vinifera* grapes. Only a few of these grape varieties are used in wine production, including Chardonnay, Riesling, Cabernet, Pinot Noir, Pinot Grigio, Shiraz, Merlot and Gamay.

Wine Council of Ontario: A non-profit trade association that represents wineries from across the three DVAs of the province. The Council's role is to promote Ontario VQA wines and vintners, and to grow the economic benefits that the VQA wine industry brings to the province of Ontario. Wine grape prices are negotiated between the Wine Council of Ontario and the Grape Growers of Ontario.

Winery retail store: A store operated by the wine manufacturer for sale of its wine. Winery retail stores can be on-site or off-site.

APPENDIX C

**THE COMMON FINAL EXAMINATION
DAY 1 HEVW VERSION 1 BOOKLET – SEPTEMBER 12, 2018**

**COMMON FINAL EXAMINATION
SEPTEMBER 12, 2018 – Day 1**

Case (HEVW Version 1)

(Suggested time: 240 minutes)

It is September 2020, over two years since Andrew and Jenny expanded their vineyard and decided to build a winery to bottle their wines. Until last week, Andrew continued to be the resident winemaker at County Winery (CW). He helped select and train the new winemaker and left on good terms with Jeremy Stiles, the proprietor of CW. Jeremy agreed to be an advisor to HEVW.

HEVW's Pinot Noir releases sell out each year, largely because of the awards the wines have won. The HEVW wine club is quite successful and continues to grow as its members get first access to HEVW wines. Andrew and Jenny decided not to enter into a strategic partnership with Niagara College.

This is the first harvest in which Andrew and Jenny will be pressing and bottling their own grapes. The official grand opening of the winery, which includes retail space, and some currently unused space, is scheduled to take place on September 22, 2020, during the Crush Festival, which celebrates the grape harvest season. Jenny oversaw construction of the winery, paving of the parking lot and landscaping. She has worked hard to promote the winery and expects a lot of visitors, both at the grand opening and afterward.

Jenny and Andrew have stayed with their original vision and mission, and recently assembled an advisory board to guide them. The board consists of Andrew (president of HEVW), Jenny (vice-president operations), John Heartwood (creditor, acting as vineyard advisor), Benita Garcia (lead sommelier for Wellington Gastro Pub & Wine Bar, acting as marketing advisor), and Jeremy Stiles (owner of CW, acting as winery advisor). The board's first meeting will coincide with the grand opening of the winery.

Andrew and Jenny are again asking Bennett & Robertson LLP (BR) for strategic advice. Before HEVW's advisory board meets, Andrew and Jenny want BR to provide further analysis and advice on the opportunities and challenges they are facing, and to assist them in presenting the issues at the board meeting. All suggestions should be consistent with HEVW's long-term goals.

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APPENDIX I
EMAIL FROM THE HEARTWOODS TO JEAN BENNETT

Date: September 7, 2020
To: Jean Bennett, CPA, Bennett & Robertson LLP
From: Andrew Heartwood, HEVW

Good morning, Jean. We look forward to meeting with you and your consulting team on September 9 to further discuss our concerns. We compiled a summary of major events that have occurred since your team provided us with strategic recommendations in early 2018:

2018	February	We borrowed from John Heartwood against Andrew's equity in the Niagara vineyard – \$2.5 million is our current borrowing limit.
2018	March	We gave the farmer notice that we would no longer lease the land to him.
2018	March	We set a retail selling price of \$30 for our Pinot Noir: <ul style="list-style-type: none"> • 80% sales through the winery retail and wine club members (\$24.56 net retail revenue per bottle after discounts, fees and taxes) • 20% sales through licensees – restaurants and retail outlets (\$21.92 net licensee revenue per bottle after discounts, fees and taxes).
2018	July	We planted 20 acres with Cabernet Franc, Pinot Gris and Chardonnay vines.
2019	February	We lost 2.5 acres of Pinot Noir vines to frost damage.
2019	March	Jenny resigned from her bartending job.
2019	April	We started construction of the winery.
2020	July	We replaced the damaged Pinot Noir vines, at a cost of \$37,000.

We are encouraged by the U.S. government's reduction of subsidies to the American grape growing and wine industry, which will drive prices up in the U.S., making Canadian wine more competitively-priced in Canada. The Canadian dollar is expected to remain low versus the U.S. currency for the foreseeable future, which makes travelling to Canada and purchasing Canadian wines more attractive.

APPENDIX I (continued)
EMAIL FROM THE HEARTWOODS TO JEAN BENNETT

Prince Edward County is the fastest growing wine region in the world, with its wines recognized globally. The Pinot Noir continues to increase in popularity among premium wine drinkers, and consumers are willing to pay a significant premium for organic wines. The number of millennials visiting the region is also increasing.

In its recent budget, the Ontario government committed to supporting the Ontario wine industry and announced new grant programs, especially for producers using sustainable farming and innovative packing methods.

The number of local wineries in our area has doubled. There are a number of virtual winemakers looking to bottle their wines, and grape growers looking for wineries to purchase their grapes. Within the next three to five years, 20 to 25 new restaurants or bars are expected to open in the region. All signs point to continued growth.

APPENDIX II
EXCERPTS FROM PRE-ADVISORY BOARD MEETING – SEPTEMBER 9, 2020

Present: Jean Bennett, Andrew and Jenny Heartwood

Jenny: Jean, we wanted to meet with you before our first advisory board meeting to get your advice on items that we plan to discuss.

Andrew: Now that we have completed planting the vineyard and building our winery, we have some new opportunities that we are exploring. We have done some analysis and would like you to review it and provide your input, including recommendations on how we should proceed.

Jean: Sure. Let's get started with discussing things that are of concern to you.

Jenny: I am concerned about our cash flow. The forecast that I prepared in January 2019 showed that our net cash for 2020 would be an outflow of \$100,000. I haven't had time to update the forecast but, considering the lost revenue of \$155,000 caused by the damaged vines and the replanting costs of \$37,000, I estimate that the outflow will be closer to \$300,000. We are getting close to our borrowing limit with John.

Andrew: I take some responsibility for our financial problems. Balancing the different demands on my time has been challenging. I didn't get the damaged Pinot Noir vines replanted until just this past July. The good news is that there should be no more planting for many years.

Jenny: It's unfortunate that we didn't have insurance in place on the vines. I thought that Andrew had done that and he thought I had.

Andrew: Insurance isn't all we need. We have to make a decision on purchasing equipment to protect our vines. I researched two options that we should get the board's opinion on. I have put together some background information for their consideration (Appendix III).

Jenny: We have both been so busy that Andrew forgot to tell me about the delay in replanting and I didn't inform him of my overspending on the winery.

I think my winery decisions were right. Thanks to my decor choices, we are featured on the September 2020 cover of *Vine and Wine*, and that exposure will attract more visitors.

APPENDIX II (continued)
EXCERPTS FROM PRE-ADVISORY BOARD MEETING – SEPTEMBER 9, 2020

Andrew: I purchased new equipment for the winery whereas I had budgeted for used equipment. The upfront costs were higher, but now our energy costs will be about \$35,000 lower per year and carbon dioxide emissions will decrease by over 55,000 kilograms per year. In total, we overspent by about \$250,000.

It's not all bad news. We will soon be bottling our 2019 vintage, which is our best Pinot Noir to date. Over the winter, we will enter it in several national and international wine competitions.

I plan to start producing a special "Heartbreak Reserve Pinot Noir," aging it an additional 12 months. I prepared an analysis of the impact on revenue (Appendix IV).

Jenny: I am not sure this is a good idea right now. We need to consider how it impacts our immediate cash flow needs. Please let us know if you think we should proceed.

We also need to apply for some government grants. Other local winery owners tell me that grants average 4% of net revenue and that vineyards and wineries pursuing organic and sustainable methods can get grants exceeding 6% until the winery reaches \$2.5 million in net revenue. With hindsight, we should have been more proactive about pursuing grants, but I just couldn't find the time.

We have a proposal from D'Vine-on-Tap (DOT) that I think we should seriously consider. It will provide immediate cash flow. DOT wants to use space in our winery to operate a keg-filling facility. Its marketing representative has provided information on the opportunity, which I have summarized (Appendix V).

The operation can be up and running shortly after we sign the agreement. It could be a great channel for selling our new varietals, which we will be harvesting for the first time this season. Once the vines are at full production in 2022, we may not be able to sell the full production from these varietals through our existing distribution channels.

Andrew: If we rent that space to DOT for five years, our opportunity to be a major player in the Prince Edward County tourism events will be limited, which is one reason we invested so heavily in this beautiful facility. And have you considered other implications of this idea? Wine on tap is relatively new and I am not sure how the market will react to it. It may be perceived as lower-quality wine. Selling our wine on tap may not get it to the right market.

APPENDIX II (continued)
EXCERPTS FROM PRE-ADVISORY BOARD MEETING – SEPTEMBER 9, 2020

Jenny: Andrew, we have to deal with our short-term cash flow problem. I think this DOT idea is what we need right now. Maybe appealing to a wider market for some of our wines is a good idea.

In addition to the DOT idea, there are other ways to generate cash that we should consider.

Andrew: I agree. Jeremy suggested that a better way to generate cash is to maximize the use of our excess bottling capacity. CW does this by bottling for virtual winemakers in our region and also selling their wines in its store. They also purchase grapes from local vineyards and produce more wine that way. I have prepared information on these opportunities (Appendix VI).

As much as I like the opportunity to fill our bottling capacity, I do not want to harm our own wine sales or negatively impact our brand by producing wines for other vineyards or from purchased grapes. It could also reflect badly on our flagship Pinot Noir if customers drink wine from purchased grapes, thinking it comes from our vineyard. I am not confident that the quality of the wines produced will meet our standard, so I am somewhat reluctant to pursue these options.

Jenny: Can't we just brand the wines from purchased grapes differently to distinguish them from our wines?

Andrew: I just want to be sure we don't damage our reputation as an estate winery.

Jenny: That is a risk, but I don't think it's insurmountable. In fact, pursuing DOT could free up additional bottling capacity, which could then generate more cash flow through a combination of the virtual winery and purchasing of grapes.

Our long-term goal remains to become a successful small- to mid-size winery. Long term, we should be able to do this with wines from our own vineyard. But in the short-run, we need to consider all options. Since I am no longer working at the bar and Andrew has resigned from his position at CW, we no longer have income from other sources to help out.

APPENDIX II (continued)
EXCERPTS FROM PRE-ADVISORY BOARD MEETING – SEPTEMBER 9, 2020

- Jenny: We don't get dividends from Andrew's share of the family vineyard as long as we have the debt to his father. I think we should repay this loan, with debt from a bank or other source, so that we will at least get our dividend income. I have some financing options to present to our advisory board (Appendix VII). These ideas are at an early stage. We are looking for you to identify any potential disadvantages. Do you think any of these are worth investigating further, or do you have other suggestions?
- Jean: This discussion has been helpful. We will analyze the decisions you are facing after reviewing the material you provided. We will focus on the strategic implications of the alternatives, as that is what your advisors will be concerned with. I will have CPA, who was part of the original team of advisors, prepare the report.

APPENDIX III VINEYARD UPDATE

Prepared by Andrew Heartwood

New vines

The 20 acres planted in July 2018 with VQA-qualified Cabernet Franc, Pinot Gris and Chardonnay vines are growing well and are on track to produce the first harvest in 2020, with an estimated 25% yield. The actual costs for these vines are close to our targeted costs. We continue to use organic farming techniques, which result in lower yields and higher costs but a better wine. The remaining ten acres were to be used for the winery (5 acres) and the potential joint venture with Niagara College (5 acres). We have not yet done anything with the five acres that we had set aside for the college.

Pinot Noir frost damage

The warm air that rises from Lake Ontario mitigates the chance of frost damage to our hillside vineyard, but not during extreme cold. We have experienced extreme cold twice in the past three winters, and avoided frost damage by building bonfires at the bottom of the vineyard hillsides. Sudden cold temperatures in mid-February 2019 resulted in the loss of 25%, or 2.5 acres, of our Pinot Noir vines. The table on the following page shows the impact of the loss, and our annual vineyard and winery production with the replacement vines included, until we reach full production in 2025.

APPENDIX III (continued)
VINEYARD UPDATE

Annual vineyard and winery production forecast – all varietals

Production in equivalent bottles	2020	2021	2022	2023	2024	2025
Pinot Noir						
Original vines	19,318	19,318	19,318	19,318	19,318	19,318
Replacement vines	Y1 – none 0	Y2 – none 0	Y3 (25%) 1,610	Y4 (75%) 4,830	Y5 (100%) 6,440	6,440
Total Pinot Noir	19,318	19,318	20,928	24,148	25,758	25,758
Other varietals (planted in 2018)	Y3 (25%) 26,186	Y4 (75%) 78,558	Y5 (100%) 104,744	104,744	104,744	104,744
Equivalent total bottles of wine aging in tanks (bottled in subsequent year)	45,504	97,876	125,672	128,892	130,502	130,502
Total bottles of aged wine available for sale in current year	19,318	45,504	97,876	125,672	128,892	130,502
Net revenue ¹	\$464,250	\$967,692	\$1,974,575	\$2,516,708	\$2,594,091	\$2,632,783

¹ Assumes net revenue for other varietals will be 80% of the Pinot Noir.

Frost-prevention equipment

With climate change leading to more frequent and extreme cold, I am considering investing in equipment to help prevent vine frost damage. Details of the equipment options are as follows:

	# of Units required for 30 acres	Useful life in years	Capital cost per unit	Capital cost for required number of units	Annual operating costs per unit	Total annual operating costs
Wind machine	3	24	\$35,000	\$105,000	\$700	\$2,100
Oil heater	600	8	\$60	\$36,000	\$20	\$12,000

Wind machines pull warm Lake Ontario air down from high above a field, pushing away the cold air near the vines and replacing it with air that is at least five degrees warmer. They are fuel-efficient but generate noise pollution, which our neighbours might not like.

APPENDIX IV
HEARTBREAK RESERVE PINOT NOIR

Prepared by Andrew Heartwood

We will produce a special “Heartbreak Reserve Pinot Noir,” taking 20% of each year's harvest, starting with our 2019 harvest and aging it for an additional 12 months. This wine will command a 75% price premium over our current Pinot Noir price of \$30. Restaurants are willing to pay more for aged wines, but are unlikely to accept an increase of more than \$5 per bottle. If the increase is any higher, we risk being removed from their wine list altogether. The volume of premium wine that we could sell through our winery store and wine club is limited and we will have to sell through other channels. I expect it will all be sold each year.

I calculated the amount of current sales we give up each year if we do this.

	2020	2021	2022	2023	2024	2025
Number of bottles held for an additional 12 months (20% of previous year's)	3,864	3,864	3,864	4,186	4,830	5,152
Sales price	\$30	\$30	\$30	\$30	\$30	\$30
Reduction in Pinot Noir sales revenue due to delay	\$115,920	\$115,920	\$115,920	\$125,580	\$144,900	\$154,560

APPENDIX V D’VINE-ON-TAP PROPOSAL

Prepared by Jenny Heartwood

D’Vine-on-Tap (DOT) works with wineries to market and distribute a variety of wines to restaurants and bars. DOT currently operates two keg-filling facilities in partnership with local wineries in other regions of southwestern Ontario. Wineries send their wines in bulk to DOT and DOT fills large kegs with the wine. The kegs are owned by DOT and used in the restaurants and bars. The restaurants pay a security deposit to DOT for the kegs and pay the Liquor Control Board of Ontario price for the wine, which DOT submits to the wineries, less a keg-filling fee.

DOT’s proposal to HEVW:

- DOT will contract with local wineries, including HEVW, to keg and sell their wines.
- HEVW will provide 2,000 square feet of space in the winery showroom for DOT to use as its keg-filling facility.
- DOT will waive the keg-filling fee for HEVW’s kegs.
- DOT will be responsible for all costs associated with setting up the keg-filling facility.
- HEVW will make a five-year commitment to DOT with respect to the space and DOT will pay HEVW \$100,000 up front to rent the space for the five years.

The DOT account manager provided me with their estimate of the volume of kegs they expect to sell. DOT has solid evidence to suggest that, if we set up this facility, five new restaurants or bars offering wine on tap will open in the area each year for the next five years. DOT has suggested we could obtain 30% to 40% of the market based on the reputation of our wines. The manager tells me that wine on tap is becoming very popular in the areas where DOT has set up previously, and that having wine on tap results in an overall increase in wine sales.

The stainless-steel kegs have a 30-year lifespan. By eliminating the need for glass, cork, labels and capsules, packaging costs are reduced, which means increased profits.

If we do not pursue this option, we will use the full 2,500 square feet of space to host tourism and other events throughout the year. Longer term, we may consider offering another location for DOT.

APPENDIX V (continued)
D'VINE-ON-TAP PROPOSAL

I prepared the following forecast based on HEVW getting 40% of the market:

D'Vine-on-Tap	2021	2022	2023
Estimated annual keg volume per restaurant/bar	87	87	87
Total restaurants and bars offering wine on tap	5	10	15
Total kegs for all restaurants and bars	435	870	1,305
HEVW wines	40%	40%	40%
HEVW keg sales	174	348	522
HEVW equivalent bottles	4,524	9,048	13,572
Net bottle equivalent profit with savings on variable bottling costs of \$1.75	\$13.69	\$13.69	\$13.69
Annual margin from keg sales	\$61,934	\$123,867	\$185,801

APPENDIX VI WINERY UPDATE

Prepared by Andrew Heartwood

Winery

Our carbon footprint is being reduced through a combination of solar panels and geothermal walls in the winery, and the new energy-efficient equipment that we purchased. We have received all the necessary licenses and VQA approvals. We will no longer have to pay the \$3 bottling fee to CW, or a commission to sell our wine in its retail store.

Bottling line capacity utilization

The new bottling line is state-of-the-art and will result in high productivity. Our winery has the capacity to bottle 15,000 cases annually. I have estimated our own bottling requirements and calculated the excess capacity as follows:

Number of cases	2020	2021	2022	2023	2024	2025
Winery capacity	15,000	15,000	15,000	15,000	15,000	15,000
HEVW production	1,610	3,792	8,156	10,473	10,741	10,875
Excess capacity	13,390	11,208	6,844	4,527	4,259	4,125

We hope that one, or a combination, of the following alternatives will fill:

1. the short-term excess capacity, and
2. the ongoing extra capacity we will have once our vines reach full production.

Bottle wines for virtual winemakers

We could perform a bottling service for virtual winemakers, charging \$3 per bottle plus variable costs.

We expect the demand by virtual winemakers in the region to be 3,750 cases (45,000 bottles) this year and to increase by about 5% annually for the foreseeable future.

We could also offer to sell these wines in our retail store on behalf of the winemaker, earning a commission on the sales. We were paying CW 10% of the gross retail price when they sold our wines, and could expect the same from virtual winemakers that we bottle for.

APPENDIX VI (continued)
WINERY UPDATE

Bottling line capacity utilization (continued)

Purchase grapes from other growers and bottle as HEVW wine

We could produce Cabernet Franc, Pinot Gris and Chardonnay, under our own label, from grapes purchased from other growers. There are enough grapes available for purchase that we could fill our entire excess capacity. We could sell the wine in our retail store or at organized events in our tasting room.

	Per bottle
Normal margin to bottle HEVW Cabernet Franc, Pinot Gris, Chardonnay	\$ 7.51
Sales price reduction as not organic or estate-grown grapes	(4.00)
Extra paid to purchase grapes	(1.00)
Net margin per bottle	\$ 2.51

APPENDIX VII FINANCING OPTIONS

Prepared by Jenny Heartwood

1. We could delay payment to the winery contractor.
2. We could seek a bank loan or an operating line of credit. Jeremy says CW's bank is looking for new clients. CW was able to borrow against 40% of their sales value of bottled wine in inventory plus 75% of the value of their land and winery. CW's loan can be drawn in \$50,000 increments and paid back at any time, with interest at prime (currently at 2%) plus 4% on the average daily balance, calculated at month-end.
3. Jeremy is willing to invest in HEVW, offering to purchase 25%.
4. We could sell some of Andrew's share of the Niagara family vineyard, which is currently valued at \$3 million, to a family member, or try to get permission to sell to someone else.
5. We could pre-sell some of our wine to wine club members, perhaps offering them a small discount.

APPENDIX D

**DAY 1 (HEVW VERSION 1) – SEPTEMBER 12, 2018
MARKING GUIDE AND SAMPLE CANDIDATE RESPONSE**

**MARKING GUIDE
HEARTBREAK ESTATES VINEYARD AND WINERY (HEVW)
VERSION 1**

Summative Assessment #1 – Situational Analysis

Competencies

2.3.2 Evaluates the entity's internal and external environment and its impact on strategy development

Enabling:

1.2.2 Performs work competently and with due care.

2.1.1 Defines the scope of the problem.

2.1.2 Collects and verifies relevant information.

2.1.3 Performs appropriate analyses.

2.1.4.4 Analyzes and synthesizes the view of others to develop a more complete understanding of issues and/or implications of alternatives.

For Summative Assessment #1, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate used a reasonable situational analysis when analyzing the major issues facing HEVW.

Unsure – The candidate attempted to use a reasonable situational analysis when analyzing the major issues facing HEVW.

No – The candidate clearly did not use a reasonable situational analysis when analyzing the major issues facing HEVW.

*Competent candidates should complete a sufficient situational analysis. The candidate should focus on describing the factors that have changed and are relevant to the decisions to be made—a recap of the mission/vision and key success factors (KSF), as well as certain elements of the SWOT, is appropriate. **Note that for this case, little has changed, so candidates do not need to spend a lot of time on this part of their response.***

*Candidates should draw upon their situational analysis when analyzing the major issues facing HEVW (risk management of the vineyard, production of Heartbreak Reserve, D'Vine-on-Tap (DOT) proposal, use of excess winery capacity, cash flow and financing and governance issues). **To understand and respond to the issues raised, this case requires that candidates have a thorough understanding of the wine industry and HEVW from Cap 1.***

Mission and Vision Points

Day 1 – Andrew and Jenny (HEVW) are still committed to the same vision and mission.

Vision statement: Grow the finest grapes, let them shine in the finest wine and attract all types of people from all places to see where the magic happens at our vineyards in Prince Edward County, Canada.

Mission statement: Our **vineyards** will grow premium *vinifera* grapes, and we will use hand labour and sustainable farming methods to care for the grapes to the point of harvest.

Our **winery** will produce premium wines, which are the best expression of our unique terroir, with minimal intervention and minimal impact on the environment.

Our **wines** will please the most discerning wine lover's palette, and we will introduce fine wine to an entirely new wine loving demographic.

Our **business** will provide a satisfactory profit to enable the owners to focus on this business with sufficient returns to fund future growth goals.

Even if candidates recommended changes to the mission in their Cap 1 group work, there is a commitment to the original vision and mission expressed in the Day 1 case, which should be used to support their recommendations.

Candidates are NOT expected to discuss KSFs and SWOT in detail – they should, however, recap and use them in their Day 1 case analysis.

Vineyard KSFs from Cap 1 and Day 1 update

- Experienced and knowledgeable premium grape grower.
- Grows VQA-approved grape varieties (vinifera and specific hybrids) that are in demand.
- Located in a VQA-designated viticultural area (DVA).
- Varietals grown are appropriate for the climate, soil and topography of the vineyard location
- Have sufficient working capital to sustain the farm while waiting for the grapes to reach maturity and 100% production.
- Can take advantage of risk-management programs offered in Ontario (e.g., AgrilInsurance) to address various risks and uncertainties.
- A risk-management program is required for vineyard exposure to extreme weather, usually consisting of preventative methods.

Winery KSFs from Cap 1 and Day 1 update

- Consistently high-quality wine
- Knowledgeable and reputable winemaker (preferably with awards)

- Winery offers a tasting facility
- Attractive facility both outside and inside (architecture, car parking, signage, interior design ambience, etc.)
- Effective use of winery capacity to maximize revenue

Marketing and distribution:

- Wine community partnerships; special wine events and festivals
- Experiential wine programs
- Ecotourism, unique wine tours
- Social media presence
- Wine on tap is becoming more popular, and millennials are flocking to restaurants offering good-quality wine on tap.

Strengths (from Cap 1)

- Experience in vineyard and winery operations

Strengths (NEW from Day 1)

- Andrew is now full time at HEVW (no longer at CW) so he can commit his full attention to HEVW. However, this also means he is 100% dependant on HEVW for income.
- Pinot Noir sells out each year and the wine club is growing, showing continued strength for the HEVW brand.
- New state-of-the-art winery and tasting room with 2,500 sq. ft. of excess capacity for additional revenue opportunities.
- Excess bottling capacity to create additional, much needed revenue (and extra winery space to rent out).
- Established an advisory board to provide guidance to Andrew and Jenny.
- Still have five acres of land available for future development.
- Prince Edward County is recognized globally for its wines helping the HEVW brand grow beyond the local market.

Weaknesses (from Cap 1)

- If Andrew sells his share of the family farm in Niagara to obtain financing, he has to sell it to family members, and they do not have cash available.
- Neither Jenny nor Andrew have business, tax, regulatory reporting or accounting expertise.
- No crop insurance is in place.
- Andrew cannot collect dividends from his ownership interest in the family farm until the loan is paid off in full. (We do not know the dividend amount, but interest on the loan is 6%.)

Weaknesses (NEW from Day 1)

- Cash flow issues:
 - Jenny estimates cash outflow will be \$300,000 which is well beyond the \$100,000 that was forecast.
 - Lost 2.5 acres of Pinot Noir vines to extreme weather, resulting in additional costs to replant the vines and approximately \$155,000 of annual lost wine sales revenue at current pricing until new vines reach maturity.
 - Overspending on winery by \$250,000 contributed to funding shortfall (potential financial control issues and/or poor management decision making).
 - Loss of both Andrew's stable income as a winemaker at CW and Jenny's salary now that both are committed full-time to HEVW.
- There may be insufficient working capital or financing to support the vineyard costs until it reaches 100% production. Currently Andrew and Jenny are close to the maximum \$2.5 million funding limit and may not be able to pay off the loan.
- Limited frost risk mitigation strategies in place and this is a high-risk for HEVW considering climate changes and weather-related vineyard losses.
- Andrew and Jenny have not followed through on obtaining government grants that are available to small growers and wineries.

Opportunities (NEW Info in Day 1 Case)

- US administration reducing subsidies to American wine industry, resulting in increased prices, making Canadian wine prices more competitive.
- Several restaurants and bars are expected to open in the county over the next few years providing HEVW with more potential distribution channels.
- CAD currency is expected to remain low versus US currency, making Canadian prices more attractive and attracting American tourists.
- New government grants are available to the wine industry which would help HEVW with its current cash flow problem.
- Consumers are willing to pay more for wines grown using organic farming techniques. If HEVW remains true to its mission of being environmentally friendly, they could attract some of these customers.
- Pinot Noir is growing in global popularity among premium wine drinkers which is beneficial for HEVW since the pinot noir is their primary wine.
- Wines that are aged garner a higher price from consumers, both in the winery and in restaurants.
- There are an abundance of local growers are looking for wineries to purchase their grapes which HEVW could use to fill its excess capacity.

Threats (NEW Info in Day 1 Case)

- The number of wineries in the county has doubled, resulting in increased competition.
- Weather has been more challenging with extreme cold in two of the last three winters. Since HEVW currently does not have insurance nor equipment to prevent frost damage, this is high-risk.

Quantitative Analysis

- HEVW is nearing its credit limit of \$2.5 million meaning HEVW will have to look for alternate means of financing if any is required.
- Cash outflow for 2020 is estimated at \$300,000 which is \$200,000 more than forecast. Since both Jenny and Andrew are entirely dependent on HEVW for income, short term cash flow is vital.

Summative Assessment #2 – Analyzes the Major Issues

For Summative Assessment #2, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate completed a reasonable assessment of the major issues facing HEVW.

Unsure – The candidate attempted to complete a reasonable assessment of the major issues facing HEVW.

No – The candidate clearly did not complete a reasonable assessment of the major issues facing HEVW.

This summative assessment is based on Assessment Opportunities #2 to #6.

Assessment Opportunity #2 (Strategic Issue #1 – The candidate discusses HEVW's approach to risk management and makes a recommendation.)

Competent candidates will complete both a qualitative and quantitative assessment of HEVW's current approach to risk management and assess the frost damage prevention alternatives (new equipment options); candidates should also qualitatively address the need to purchase crop insurance to manage risks.

Candidates are provided with most, but not all, of the calculations required. They should recognize the need to compare the NPVs using the right time frame.

Competencies

2.3.3 Evaluates strategic alternatives

Enabling: 2.1.2 Collects and verifies relevant information.

2.1.3 Performs appropriate analyses.

2.1.4 Integrates information to investigate each potentially viable solution or conclusion.

2.1.6 Uses creativity and innovation to enhance problem-solving and decision-making.

Quantitative Analysis of Wind Machines versus Oil Heaters

	Wind	Oil			
		Total	Years 1 – 8	Years 9 – 16	Years 17 – 24
Discount rate	6%		6%	6%	6%
Life/Annuity period	24		8	16	24
PV \$1			1	0.5919	0.3937
PV Annuity	12.55		6.2098	6.2098	6.2098
Capital costs	\$105,000	\$108,000	\$36,000	\$36,000	\$36,000
Annual operating costs	\$2,100	\$12,000	\$12,000	\$12,000	\$12,000
PV Wind operating costs	\$26,355				
PV Oil operating costs		\$122,254	\$74,518	\$44,107	\$29,338
PV Capital costs		\$59,062	\$36,000	\$21,308	\$14,173
Total PV	\$131,355	\$219,444	\$110,518	\$65,414	\$43,511

Although the upfront costs for oil heaters are approximately one-third of the wind machines, the oil heaters must be replaced every eight years and the annual operating costs are higher, resulting in a total present value of \$219,444. The present value favours the wind option by approximately \$88,000.

Qualitative Analysis

It is important the HEVW implement preventative measures to address the growing risk of extreme cold that has occurred, and is anticipated to increase, which leads to major financial losses for the company. These losses are experienced until the new vines reach maturity.

Oil Heaters

- The lower upfront costs of the oil heaters would help with the current cash flow challenges (LINK to SWOT) and they would only operate during extreme cold. However, they will need to be replaced every eight years, resulting in higher total capital investment ($3 \times \$36,000 = \$108,000$).
- HEVW's mission is to use sustainable farming techniques (LINK to Mission); to implement a solution that considerably increases the carbon footprint of the vineyard is not consistent with that mission.

Wind Machines

- The upfront cost of the wind machines is higher, resulting in additional financing requirements in the short term (LINK to SWOT).
- The carbon footprint is much lower than the oil heaters, so the wind machines align better with HEVW's mission.
- The noise pollution may disturb the neighbouring farm residents which may impact HEVW's community relationships.
- There are only three wind machines to maintain (versus 600 oil heaters), so it would require a lot less resources to operate. However, if one wind machine breaks down, the impact will be greater whereas if one oil heater breaks down, the impact will be minimal.

Crop Insurance

HEVW currently has no crop insurance. The losses incurred to remove and replace the Pinot Noir vines were considerable (\$37,000); however, the losses associated with the lost production are even greater (\$155,000 per year until the new production phases in) (LINK to SWOT). Therefore, purchasing both crop insurance and production loss insurance is a worthwhile investment in order to mitigate future losses. Installing crop protection equipment should reduce the cost of the insurance.

Conclusion

The wind machines are the solution with the lowest carbon footprint (LINK to mission) and the lowest lifecycle cost, so are the preferred choice IF HEVW can find the necessary funds to finance the purchase.

If cash flow is an issue and financing cannot be obtained, crop insurance should be purchased in the short term in order to reduce risk, and the equipment purchased in the longer term, once HEVW has more cash flow. However, if HEVW's cash flow is sufficient, it should purchase both the wind machines and the crop insurance.

Another option would be to purchase the oil machines now since the capital cost is much lower and review in eight years' time, when they require replacement, or to phase in wind equipment over the next few years, starting with protection of the Pinot Noir as it is the most valuable and least hardy crop.

Having crop protection equipment would potentially reduce the cost of insurance.

Assessment Opportunity #3 (Strategic Issue #2 – The candidate discusses the option of creating a “premium” batch of Pinot Noir.)

Competent candidates will complete both a qualitative and quantitative assessment of the option of further aging wine to create a reserved, “premium” batch. Candidates should discuss whether it is feasible and consider the opportunity cost of holding back some wine for a year.

Quantitative: Candidates should identify that aging the wine for an additional year will result in a time lag for the cash flow but will increase the amount of cash flow overall. Candidates should also recognize that aging the wine for an additional year will result in a decrease in the working capital.

Quantitative Analysis

	2020	2021	2022	2023	2024	2025
Number of bottles held for an additional 12 months (20% of previous year's)	3,864	3,864	3,864	4,186	4,830	5,152
Sales price	\$30	\$30	\$30	\$30	\$30	\$30
Reduction in sales revenue of Heartbreak Pinot Noir	\$115,920	\$115,920	\$115,920	\$125,580	\$144,900	\$154,560
Increase from sale of Heartbreak Reserve Pinot Noir	0	202,860	202,860	202,860	219,765	253,575
Net change – annual	(115,920)	86,940	86,940	77,280	74,865	99,015

By aging 20% of the Pinot Noir for another year, some revenue would be deferred each year. This is most significant in the first year where HEVW would have a decrease in cashflow of \$115,920.

Qualitative Analysis

- Adding this new premium product is in line with HEVW’s mission and vision. (LINK to vision)
- This may help win more awards in the future which will further strengthen the HEVW brand and future sales.

- Millennials will not be happy with the increase in price, but baby boomers will not mind (LINK to Cap 1) and are willing to pay the premium, so there is a market for this high-quality wine.
- There is an issue with pricing in restaurants who will not accept an increase of more than \$5 per bottle. However, HEVW can sell through retail and wine club so it may not be necessary to sell to restaurants.
- Producing the premium wine will put a lot of pressure on cashflow in the first year and cashflow is currently an issue. (LINK to SWOT)
- The current Pinot Noir sells out, so reducing the inventory available by 20% may make more customers unhappy as the pinot noir be sold out faster and harder to acquire.
- Uncertain if HEVW has the storage capacity to hold 20% of their inventory for a year. Especially if they use some of the excess space to partner with D’Vine on Tap. (LINK to other issues)

Candidates should note that HEVW must charge the same for all channels (winery, licensee, LCBO), although margins will differ. They should not recommend charging less to the restaurants and more in the winery and wine club, as it is not allowed (LINK to Cap 1).

Recommendation

The benefits of aging the wine an additional year are lucrative, in terms of the added revenue, after year one. Therefore, HEVW should make the premium wine. However, in the short term, the cash flow issue is a priority. Unless other sources of funds or financing can be found, the decision to “age” should be delayed by a year or two [LINK to cashflow] when HEVW is in a stronger financial position.

Assessment Opportunity #4 (Strategic Issue #3 – The candidate considers the D’Vine-on-Tap partnership.)

Candidates are expected to recognize that, due to space constraints, expanding into events (other than small ones) would not be possible if the DOT option is pursued. They should discuss whether DOT is in the best interests of HEVW from the perspective of their vision and mission.

Candidates are expected to analyze the quantitative information presented and to consider the upfront cash and incremental revenue it provides.

Stronger candidates will also integrate this opportunity with the option of purchasing grapes and using the bottling capacity to achieve the maximum net margin.

Quantitative Analysis

The 40% of the market from DOT sales is provided in the case but candidates should consider the lower end of the range (i.e. 30%) to err on the side of caution and because the information is coming from a biased source.

	2021	2022	2023
40% of the market	\$61,934	\$123,867	\$185,801
30% of the market	\$46,451	\$ 92,900	\$139,351

Since there will be an opportunity cost (i.e. the wine is sold in kegs instead of bottles), it would be reasonable to consider the incremental difference. On the assumption that the margin, whether it is sold per bottle or in the kegs, is the same with the exception of the \$1.75 variable costs of the bottle itself, HEVW could benefit as follows:

	2021	2022	2023
HEVW equivalent bottles	4,524	9,048	13,572
Savings on variable bottling costs	\$1.75	\$1.75	\$1.75
Difference by going with DOT	\$7,917	\$15,834	\$23,751

The benefit of going with DOT is not significant as compared to current sales in bottles. The one thing that is making DOT more attractive quantitatively is the \$100,000 upfront payment which would help with the current cash problem (LINK to cashflow).

Qualitative Analysis

- There is only 2,500 square feet of space available for new uses and if it is used for DOT, there will be no space for events which was a key purpose of the new building.
- There is a five-year commitment so HEVW would need to consider the opportunity cost over five years to the \$100,000 rental revenue.
- There is a perception that the quality of wine in kegs is lower. Therefore, selling HEVW wine in kegs would be contrary to the vision. [LINK to vision]
- There is no cost to HEVW to do this, which is good, considering its cash flow situation. Moving ahead with DOT would help with the short-term cash problem with the \$100,000 upfront payment from DOT.
- It will be difficult for HEVW to be part of the seasonal wine events (which is a key success factor) if they have no available space to host the influx of visitors [LINK to KSF – Cap 1].
- This is an opportunity to get involved at the onset of a new distribution method that is growing in popularity, especially among millennials who like good wine and appreciate value [LINK to SWOT – Cap 1].
- This would be a good distribution channel for the new wines when the grapes begin producing wine next year (first harvest in 2020 and first wine in 2021), or if we purchase grapes while waiting for the vineyards to reach full production (INTEGRATION).

Recommendation

Since HEVW needs cash in the short term and this option requires no additional investment by HEVW and provides \$100,000, it is worth considering. However, the financial benefit of selling in kegs versus bottles is minimal, and that is based on sales projections from DOT that are biased. In addition, the perception that wine in kegs is lower quality is contrary to HEVW's vision and losing the space for events is contrary to a KSF of attracting visitors for events. Therefore, I recommend that HEVW not proceed with the partnership with DOT.

Assessment Opportunity #5 (Strategic Issue #4 – The candidate discusses use of the excess capacity in the bottling facility.)

Competent candidates will complete both a qualitative and quantitative assessment of the significant factors related to choosing the best option(s) for filling the short- and long-term excess capacity in the bottling facility (about 160,000 bottle excess).

Quantitative Analysis

Bottling options – contribution margin per bottle:

- Option 1 – virtual winemakers:
 - No incremental costs are associated with bottling wines for virtual winemakers; this option will simply be \$3.00 of incremental revenue (and margin) for each bottle. This could generate about \$135,000 in incremental annual profit based on the maximum demand of 3,750 cases. ($3,750 \times 12 \times \$3 = \$135,000$).
 - There is also the possibility of increasing revenue through commissions on wine sold in HEVW's retail store.
- Option 2 – purchasing grapes to process in the winery:
 - This provides less margin, at \$2.51 per bottle but a greater volume is possible as the supply of grapes exceeds the excess capacity.
- Option 3 – combination of Options 1 and 2:
 - The options are not mutually exclusive so a combination of both options can be pursued.

Quantitative Analysis

The recommended alternative is that HEVW maximize the financial contribution by giving priority to the virtual winemakers, whose contribution per bottle is higher. The balance would then be filled with purchased grapes. This allows for the capacity and margin to be maximized.

	2020	2021	2022	2023	2024	2025
HEVW excess capacity (cases)	13,390	11,208	6,844	4,527	4,259	4,125
Volume						
Virtual winery ¹	3,750	3,938	4,134	4,341	4,259	4,125
Grape purchase	9,640	7,270	2,710	186	0	0
Total volume	13,390	11,208	6,844	4,527	4,259	4,125
Margin						
Virtual winery	\$135,000	\$141,768	\$148,824	\$156,276	\$153,324	\$148,500
Grape purchase	290,357	218,972	81,625	5,602	0	0
Total margin	\$425,357	\$360,740	\$230,449	\$161,878	\$153,324	\$148,500

Andrew estimates that HEVW could earn a 10% commission on sales of the virtual winemaker’s wine. If we assume a sales price similar to HEVW wine (\$30) and all bottles produced are sold, then HEVW could earn:

	2020	2021	2022	2023	2024	2025
Cases	3,750	3,938	4,134	4,341	4,259	4,125
Bottles	45000	47256	49608	52092	51108	49500
Commission per bottle	\$3	\$3	\$3	\$3	\$3	\$3
Total commission	\$135,000	\$141,768	\$148,824	\$156,276	\$153,324	\$148,500

Qualitative Analysis

Option 1 – virtual winemakers:

- This option would enable HEVW to protect its own brand as the wines will be labelled under the virtual winemaker’s name (LINK to Cap 1 – vision and mission).
- HEVW can sell the virtual winemakers’ wine in HEVW’s winery store which means more selection for visitors which makes the store more attractive.
- With the virtual winemakers, there is no issue of carrying inventory of unsold production as the virtual winemakers will be responsible for it.
- Selling other brands in their shop could cannibalize sales of HEVW wines.

Option 2 – purchasing grapes to process in the winery:

- Purchasing grapes from the other growers will reduce the ability for Andrew to control the quality of the wine and this goes against the mission [LINK to mission].
- There is a chance that selling this wine in HEVW’s winery store could cannibalize the sales of the popular Pinot Noir.

¹ Annual increase of 5%.

- This alternative may support the option to partner with DOT if HEVW can use wine from purchased grapes to fill the kegs. (Integration)
- The wines may not be approved by the VQA and could therefore not be considered estate wines (estate grown and bottled) as that would be against the name of the company (Heartbreak Estates Vineyard and Winery) (LINK to Cap 1); they can be sold but not under the Estate name.

Additional considerations candidates could discuss:

- Looking for opportunities to grow revenue streams will help HEVW achieve its objective of becoming a profitable, medium-sized winery (targeting revenues of between \$2 and \$5 million) (LINK to objectives).
- Both options provide an opportunity to partner with other community businesses (KSF from Cap 1).
- Both opportunities will generate additional cashflow/profit and both address the KSF of using any available capacity.

Recommendation

Based on the fit with HEVW's mission and vision and need for cash flow, fill as much of the excess capacity as possible with the virtual winemakers (i.e., bottling for them and selling their wines in store) and fill the remaining capacity with purchased grapes.

Candidates could also consider how the DOT option may impact this.

Assessment Opportunity #6 (Strategic Issue #5 – The candidate discusses other operational issues.)

Candidates should address the desire to replace the family financing with external financing, include the timing and provide feedback on the ideas that Jenny presented.

Candidates should discuss the poor communication, lack of clearly defined roles, and lack of long-range planning or consider the implications of decisions that have led to some of the current problems, such as the overspending on the winery, not applying for grants, and failing to appropriately manage vineyard risks.

Candidates could also discuss and calculate the potential government grants which would help with the short-term cashflow problem.

Better candidates will do this in an educational and supportive manner, bearing in mind that they are reporting to Andrew and Jenny Heartwood.

Financing

- A KSF is for grape growers to have sufficient working capital to sustain the farm until vines reach maturity or 100% production, and while wine ages. HEVW has a short-term cash problem and will need to address this to get through the next year or two.
- Andrew and Jenny will now need to take a salary or dividends from HEVW, as they no longer have salaries from other employment and are 100% dependent on HEVW for income.

Analysis of ideas presented by Jenny:

Before any of these ideas are pursued, an updated forecast needs to be completed. However, as requested, I have provided some preliminary analysis.

1. We could delay payment to the winery contractor.

This would be temporary at best and would damage existing relationships therefore it is not recommended.

2. We could seek a bank loan or an operating line of credit.

This may be a good way to gain the working capital funding required but not for long-term financing. The interest rate of prime plus 4% appears high and a better rate may be possible. You could consider farm loans through banks and government agencies which may provide a lower interest rate.

3. Jeremy is willing to invest in HEVW, offering to purchase 25%.

This is something that would change the ownership and is not in line with what I understand is HEVW's mission and vision. It would also require valuation and would change the dynamics of decision making. Therefore, this is not a wise option, especially since the financing issue is short-term while giving up 25% of the company is long-term.

4. We could sell some of Andrew's share of the Niagara family vineyard, which is currently valued at \$3 million, to a family member, or try to get permission to sell to someone else.

You cannot currently sell outside the family (LINK to Cap 1) and are not likely to get permission to do so. The family currently does not have the fund to buy Andrew's share.

5. We could pre-sell some of our wine to wine club members, perhaps offering them a small discount.

If the discount offered is reasonable, this may be a good way to finance some working capital but it is likely that the amount raised this way will be small. Once you complete a forecast and find that the cash needs are low, this may be the best alternative for raising funds.

Overall, these options are not overly attractive (or feasible). The best source of cash will be generated through the use of the excess capacity. Assuming everything that is produced is sold, then the excess margin generated should cover the short-term cashflow shortage. If it does not, then the next best option would be to pursue a line of credit which is the right tool to use to bridge short-term financing gaps.

Governance Issues

Candidates are not specifically directed to discuss these issues; however, there is clear evidence of a communication issue between Andrew and Jenny that has contributed to poor decisions and indicates that their roles and responsibilities are not clearly defined or understood. They also appear too busy to handle the current workload. They may get even busier when the winery opens and take on some of the other opportunities that are being recommended (e.g., virtual winery, and grape purchases).

Evidence of communication issues and poor decisions include not purchasing crop insurance, not applying for grants and overspending.

Andrew and Jenny should start to schedule meetings where they can review the operations regularly and ensure all duties are assigned. They can work closely with their new advisory board to obtain guidance on setting priorities and for advice on their roles and responsibilities. They may even want to consider hiring an assistant to help pursue the great opportunities for growth they are facing as Jenny and Andrew cannot do it all.

Applying for government grants

The time invested to apply for grants will be rewarded with increased cash flow and reduced financing requirements (LINK to SWOT). While the grants may not be significant in the first year, by 2023 they could be worth more than \$150,000.

	Revenue	Grant potential 6%
2020	\$ 464,212	\$ 27,853
2021	\$ 967,692	\$ 58,062
2022	\$1,974,575	\$118,475
2023	\$2,516,708	\$151,002
2024	\$2,594,091	\$155,645
2025	\$2,632,783	\$157,967

Summative Assessment #3 – Conclude and Advise

Competencies

Enabling

2.1.4 Integrates information to investigate each potentially viable solution or conclusion.

2.1.5 Recommends and justifies a solution or conclusion based on an integrative view of information for the situation.

For Summative Assessment #3, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate provided reasonable conclusions for each major issue.

Unsure – The candidate attempted to provide reasonable conclusions for each major issue.

No – The candidate clearly did not provide reasonable conclusions for each major issue.

Competent candidates will provide a logical conclusion, for all the issues, that is consistent and flows from their analysis. Candidates can provide their conclusion immediately after their analysis but should also present an overall conclusion to provide a sense of completion to the report (a wrapping-up and prioritization of the recommendations).

Candidates could recommend a different direction than what is below so long as it aligns with their analysis.

The recommendations should address the key concerns of the shareholders and display good professional judgment. Suggesting that further information is required is acceptable as long as it is justified, consistent with the analysis and not excessive.

Summary of Recommendations

Vineyard risk management:

At a minimum, HEVW should obtain crop insurance. Ideally, HEVW should install crop protection equipment to protect against any more losses. If financing can be obtained, the wind machines are recommended over the oil heaters and they could potentially be phased in to reduce capital costs and manage cashflows. This would potentially reduce the cost of insurance.

Heartbreak Reserve vintage:

Pursue this opportunity in the future, but not now. Making a vintage wine aligns with HEVW's vision and generates more profit than the non-vintage wine. However, given the current cash situation, it would be wise to wait a year or two until cash flow improves, vines mature and sales volume increases. Then HEVW will be able to absorb the first-year loss that comes from putting inventory aside to age.

DOT partnership:

Do not enter into this agreement as it departs from the core mission and vision of HEVW. While the \$100,000 received up front is attractive, the amount of incremental income is minimal. There are better uses for the extra space, particularly using it to host events which will attract more visitors.

Use of bottling capacity:

Provide services to virtual wineries to full demand, then fill remaining capacity with purchased grapes. This will use up all the excess capacity and maximize profitability. Creating a separate brand for the wine produced from purchased grapes is recommended, to distinguish it from HEVW wines and protect the HEVW brand.

Other issues:

Andrew and Jenny should meet regularly to discuss HEVW operations and assign specific tasks to each other so that there are no major duties that are overlooked. They can also leverage their new advisory board to provide advice on operations as well as strategic direction.

They should begin the application process for the government grants which will help with the cashflow problem. Ideally, the recommendations in this report help with short-term cashflow but if they do not, then HEVW should seek to obtain a line of credit to meet the cashflow needs for the next year or two.

Summative Assessment #4 – Communication Hurdle

For Summative Assessment #4, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate adequately communicated their response.

No – The candidate clearly did not adequately communicate their response.

Competencies

Enabling

3.3 Adapts communications to meet audience needs.

Insufficient communication in a candidate's response would generally include some of the following problems:

- *The reader needs to re-read sections several times to gain an understanding.*
- *It is not clear what point the candidate is trying to make.*
- *The quantitative analysis does not make sense because of a lack of labeling, formatting or illogical ordering.*

- *There is an excessive amount of spelling and grammatical errors.*
- *The language used is unprofessional.*

Summative Assessment #5 – Overall Assessment

For Summative Assessment #5, the candidate must be assessed in one of the following, based on their overall performance:

Clear Pass – Overall, the candidate provided an adequate response, clearly meeting the minimum standards for each of the summative assessments above.

Marginal Pass – Overall, the candidate provided an adequate response, with some errors or areas of omission, but including the underlying key concepts.

Marginal Fail – Overall, the candidate provided an attempt at a response, with several errors or an incomplete analysis.

Clear Fail – Overall, the candidate did not provide an adequate response because the response was deficient in multiple areas.

To be assessed a Pass, candidates were expected to perform adequately in all the summative assessments and demonstrate that they addressed the issues of importance to Andrew and Jenny in a cohesive and professional manner. Markers should consider the following in making their overall assessment.

- *Did the candidate step back and see the bigger picture, and then address the broader issues identified?*
- *Did the candidate prioritize the issues by discussing the major and minor issues in appropriate depth?*
- *Did the candidate use both quantitative and qualitative information to support their discussions and conclusions?*
- *Did the candidate use the appropriate tools to perform quantitative analyses?*
- *Did the candidate use sufficient case facts (current case and Capstone 1 case) about the external and internal environments to support their discussions?*
- *Did the candidate communicate their ideas clearly, integrating and synthesizing the information?*

SAMPLE RESPONSE – HEVW VERSION 1

Below is an actual passing candidate response.

Day 1

To: Board

From: CPA

Date: September 2020

Re:

Current situation analysis

Strengths

- Continue to win awards
- Thanks to your decor choices, featured on the 2020 cover of Vine and Wine, will attract more visitors

Weaknesses

- Lost 2.5 acres of Pinot Noir vines because of the frost, replanting cost 37k
- First time Andrew and Jenny will be pressing and bottling their own grapes.

KSF

- Sells out all the production
- The club is very popular and continues to grow.
- PE County is the fastest growing wine region in the world
- The wines of the County are recognized globally
- Pinot Noir continues to increase in popularity among premium wine drinkers

Opportunities

- US government reducing subsidies will result in increased prices in the USA
- US government reducing subsidies will result in making Canadian wines more competitive
- Travelling to Canada and purchasing Canadian wines will be more attractive
- Consumers are willing to pay more for organic wines
- Number of millennials visiting the region is increasing
- Ontario government committed to support the Ontario wine industry and announced new grant programs for producers using sustainable farming and innovative packing methods.
- Many virtual winemakers are looking for wineries to bottle their wines
- Grape growers are looking for wineries to purchase their grapes
- Within the next three to five years, 20 to 25 new restaurants or bars are expected to open in the area and the growth will continue.

Threats

- Canadian dollar will remain low versus American dollar for the foreseeable future
- Number of local wineries has doubled in the area (competition)

Purchase of frost-prevention equipment

Quanti: Appendix 1

Option 1

Option 2

Quali

Advantages

- You would be able to pay fixed amounts and thus ensure cash flow stability which is a

concern for you and ensure you have sufficient profits as your mission requires because you will not have to pay unpredictable amounts if some vines are damaged by the frost again in the future since it happened twice in the past three winters.

- You would be able to control temperatures (control for at least five degrees which is ideal) which is a major factor for obtaining good Pinot Noir grapes, which is directly in line with your mission to grow the finest grapes and to take care of them.
- The wind machines are fuel-efficient so they are perfectly in line with your mission to use sustainable farming methods and this up to the point of harvest.
- The wind machine is fuel-efficient so you would qualify and benefit from the government grant programs offered to encourage your sustainable methods and thus you would have more inflows and alleviate your current cash flow problem.

Disadvantages

- Both options generate noise pollution which could create tension with your neighbours and be disturbing for visitors coming to visit your vineyard which would not be in line with your mission to attract more people from all places because they will not want to live a less enjoyable experience and also you will not be able to benefit from the increase in the number of visitors coming to Canada to purchase wine.
- Both options generate noise pollution it is possible you may not be able to benefit from the PE county advantage, the fastest growing wine region in the world thus more vineyards, more visitors because your equipment is disturbing and visitors will not want to visit you because of this.
- You currently have cash flow problems thus these projects would require immediate payments which will increase your cash flow problems and could even jeopardize HEVW

continuity because the amount you can borrow from John has reached its full capacity.

Recommendation: I recommend going ahead with the purchase of the equipment. I recommend more specifically buying the equipment for the wind machine because it is fuel-efficient and is perfectly in line with the values and the mission of your company. With quality products and your future prospects and considering the reasonable amount you have to pay upfront, financing should not be too difficult.

Production of HeartBreak Reserve Pinot Noir

Quanti: Appendix 2

Quali:

Advantages

- The Heartbreak wine won many awards and continues to be recognized for its premium quality thus create an even better quality version will improve the reputation of your brand, it will become more prestigious, it will continue to win awards and help meet your mission to please the most discerning wine lover's palette and to the new wine loving demographic.
- This wine will command a higher price than your current Pinot Noir which contributes to the notoriety of your brand as well the positive impact on your profits which is perfectly in line with your mission to provide a satisfactory profit and sufficient returns to fund future growth goals.
- Restaurants are willing to pay more for aged wines thus your revenues would increase and you would have sufficient returns and also Jenny would feel more secure with regards to her concern about HEVW CF because in the next 3 to 5 years 20 to 25 new restaurants or bars should open in the area and the growth will continue.

- Since the Pinot Noir continues to increase in popularity among premium wine drinkers, the premium quality Heartbreak reserve Pinot Noir will surely give you the ability to retain these premium wine drinkers which will help you meet your mission to please the most discerning wine lover's palette.

Disadvantages

- Must be aged for an additional 12 months which will freeze your cash flow since you will not be able to sell these wines before that time which will harm your current cash flow situation as well as prevent you from reimbursing the amounts borrowed from John which could create tension within Andrew's family for example.
- You risk being removed from the wine list if you ask for more than \$35 per bottle for the premium Pinot Noir which would prevent you from benefiting of the growth : in the next 3 to 5 years 20 to 25 restaurants or bars will open in the area growth will continue while you are currently looking for new venues to distribute your wines because you cannot sell all your production through your winery and the club, it would be less efficient to risk not being able to distribute your wines through these restaurants and bars and thus not be able to distribute all your wine in those because those restaurants could have a preconceived image for example, their wines are too expensive, we will not even look at their price, let's look at more affordable producers.
- The consumers of your current wines being the current Pinot Noir could be attracted by the Pinot Noir reserve which would cannibalize sales since they would not buy the regular Pinot Noir any more, but The Pinot Noir reserve. This wine could thus decrease the notoriety of the regular Pinot Noir by winning awards and taking its place since you will enter several national and international wine competitions. All these impacts could prevent you for

generating satisfactory profit because for \$5 more versus the sale price of the regular Pinot Noir, their sales could be lost since the Pinot Noir reserve requires a lot of time and maybe even costs before it is sold (aged 12 month).

- Wines currently produced require a lot of management and you do not have enough time, the production of the Pinot Noir reserve could require more monitoring time during the 12 months ageing period (temperature and humidity control, etc) which will increase the problem related to your lack of time and will have an impact on the quality of the products because you will not be able to care as well for those which also does not meet your mission to care for the grapes to the point of harvest.

Recommendation: I do not recommend going ahead with the Pinot noir Reserve since you already stand out from the competition with your current Pinot Noir and there is no immediate reason to do so, HEVW is already doing very well with its current products. Also, this option would worsen your financial situation (negative CF) and your business would be in peril.

DOT proposal

Quanti: Appendix 3

Quali:

Advantages

- Works with wineries to market a variety of wines to restaurants and bars which helps promote your products and introduce fine wines to new wine loving demographic because you will benefit from DOT's promotion with restaurants and bars which are growing in your area for the next 3 to 5 years and even after.

- Currently operates two keg-filling facilities in partnership with local wineries in other regions of southwestern Ontario which demonstrates DOT has expertise in these processes and will be able to help you which will reduce your tasks because you need new distribution channels to sell your wines and allow time to communicate between you since you do not have enough time and HEVW activities are suffering.
- DOT will waive the keg-filling fee and the costs for setting up keg-filling facilities which will help improve your financial situation and thus your cash flow which is currently a concern since you will not have cash to pay.
- DOT would pay you 100k upfront which would alleviate your current cash flow problems, a real concern for you at this time or to use part of this amount to finance equipment required to control temperature we recommended before.
- Wine on tap is becoming very popular and opening of 5 restaurants or bars for the next years and economic situation in Canada is ideal and good for tourism which would meet your vision to attract people from all over the world and introduce your wines since many will come in the County as a lot of visitors are expected.
- You would qualify to receive government grants (because the process eliminates glass cork labels so meets government innovative packing methods) which will help you generate more revenues and ensure satisfactory profitability to implement future projects such as the possibility to market the Pinot Noir reserve if competition becomes too strong.

Disadvantages

- The space must be rented for five years thus if you ever want to use your spaces to market your Pinot Noir reserve wine (because the competition will be higher since vineyards will multiply in your area in the next few years) it will be impossible to do this which could

jeopardize your business because you will not be able to counter the competition with a premium product such as the Pinot Noir reserve.

- The space must be rented for five years thus you will not be able to use the space to host tourism and other events which will prevent you from using your well-designed space that was featured on the cover of the September magazine of Vine and Wine and that could attract more visitors. Visitors would be disappointed if they are not able to visit the space they saw in the magazine which would prevent you from benefiting from this opportunity to promote further your company and your wines such as determined in your mission and vision.
- Wine on tap is new and it is possible the population reacts badly which would have an impact on your brand image and it may be perceived as a lower quality wine which is against your mission and vision.
- Many millennials will visit the region and they give importance to wines produced by vineyard with the same characteristics as your current wines and wine on tap may not attract them to your vineyard which is against your mission to introduce fine wine to an entirely new wine loving demographic thus the millennials.
- Since DOT owns the facilities, it is possible some residues or other techniques used by DOT hinder the organic characteristic of your wine which would cause an enormous scandal, hinder your brand image as well as damage your credibility.
- Could deviate from your market which is against your mission and vision because your wine would be perceived as lower quality and lose reputation.

Recommendation: We do not recommend pursuing the DOT proposal, you will have opportunities such as hosting of tourism events which are more in line with your business and you should use them.

Winery – Bottling capacity

Bottle wines for virtual winemakers

Quanti: Appendix 4

Quali:

Advantages

- You could use your capacity in the short-term since you can use those spaces to transform wine for other vineyards.
- It would be possible to use non organic grapes for 20% of the bottle without jeopardizing the organic status thus even if those grapes are not organic, no worry for your wine they will still be considered organic by the VQA.

Disadvantages

- It is possible the grapes are not organic and it could have an impact on the image of your wines since millennials and other consumers give special attention to this org indication and there is a risk you could lose them as well as not meeting your mission to use sustainable and organic methods.

Bottling HEVW wines produced from grapes purchased from other growers

Advantages

- Would reduce your costs and increase your revenues which is directly in line with your mission to provide satisfactory profit and sufficient returns.

Disadvantages

- HEVW does not know what is the quality of the grapes that would be purchased and Andrew

nor the employees have no control over the quality thus your reputation could be jeopardized as well as not meeting your mission which is to take care of the grapes up to the point of harvest but with this option, you will not be able to take care of the grapes.

- Your brand could be associated with lower quality grapes which prevent you from winning major awards and improving the notoriety of your brand.

Recommendation: We recommend going ahead with the bottling of wine but not to sell wines from other vineyards.

Financing options from the bank

Advantages

- Repayment would be at a fixed amount which would not impact your cash flow since repayments are stable and you will always have the same amount to pay thus ensuring financial stability which you currently need.

Disadvantages

- 75 % of your wine inventory land and more will be given as guarantee so you would not be able to use them for a future bank loan request and prevent you from borrowing additional amounts.

Other suggestions

- Negotiate with John, possible he could lend you an additional amount, find out if Andrew's family members are able to buy your share of the family vineyard since you are not involved in it anymore. Otherwise, use tax strategies to achieve it such as creation of a management company and roll over etc...

Do not sell the share in the wine club, it is going too well it helps you to

STEP BACK : You are currently too busy. You do not have time to communicate together which cause important losses and delays important decision making. It is important that you find time for example hiring knowledgeable staff which could help you, then you would have more time to manage and not jeopardise the financial health because you would not have to pay for losses that could have been avoided. We strongly recommend that you keep some time to continue monitoring the quality of your vines and ensure that you give them the best care possible in order to cater to your mission and your vision. It would be important to prioritise projects that are in line with the quality of the wines especially the project number 1 which we recommended because it is essential to your company and to the realization of your values.

Appendix 1	Analysis of present value of both equipment options			
	Option 1 - Wind mach	Option 2 - Oil heater		
Capital cost for required number of units	105000	36000		
Annual cost per unit	2100	12000		
Present value for 24 to compare on sm basis	26355.75081	150604.2903		
Nb of reinvestment required for 24 years	0	2		
Amount to reinvest every 8 years		36000		
Present value				
Year 8		22586.84537		
Year 16		14171.26621		
Total - at present value	131,355.75	223,362.40		
Option 1 is the most advantageous from a financial point of view. The amount to be paid at present value is lower at the end of the 24years.				
The rate used is the rate provided in the CAP being John's loan rate of 6%.				
Since the most sensitive varietal to frost damage is the Pinot Noir, we will analyze if the project is worthwhile from a quantitative perspective.				
			Revenue	464250
			Nb of bottles	38636
	2020			
Loss related to damaged vines	-155000		Average cost per bottle	12.01599544
Replacement costs	-37000		Pinot noir	14.41919453
Total	-192000		Other	9.612796356
Losses are about 192k while option 1 would cost 131k over 24years which is much lower than the amount necessary to replace				
These vines in the future should such a situation occur. Option 2 is more expensive at the end of the 24years, but since losses could occur more than once in the next 24 years, option 2 should also be considered.				

Pinot noir	2020	2021	2022	2023	2024	2025	2025
Net revenue (Pinot Noir)	0	0	23214.9032	69644.7096	92859.61	92859.6128	92859.6128
Estimated variable costs according to CAP	-16260	-16260	-16260	-16260	-16260	-16260	-16260
Option 1							
Costs	-2100	-2100	-2100	-2100	-2100	-2100	-2100
Upfront investment in 2020	-105000						
Total	-123360	-18360	4854.903199	51284.7096	74499.61	74499.6128	74499.6128
							197260.126
NPV	73900.126	The npv is positive which means that option 1 meets minimum return required by Andrew and Jenny.					
Option 2							
Costs	-12000	-12000	-12000	-12000	-12000	-12000	-12000
Upfront and recurring investment	-36000	0	0	0	0	0	0
Total	-64260	-28260	-5045.096801	41384.7096	64599.61	64599.6128	64599.6128
							148578.6152
NPV	84318.61517	The npv is positive which means that option 2 meets minimum return required by Andrew and Jenny.					
Only costs and revenues from Pinot Noir are considered since it is the most sensitive (vines most sensitive to climate)							

Appendix 2							
FT incremental	2020	2021	2022	2023	2024	2025	
Sales decrease	-115920	-115920	-115920	-125580	-144900	-154560	opportunity costs
Increase in sale \$5 or 17%	135240	135240	135240	146510	169050	180320	
Total	19320	19320	19320	20930	24150	25760	
%	0.041615509					0.009930261	
FT incremental	2020	2021	2022	2023	2024	2025	
Sales decrease	-115920	-115920	-115920	-125580	-144900	-154560	
Increase in sale \$5 or 75%	202860	202860	202860	219765	253575	270480	Regular price of Pinot 30
Total	86940	86940	86940	94185	108675	115920	increase (reserve Pinot 1.75 52.5
%	0.18726979					0.044029455	
From a financial point of view, with a sale price of 1.75 of the regular Pinot Noir, the resulting incremental CF would be around 89k and 115k which represents more than 20% of your sales estimates for 2020, but only 4% of Sa for 2025.							
If we consider the option of a \$35 sales price being the maximum the restaurants will be willing to pay, the incremental margin would only be 4% in 2020 and 1% in 2025 which is not much from a financial point of view.							
Even if the two options are profitable taking into account only the above amounts, additional costs related to aging could be required and were not taken into account in the analysis so it is incomplete.							

Appendix 3				
Increase in restaurants and bars per year seems a little too optimistic				
	40%	2021	2022	2023
Estimated current MBN		12	12	12
MBN with wine on tap		13.69	13.69	13.69
Difference		1.69	1.69	1.69
Addit margin		7645.56	15291.12	21246.68
You could get additional margin between 7645 and 21k by 2023				
From a financial point of view this option is interesting				
	30%	2021	2022	2023
Estimated current MBN		12	12	12
MBN with wine on tap		13.69	13.69	13.69
Difference		1.2675	1.2675	1.2675
Addit margin		5734.17	11468.34	15935.01
You could get additional margin between 5734 and 15k by 2023				
From a financial point of view this option is interesting				

Appendix 4	2020	2021	2022	2023	2024	2025		
Revenue per bottle	3	3	3	3	3	3		
Nb of bottles	45000	47250	49612.5	52093.125	54697.78	57432.67031	5% increase per year	
Products variables par bottle	135000	141750	148837.5	156279.375	164093.3	172298.0109		
You could generate annually between 135k and 172 which is quantitatively interesting.								
Sales commission								
Number of bottles sold	45000	47250	49612.5	52093.125	54697.78	57432.67031		
assume all								
Average estimated sale price								
	9	9	9	9	9	9	According to HEVW wine quality and CAP	
Total	405000	425250	446512.5	468838.125	492280	516894.0328		
Comission	40500	42525	44651.25	46883.8125	49228	51689.40328		
Additional total inflows	175500	184275	193488.75	203163.1875	213321.3	223987.4142		
From a quantitate point of view this option is interesting, in fact if you act as a virtual winery and you sell the wines you will make a profit between 175 500 and 223k by 2025								
	Per bottle							
Net margin per bottle	2.51	2.51	2.51	2.51	2.51	2.51		
Number of bottles	45000	47250	49612.5	52093.125	54697.78	57432.67031		
Total	112950	118597.5	124527.375	130753.7438	137291.4	144156.0025		
From a quantitative point of view, this option is less interesting than the first one								

APPENDIX E

**THE COMMON FINAL EXAMINATION
DAY 1 HEVW VERSION 2 BOOKLET – SEPTEMBER 11, 2019**

**COMMON FINAL EXAMINATION
SEPTEMBER 11, 2019 – Day 1**

Case (HEVW Version 2)**(Suggested time: 240 minutes)**

In February 2018, Bennett & Robertson LLP (BR) completed a consulting engagement for Heartbreak Estates Vineyard & Winery Ltd. (HEVW). At that time, Andrew and Jenny were considering how to best proceed with developing their business.

It is now March 2021, and Jean Bennett, the partner in charge of the initial engagement for the Heartwoods, received a phone call, asking for BR's help again.

The developments with respect to issues addressed in the initial engagement are summarized below:

Area	Action
Vineyard	<ul style="list-style-type: none"> • In November 2018, terminated the farmer's lease. • Planted vines on 10 acres of previously-leased land in 2019 and 10 acres in 2020, with the remainder to be planted in 2021. • Cultivating heirloom and exotic vegetables as a cash crop until all the vines are planted.
Niagara College	<ul style="list-style-type: none"> • In July 2018, signed agreement with Niagara College (NC). • NC financed and managed construction of the facility. • Building was completed in March 2019, the first viticulture cohort started in September 2019 and winemaking is scheduled to start in September 2021.
Winery	<ul style="list-style-type: none"> • Decided to build a winery but have deferred starting construction. • Continue to use County Winery (CW) as a virtual winery and Andrew is still the resident winemaker.
Distribution	<ul style="list-style-type: none"> • All sales are through CW, the wine club and local restaurants.
Accounting system	<ul style="list-style-type: none"> • Implemented an accounting system and performance measures as per BR recommendations. • Jenny left her bartending job and has been working full-time at HEVW, performing administrative and accounting functions. She took some marketing and accounting courses at NC.
Other	<ul style="list-style-type: none"> • No additional financing was obtained. • A Board of Directors was formed with John, Andrew, and Jenny Heartwood, a banker, an Agriculture and Agri-Food Canada researcher, and an NC representative.

After her meeting with the Heartwoods, Jean provides you with a transcript of the meeting (Appendix I) and other information she has gathered. She asks you to draft a report to the client addressing the strategic issues, and any other issues of significance you identify.

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APPENDIX I TRANSCRIPT OF CLIENT MEETING

Andrew: It is nice to see you again, Jean. When we started our business, we had no idea that there would be so much involved and so many decisions to make. Our goals haven't changed. We are still committed to growing the finest grapes, producing premium wine, attracting people to our region and providing a comfortable living for our family.

Jenny: We have moved forward in several areas but there always seem to be new and exciting opportunities in our region. The basics of the industry are the same, with distribution channels, licensing and regulations still important considerations. As expected, customers are increasingly interested in the story behind the wine. The LCBO's publicly available information provides useful data on the trends in the industry. It says millennials and baby boomers are the top wine consumers, at 36% and 33% respectively. LCBO is also very active in social media venues these days—I read that there are over one million visits to its website per year, 15,000 twitter followers and over 150,000 Facebook followers. It is important that we keep up with developments in the industry.

Vineyard discussion

John: I was pleased with the decision to give priority to establishing the vineyard. Planting the grapes in phases was a good idea because it required less cash up front and means that replacement of the vines, which last 20 years, will be staggered. The grants received and operating cash flow provided adequate financing for the vineyard. The free student labour from NC has come in handy, and Andrew and Jenny have been working long hours without much financial reward.

Andrew: We decided to plant four varieties of grapes, Pinot Noir and Cabernet Franc in the red category and Pinot Gris and Chardonnay in the white category. Assuming all goes well in terms of weather and other factors, yields are estimated to increase from the current 2,200 cases to 2,900 cases of wine in 2022, 5,100 in 2023, 7,800 in 2024, 9,300 in 2025 and full production of 10,000 cases in 2026.

APPENDIX I (continued)
TRANSCRIPT OF CLIENT MEETING

Jenny: Rather than leave the fields idle as we phase in our vines, we partnered with Hearty Kitchens and planted vegetables. We sell the produce to local restaurants, since there are so many new ones, to local consumers and at farmers' markets. This has been surprisingly lucrative, providing close to \$65,000 in cash flow last year! We are contemplating continuing this initiative and planting fewer grapes.

John: Really? Why? This is a wine business, not a vegetable business.

Niagara College discussion

Andrew: We entered into an agreement with NC (Appendix II). I felt I had to take advantage of this once-in-a-lifetime opportunity; if not, I was certain someone else would. I was excited about the benefits to us.

However, the final agreement was substantially different from the original proposal. We felt pressured to agree to NC's terms, even though some were undesirable. I wonder whether we acted too quickly.

Student numbers are higher than anticipated and are projected to keep increasing, which is presenting challenges. It means more work in terms of my teaching duties, more students in the vineyard and more NC staff making site visits. Some of the students and instructors are not as careful as they should be and have damaged the plants. Though inconvenient, I feel the need to be present when they are onsite. And, they sometimes arrive unannounced.

Having students work in our vineyard has had mixed results—a small number of the students are terrific, most are average and some create more work than they accomplish. If I was hiring, I could be more selective, but the agreement stipulates that I use them all.

Some of the changes to the final agreement were better for us. For example, instead of us building the facilities as initially proposed, we contributed the land and the college provided the buildings and equipment, including classroom space, the greenhouse, laboratory and waste-water treatment plant. We did not have to arrange any financing or assume any risk associated with the buildings.

APPENDIX I (continued)
TRANSCRIPT OF CLIENT MEETING

Andrew: The students' union recently challenged the status of unpaid work terms, stating that students are employees and should be paid. NC has agreed and is in the process of making changes to the arrangements with students. As free labour was part of our contract, NC has requested that we renegotiate the terms of our agreement.

Jenny: I was planning to use the NC space to offer wine appreciation courses and special sessions to our wine club members and other customers, and to offer sessions on grape-growing to hobby farmers in our area. However, I am still waiting for approval from NC, who are insisting this is a violation of our non-competition clause. I am also concerned that, if classes are added to accommodate the increase in students, we will have less opportunity to offer our own courses and other activities.

Andrew: I have arranged a meeting with NC and would like your suggestions about changes we should try to negotiate.

John: There have been some benefits from our association, such as the helpful ideas that have emerged from the research projects. However, having the NC representative on our board makes for lengthy discussions, which interferes with the operation of our business. We might be better off without these complications. While renegotiating is an option, we'd like to consider the implications of cancelling the agreement.

Jean: We'll look at your different options.

Winery discussion

Jenny: Andrew studied to be a winemaker and does not want to just grow grapes. We decided to build a winery, and had preliminary designs drawn up. I am researching suppliers of environmentally-friendly equipment. As we needed to focus on other critical aspects of our business, we have not yet started construction. Now we are reconsidering the need to build. Jeremy Stiles, CW's owner, has decided to sell his winery and semi-retire. He plans to continue growing and harvesting grapes. A large, commercial winery has made an offer but Jeremy would prefer that ownership remain local and has also made us an offer. He has provided a framework for an agreement (Appendix III). The terms look very favourable. We must decide soon.

APPENDIX I (continued)
TRANSCRIPT OF CLIENT MEETING

Andrew: Capacity at CW is 20,000 cases, which is significantly higher than the winery we would build. It is quite successful and if we purchase it, we would be producing for CW, Black Label Vineyards and potentially others, which would provide us with much needed cash flow. Alternatively, by building our own winery, we will have full control over the use of its productive capacity, as we won't be committed to producing for others. There will be no issue with producing our own wine.

John: Purchasing CW's winery will cost more than building our own winery as planned, but it will present additional opportunities. As well as bottling wine for other vineyards, the wines we bottle could be sold in the retail store at CW's winery and bring in additional profit.

Andrew: I know the facilities and staff at CW well. The equipment is dated and less efficient, but reliable. The staff are experienced, which is important with winemaking. It could be a challenge to get staff for our own new winery. The environmental impact that a business makes is becoming more important in our industry.

John: Andrew, I understand that you want to build an up-to-date, gravity-fed winery, but perhaps that is overly ambitious. Some of the technology is unproven. I think there are many advantages to buying instead of building.

Andrew: Jeremy has always been quite involved in the winery. Even though I am the resident winemaker, he still makes the final decisions. He has offered to help after the sale, at no charge. I am a bit concerned about whether Jeremy will be able to step back and let me take over. The draft agreement also requires us to produce wine for Jeremy and honour CW's contract with Black Label Vineyards.

I don't want to borrow any additional money against my interest in the family farm. If we buy CW's winery, we won't need a loan and won't be paying interest.

John: If you choose to build, the financing from Farm Plus Financial (Farm Plus) is still available. The terms provided by Farm Plus are unchanged except that the option to postpone principal payments has been removed. The estimated cost to build a winery with a 10,000-case capacity was \$1.2 million in 2018.

APPENDIX I (continued)
TRANSCRIPT OF CLIENT MEETING

Jenny: CW's licences, including all LCBO permits, can be transferred to HEVW, which would save a lot of work. CW is not an estate winery and sells VQA and non-VQA wines. The challenge will be to rebrand it as HEVW so it is not forever known as CW. And what about all the time and money we have invested in the new winery, getting plans drawn up and researching equipment? Do we just ignore that and start over with this new plan?

Jean, can you help us compare the two options? Please suggest changes to Jeremy's proposal that you think are warranted. The price is fixed but he might accept other changes.

Jean: We'll do a preliminary analysis of the financing aspects of buying CW's winery compared to building your own, and explain the other factors you need to consider in making your decision.

Wine bar discussion

Jenny: Our association with NC has led us to an exciting opportunity with Sara Sherbini, who recently graduated from NC's culinary program. To pursue her passion for culinary arts, Sara plans to open a wine bar. We discussed her ideas (Appendix IV) and her business plan (Appendix V). Her enthusiasm is contagious! Although we only met recently, Sara and I have much in common, and I want to do this to support her and our local community.

Having Sara establish her wine bar at HEVW will attract customers and, with her social media presence, will help increase our brand awareness. We will provide space, either as part of our new winery if we decide to build it, or in a new building on HEVW property if we purchase CW. Sara knows we have been growing vegetables and asked for a "restaurant garden." I am not sure exactly what she has in mind, but I don't think it will require a significant amount of space.

Andrew: This seems like a lot of work to me. I know you think you can handle it, Jenny, but I also thought that about the college. I am not sure we should embark on yet another new venture.

APPENDIX I (continued)
TRANSCRIPT OF CLIENT MEETING

Jenny: Sara would handle the operational and marketing duties and I would just handle the administrative tasks. I expect we can save money by sharing HEVW's accounting and merchant payment systems.

Because they can access our wine directly, the wine bar will not have to carry much inventory, which should make cash flow easier for Sara. She tells me she already has project financing in place.

The wine bar will be a separate business and Sara needs to be the sole owner so she can access funding from the Youth Ventures Fund. She has suggested paying HEVW a percentage of profits.

John: I understand that you think partnerships and collaborations are the way of the future, but I am concerned that it might divert HEVW from its primary goals of growing premium grapes and producing award-winning wines. With these partnerships, who is really in charge?

Andrew: Jean, what do you think of this wine bar opportunity?

With so many decisions to make, I am not sure where we start. Each decision seems to depend on or impact another. Can you help us sort this out by suggesting where to start, and by setting priorities?

Jean: Of course.

APPENDIX II
CONTRACT TERMS BETWEEN NIAGARA COLLEGE
AND HEARTBREAK ESTATES VINEYARD & WINERY LTD.

- | | |
|-------------------|--|
| Term | <ul style="list-style-type: none">• 25 years |
| Academic | <ul style="list-style-type: none">• All aspects of the academic program will be the sole responsibility of NC.• Andrew Heartwood will teach one course per semester in each program (viticulture and winemaking) and will be paid on a per-section basis at the instructors' set rate, being \$10,500 in 2018. If student numbers increase so that more than one section of a course is required, Andrew will teach all sections, and be paid \$10,500 per section.• Students will complete their work term in HEVW's vineyard and winery without compensation.• HEVW will provide students with access to its vineyard and winery operations, and allow onsite visits by faculty and staff to ensure academic standards are met. |
| Capital | <ul style="list-style-type: none">• Facilities construction will be managed and financed by NC.• Ownership of the buildings will transfer to HEVW at the end of the contract.• HEVW will provide five acres of land for the building site and experimental vineyards. |
| Operations | <ul style="list-style-type: none">• HEVW will not compete with NC in offering vineyard and winery classes.• Use of the facilities for non-academic purposes will be managed jointly by Andrew Heartwood and a representative of NC. HEVW will be charged an hourly fee for this use.• NC will promote HEVW on its website and in advertising related to the applicable programs.• HEVW will identify itself in all promotional material and on labels as a "Niagara College Teaching Winery."• NC will provide access to its commercialization services, such as advertising and marketing plan, international marketing and e-commerce, on a cost-recovery basis.• HEVW will allow access to its vineyard and winery for collaborative research with other faculties at NC and allow installation of VineAlert monitors by the Canadian Food and Wine Institute's research division, and consent to the regular collection, transmission and publication of data from the monitors via the internet to NC and to HEVW's computer system or portable devices.• HEVW will make an ongoing commitment to invest in innovation and technology and comply with sustainability objectives of NC, which include LEED buildings and no use of herbicides, and will complete sustainability reports, such as water usage, as requested by NC.• HEVW will provide NC's research and industry liaison with a seat on HEVW's board.• NC will provide HEVW with regular communications on provincial and federal government innovation and research grants and will provide support for HEVW's grant applications, on a cost-recovery basis. |

**APPENDIX III
FRAMEWORK FOR AN AGREEMENT WITH COUNTY WINERY**

1. Production:
 - a) HEVW will produce wine for CW at the current production level of 10,000 cases per year, for an \$80,000 annual fee plus variable bottling costs, for five years (2021 to 2025 inclusive).
 - b) HEVW will honour CW's contract with Black Label Vineyards to produce 3,500 cases per year (2021 to the end of 2025, when the contract expires).

Capacity (in cases)	20,000
Production commitments through 2025:	
County Wine	10,000
Black Label Vineyards	3,500

2. Sales:
 - a) CW wine will continue to be sold in the onsite retail store.
 - b) CW will pay a 10% commission to HEVW.
3. Employees:
 - a) Current employees will be retained, with no changes to their terms of employment.
4. Payments:
 - a) Total payment will be \$2.7 million, in monthly instalments of \$15,000 for 15 years.
5. Assets:
 - a) Ownership of assets, the winery building, parking lot and all equipment will transfer when the final payment is made.
 - b) The winery portion of CW's land will be leased by HEVW for \$1 per year.
6. Other:
 - a) The winery will be called "Heartbreak Vineyard & Winery at County Estates."
 - b) Until final payment is received, Jeremy Stiles will have a seat on HEVW's board.

APPENDIX IV
JENNY'S NOTES FROM DISCUSSIONS WITH SARA SHERBINI

Sara envisions a truly unique wine bar with great food and wine, a relaxed atmosphere and outstanding service. She also sees pop-up bars playing a key role in the business. Pop-ups are temporary locations of a business used to create excitement and generate awareness of something new and different, and Sara says they are quite popular with NC students. The pop-up locations would provide additional revenue and would introduce new customers to the wine bar and HEVW. We can widen our customer base by reaching consumers who might not usually drink Canadian wine. By having pop-ups in many different locations, we can introduce the wine bar and new wines to so many potential new customers!

At the pop-ups, we can offer discount coupons for the wine bar and HEVW's retail store, and perhaps free samples. We can have pop-ups at festivals and special events. We could also have customer appreciation nights for our wine club members, and to try to attract new members. As we earn a high margin on pop-up sales, added promotion will be beneficial.

Sara plans to try out new menu items at the pop-ups to gauge customer reaction, and thinks we could also do this with new wines. She sees the potential for significant profits. I get the sense that Sara understands controlling costs. She suggests we use student interns from NC's culinary program, as we do in the vineyard and will do in the winery. She has been going to vintage sales to look for unique furnishing and fixtures.

Sara is keen to promote the wine bar and HEVW on Instagram and through other social media venues. The wine bar will sell our wine and other wines that Sara and I approve for sale, including wines that HEVW potentially produces for other vineyards. The option to sell their wines could be an incentive for other vineyards to use our services.

Sara thinks that joint promotions with NC and its culinary program might also be possible. She also proposes that HEVW open an online wine store, selling gift certificates to the wine bar, our wines, wine glasses, wine racks and assorted accessories bearing our logo.

Sara is eager to get started and suggests we start with pop-ups, including one onsite at our vineyard, until the building is ready.

APPENDIX V EXCERPTS FROM WINE BAR BUSINESS PLAN PROPOSAL

Vision

To operate a business that is respectful of the environment, puts people first and contributes to the community.

Mission

- *To serve delicious food, incorporating fresh local ingredients paired with wine produced onsite and from neighbouring vineyards.*
- *To provide outstanding customer experiences.*
- *To treat staff with respect, giving them autonomy and control of decisions.*
- *To be fiscally responsible, generating the maximum revenue, keeping costs as low as possible and generating above-average profit.*

Description

- We will operate a wine bar with a tapas menu featuring organic, sustainable, local produce.
- We will be located at a restaurant onsite at HEVW, and set up various pop-up locations across southeastern Ontario, focusing on locations where young people gather, such as university and college campuses.
- Staff will be well trained and have expert knowledge of the food.
- The atmosphere will complement the food.
- We will support artists from Prince Edward County and all of southern Ontario by hosting performances by musicians and displaying the work of visual artists.
- We will support the community and will participate in charitable events.
- We will offer wine appreciation sessions and tasting specials.
- We will offer special events for wine club members.
- We will be open from noon to 10:00 pm daily.

APPENDIX V (continued)
EXCERPTS FROM WINE BAR BUSINESS PLAN PROPOSAL

Projected Financial Information
Net Income Year 1

	<u>HEVW Site</u>	<u>Pop-ups</u>	<u>Total</u>
Revenue			
Food	\$ 540,000	\$ 48,000	\$ 588,000
Wine	540,000	72,000	612,000
Total	<u>1,080,000</u>	<u>120,000</u>	<u>1,200,000</u>
Gross margin	486,000	57,600	543,600
Salaries and benefits	194,400	11,520	205,920
Other operating costs	<u>97,200</u>	<u>0</u>	<u>97,200</u>
Net income	<u>\$ 194,400</u>	<u>\$ 46,080</u>	<u>\$ 240,480</u>

Notes:

1. Food margins average 30%.
2. Wine margins average 60%.
3. Restaurant salaries are normally 35% of food revenues but Sara plans to pay more than the industry average to reflect how much she values good staff.
4. Pop-up salaries are lower, as Sara will be the chef and will use casual staff, with no benefits.
5. Projection assumes no salaries for Sara or Jenny.
6. Projection assumes no occupancy costs, as space is provided by HEVW.
7. Projection assumes an average of two pop-ups per month and revenues of \$5,000 per pop-up.

Startup costs, not included in the income projection, are as follows:

Working capital	\$ 10,000
Kitchen equipment	150,000
Furnishings and fixtures	30,000
Glassware and cutlery	10,000
Uniforms and linens	5,000
Other	<u>5,000</u>
	<u>\$ 210,000</u>

APPENDIX V (continued)
EXCERPTS FROM WINE BAR BUSINESS PLAN PROPOSAL

Financing sources are as follows:

Government youth ventures loan	\$ 150,000
Family and friend loans	<u>60,000</u>
	<u>\$ 210,000</u>

APPENDIX F

**DAY 1 (HEVW VERSION 2) – SEPTEMBER 11, 2019
MARKING GUIDE AND SAMPLE CANDIDATE RESPONSE**

MARKING GUIDE
HEARTBREAK ESTATES VINEYARD & WINERY LTD. (HEVW)
VERSION 2

Summative Assessment #1 – Situational Analysis (Update)

For Summative Assessment #1, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate used a reasonable situational analysis when analyzing the major issues facing HEVW.

Unsure – The candidate attempted to use a reasonable situational analysis when analyzing the major issues facing HEVW.

No – The candidate clearly did not use a reasonable situational analysis when analyzing the major issues facing HEVW.

Competencies

2.3.2 Evaluates the entity's internal and external environment and its impact on strategy development

Enabling:

1.2.2 Performs work competently and with due care.

2.1.1 Defines the scope of the problem.

2.1.2 Collects and verifies relevant information.

2.1.4.4 Analyzes and synthesizes the view of others to develop a more complete understanding of issues and/or implications of alternatives.

The focus should be on updating HEVW's situation since Capstone 1, describing the factors that have changed and the key factors that are relevant to the decisions to be made (e.g., option to build winery, option to purchase County Winery (CW), Niagara College (NC) partnership considerations, wine bar proposal, etc.). Recapping parts of the mission/vision and relevant KSFs, and presenting relevant elements of the SWOT, is appropriate. Candidates should draw upon their situational analysis when analyzing the major decisions that the company must make.

Mission and Vision

- HEVW's mission and vision are unchanged, as stated by Andrew in the simulation: "We are still committed to growing the finest grapes, producing premium wine, attracting people to our region and providing a comfortable living for our family."

Key Success Factors

- KSFs remain the same (from Cap 1):
 - Industry knowledge of owners
 - Location of vineyard
 - Sufficient access to financing
 - Marketing expertise
 - Product quality; estate winery, VQA-approved products
 - Distribution channels
 - Full use of productive capacity

Situational Factors

- Andrew's desired pursuit remains to be a high-quality winemaker; he does not wish to simply grow grapes (from Cap 1).
- Trends are continuing, such as new restaurants opening and hobby farms being established in the region.
- HEVW remains committed to environmental sustainability and responsible business practices (from Cap 1).
- HEVW's goals include attracting more people to the region and earning enough income to provide a comfortable living for Andrew and Jenny's family.
- Its target market is premium-wine drinkers (typically older consumers with more disposable income) (from Cap 1).
- Since Cap 1, the external environment of HEVW remains largely the same as there have been no major changes to the industry:
 - Distribution channels, licensing and industry regulations are all still important considerations when making business decisions.
 - Consumers of HEVW and the wine market in general are interested to know the story behind the wine they purchase.
 - Millennials make up 36% of the overall market for wine whereas baby boomers, who tend to be HEVW's top consumers, make up 33%.
- HEVW currently sells its products exclusively through CW, the wine club and local restaurants.
- HEVW's partnership with NC is evolving. The building has been constructed and classes have begun.
- If HEVW agrees to the current proposed agreement framework with CW, an additional board seat will be given to Jeremy Stiles.

SWOT Analysis

Strengths

- HEVW has prioritized establishing a vineyard. HEVW planted four varieties of grapes and, if the vineyard's development goes according to the plan, HEVW's production capacity will steadily increase from 2,200 cases in the current year to 10,000 cases in 2026.
- Since Cap 1, the remaining acres are being used to cultivate a cash crop of heirloom vegetables as a way to generate extra revenue.
- Since Cap 1, HEVW has implemented an accounting system and various performance measures.
- Since Cap 1, Jenny has left her former position as a bartender and has been working full-time at HEVW, where she performs various administrative and accounting tasks.
- Since Cap 1, HEVW has formed a formal Board of Directors and the following individuals have a board seat: Andrew, Jenny, and John Heartwood, a banker, an Agriculture and Agri-Food Canada researcher, and an NC representative.
- HEVW has been able to reduce its operating costs through the use of free student labour that became available via the agreement with NC.
- No new financing has been required.

Weaknesses

- HEVW is limited by the amount of land available for grape cultivation; HEVW's total land consists of 40 acres, 20 of which have already been planted.
- Jenny and Andrew have been working long hours without much financial reward; it is possible that they have taken on too many extra side projects and partnerships and that this has reduced the amount of time available to focus on the core business.
- John seems to disagree with some of the recent decisions that have been made at HEVW. From the simulation, John questions whether HEVW is a grape business, given the vegetable initiative. He also questions who gets to make the decisions at HEVW, given the partnership arrangements that exist and are being considered.
- Andrew and Jenny may be rushing into decisions that are not favourable to HEVW, as illustrated by the less than favourable changes that were made to the agreement with NC. It is possible that Andrew and Jenny have ineffective negotiation skills.
- Neither Jenny nor Andrew has been granted permission to use the teaching facilities that NC has built on HEVW's land.

Opportunities

- Since Cap 1, HEVW has decided to build its own winery; however, those plans are currently on hold as the start of construction has been deferred.
- HEVW still uses CW as a virtual winery and Andrew remains the resident winemaker; since Cap 1, CW has come up for sale and CW's owner, Jeremy, has offered to sell the winery to HEVW.

- Social media is beginning to play a significant role in the wine industry; the LCBO has attracted approximately 15,000 twitter followers and over 150,000 Facebook followers and its website has over a million annual visits.
- There seem to be many opportunities and proposals available to HEVW. For example, Sara has proposed an arrangement with HEVW where she would open and operate a wine bar within HEVW's winery. Her proposal also includes having pop-up bars at various locations throughout the year and an online store.
- HEVW's target market is interested in having a full and complete experience where they enjoy HEVW's wines along with other products and experiences that complement the wines.

Threats

- HEVW needs to be mindful of any production capacity constraints that may exist, especially toward 2025 and 2026.
- More competition has recently entered the region, with more restaurant openings and the potential for a large wine producer to purchase CW if HEVW decides to build its own.
- If student enrollment in NC's program continues to increase, Andrew's time constraint may become worse.
- Given the recent developments with NC's student union, NC wants to renegotiate the original agreement between NC and HEVW; this could mean increased costs and even less favourable terms for HEVW.
- The students from NC have periodically caused damage to HEVW's vines; should this continue, the quality of HEVW's products may suffer.
- If student numbers increase, Andrew may be forced to dedicate more time to teaching instead of focusing on the core business of HEVW: growing exceptional grapes and producing award-winning wines.
- Given all the partnerships and side arrangements that it is considering and has already made, HEVW is at risk of losing focus on its core business.
- Given the board seats granted through its partnerships and through the proposed arrangement with Sara, HEVW seems at risk of losing control of its company.
- HEVW must ensure that it maintains its reputation as a quality winemaker; with all the partnership agreements, HEVW's reputation may depend on the success and effectiveness of its business associates.

Financials

- No updated financial statements have been presented.
- HEVW has made no additional borrowing; the vineyard was financed with grants and cash flow from operations.
- The financing available to build the winery remains the same as in Cap 1 except HEVW no longer has the option to defer principal payments during the first five years (link back to Cap 1 – financing terms).

Summative Assessment #2 – Analyzes the Major Issues

For Summative Assessment #2, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate completed a reasonable assessment of the major issues facing HEVW.

Unsure – The candidate attempted to complete a reasonable assessment of the major issues facing HEVW.

No – The candidate clearly did not complete a reasonable assessment of the major issues facing HEVW.

Competencies

2.3.3 Evaluates strategic alternatives

Enabling:

2.1.2 Collects and verifies relevant information.

2.1.3 Performs appropriate analyses.

2.1.4 Integrates information to investigate each potentially viable solution or conclusion.

2.1.6 Uses creativity and innovation to enhance problem-solving and decision-making.

This summative assessment is based on Assessment Opportunities #2 to #5.

Our report analyzes the strategic fit of the following options:

1. Winery: whether to purchase CW or build; proposed changes to the framework with CW
2. Niagara College agreement: whether to cancel or renegotiate; suggestions for renegotiation
3. Sara Sherbini's proposal (wine bar /pop-ups): whether to proceed; potential problems with the proposed agreement and suggestions for its improvement
4. Vineyards being the core of the business and the need to focus on that

Assessment Opportunity #2 (Strategic Issue #1 – Winery – Buy CW or continue with plans to build)

Candidates are expected to discuss quantitative (cost and capacity) and qualitative factors that impact the decision to buy CW or proceed with the decision to build a winery, and suggest changes to the framework proposed by CW. As this decision is fundamental to HEVW's business, candidates should provide an in-depth analysis of this issue.

One of HEVW's main goals is to own and operate a winery. We have been asked to compare two options: purchase CW or continue with the plan for HEVW to build its own winery on its existing land.

Quantitative Analysis

See discussion under AO#5.

Qualitative Analysis

Build Option

Pros:

- The winery would be new and modern, which could help provide visitors with a quality experience and would help affirm HEVW's status as a premium brand.
- HEVW would be able to build the winery to its own specifications.
- Building its own winery fits with HEVW's image of using cutting-edge technology and reducing its environmental impact (link to mission).
- As the newly built winery will have new technology, such as the gravity-feed system, the operating costs may be lower than at CW.
- HEVW is still able to borrow the funds required to build its own winery from Farm Plus Financial; the terms provided by the bank have not changed, although the option to postpone principal payments has been removed.
- Building its own winery would also allow the focus of the operation to be solely on HEVW as no other wines would need to be produced or sold by HEVW.

Cons:

- If HEVW does not buy CW, it may be sold to a large commercial winery, which could mean more competition; this might have a negative impact on the local region (link to mission).
- If HEVW builds, it is unknown whether Andrew will be allowed to continue as the resident winemaker at CW until HEVW's own winery is ready.
- If HEVW builds, it is unknown whether the company can continue to produce its wine at CW's facility until HEVW's own winery is ready.
- The purchase cost of CW is known whereas there could be delays and cost overruns with a new build.

Purchase CW Option

Pros:

- Purchasing CW would eliminate the time and effort required to build, and the winery would be available now.
- Andrew has plenty of experience with CW's facility and equipment; this will make the transition easier.

- If HEVW purchases CW, there will be more land on HEVW's original property for growing grapes; this will increase HEVW's productive capabilities and could make HEVW a more profitable company in the future.
- When the five-year term requiring sales of CW wine ends, there will be excess capacity within the CW facility. HEVW could potentially negotiate a term extension with CW or find other wineries who may want to use the facility for bottling their wine.
- Under the current agreement framework, HEVW does not need to borrow any additional funds.

Cons:

- As CW is currently not an estate winery and sells both VQA and non-VQA wines, CW's current operations conflict with HEVW's mission to be a premium wine producer (link to mission and KSFs).
- The CW purchase agreement states that the land will never be owned, which could be a concern, especially if CW and HEVW come into conflict in the future.
- Given the older equipment at CW and the potential for additional costs (such as repairs and maintenance expenses), the purchase of CW may be a bigger risk than building; this is mitigated somewhat by Andrew's experience at CW and his knowledge of the equipment. This issue could be further mitigated if HEVW negotiates a warranty clause into its agreement with CW. HEVW may also want to consider a property inspection before purchase.
- CW is in a different physical location relative to HEVW's existing operation; given that VQA regulations mandate that a wine must be 100% from land owned or controlled by a particular winery in order for it to be designated estate-bottled at that winery (which must also be located in the DVA), this could be an issue (link to Cap 1).
- The existing CW facility is old and small; this could negatively impact HEVW's image as a premium brand. In addition, the business could be seen as CW, not HEVW.
- Jeremy may be unable to step back enough from the operations at CW; therefore, Andrew may not have complete control of the winery.

Recommendation

Much of the strategic points support building. While the financial analysis is very preliminary, it appears to favour buying CW. The revenue and operating costs of the wineries must be factored into the analysis. Also, if CW is purchased, the capacity issue and commitments will need to be addressed.

As it better meets HEVW's mission and vision, I recommend building the new winery, subject to updating the costs and doing further financial comparisons.

Provided that it is supported, either recommendation is acceptable.

Suggested Changes to the Framework Proposed by CW

Excerpt from Agreement	Recommended Change (<i>should be a strategic link for some</i>)
1a. HEVW will produce wine for CW at the current production level of 10,000 cases per year, for an \$80,000 annual fee plus variable bottling costs, for five years (2021 to 2025 inclusive).	Negotiate a change to capacity, especially in 2024 and 2025; this is key to ensuring that HEVW can meet its own increasing production.
1b. HEVW will honour CW's contract with Black Label Vineyards to produce 3,500 cases per year (2021 to the end of 2025, when the contract expires).	Negotiate a change to capacity, especially in 2024 and 2025; this is key to ensuring that HEVW can meet its own increasing production.
2. CW wine will continue to be sold in the onsite retail store. CW will pay a 10% commission to HEVW.	Limit this to a set number of cases, as CW had done with HEVW; selling more CW wine may result in fewer sales of HEVW wine.
3. Current employees will be retained, with no changes to their terms of employment.	Negotiate more flexibility in the terms with current employees.
4. Total payment will be \$2.7 million, in monthly instalments of \$15,000 for 15 years.	We are told that the price is not negotiable. HEVW could suggest flexibility in payment terms, with a reduction or discount or seasonal payments.
5a. Ownership of assets, the winery building, parking lot and all equipment will transfer when the final payment is made.	Have the ownership transfer at the start of the contract with the assets pledged as security. This would provide more flexibility to HEVW, such as additional borrowing capacity as equity is built within the asset.
5b. The winery portion of CW's land will be leased by HEVW for \$1 per year.	If HEVW wants to convert to a premium estate vineyard and adhere to VQA requirements, consider having the land included in the sale, or lease in perpetuity or for the life of the buildings.
6a. The winery will be called "Heartbreak Vineyard & Winery at County Estates."	Change the name to HEVW to ensure that branding is clear.
6b. Until final payment is received, Jeremy Stiles will have a seat on HEVW's board.	Do not add Jeremy to HEVW's board; there are already issues with the NC liaison and adding another outsider who can influence decisions is undesirable. HEVW could suggest providing Jeremy with financial statements if he is concerned about monitoring financial performance.

Integration of Issues

- Integration of the CW and NC decisions with HEVW's goals: the purchase of CW, and its relatively outdated facility, may conflict with HEVW's and NC's focus on sustainable development.
- If HEVW proceeds with the wine bar, it will require some space for a restaurant and tasting room, as well as parking and a "restaurant garden"; this could reduce the available growing space even more if HEVW decides to build its own winery.
- If HEVW buys CW and proceeds with the wine bar, it could potentially build at CW or on HEVW's existing land. The cost to build a building for only a restaurant versus as part of a winery at HEVW may differ and should be considered.

Assessment Opportunity #3 (Strategic Issue #2 – Niagara College agreement – Continue, renegotiate or end contract)

Candidates should analyze HEVW's options with respect to the NC contract. They should consider whether HEVW should agree to open the contract for renegotiation, address the contract terms that should be revised based on identified problems and make suggestions for renegotiation. They should also discuss the implications of cancelling the agreement. Candidates should keep HEVW's goals, mission and vision in mind when evaluating these decisions. A supported recommendation should be made.

Option of Renegotiating the Contract

The agreement currently reads, "Students will complete their work term in HEVW's vineyard and winery without compensation." Due to a challenge by the students' union, NC has now agreed to compensate the students. NC wants to renegotiate its deal with HEVW. If the agreement with HEVW is not renegotiated, the cost of paying students will presumably be NC's expense. NC wants HEVW to pay some or all of the costs.

Based on the last round of negotiations, in which HEVW agreed to unwanted changes, there is a potential downside to opening the contract to renegotiation. As HEVW felt pressured during negotiations in the past and as the agreement was finalized with unfavourable terms for HEVW, it is possible that Andrew and Jenny lack negotiation skills. As such, should HEVW and NC renegotiate the agreement, it is possible that the terms of the renegotiation will be even less favourable to HEVW. Nevertheless, HEVW has identified many issues with the current agreement, and renegotiation presents an opportunity to address them, as well as any anticipated issues that may arise in the future.

Conclusion

Based on the candidate’s analysis, either conclusion—to reopen negotiations or to refuse to renegotiate—is acceptable. Regardless, candidates were directed to provide “suggestions about changes we should try to negotiate.”

Analysis of Contract

Recognizing the need for give-and-take in the negotiations, we should establish what is most important to HEVW and acknowledge that trade-offs may be required. We have provided an analysis of the terms of agreement, identified problem areas and made suggestions for renegotiation.

Contract Term	Problem	Suggestion for Renegotiation
The contract has a 25-year term (versus 10 years in Cap 1, with renewal options).	This reduces flexibility; within the next 25 years, Andrew may get tired of teaching, want to sell or retire.	Consider reducing the term and negotiate renewals instead.
Andrew Heartwood will teach one course per semester in each program and will be paid on a per-section basis at the instructors’ set rate, being \$10,500 in 2018.	An increased number of students will require more work and time on Andrew’s part.	When student numbers exceed a certain amount, have NC pay for a teaching assistant (as was supposed to be part of the original agreement, per Cap 1). Give Andrew the option of teaching less in any given term, such as one course instead of one per program, or some other flexibility.
Students will complete their work term in HEVW’s vineyard and winery without compensation.	Financial incentive for the agreement was that it would result in labour savings “and the free student labour could reduce ongoing labour costs for the vineyard by 70%” (from Cap 1). A change to this will remove one of the key benefits. Also, Andrew has said that some students are not working out; if he can be more selective, that will help resolve the issue.	Have NC pay the students. If NC will not agree to pay 100%, have NC and HEVW each pay a portion. NC and HEVW can apply for grants to support this cost. Allow HEVW to select a certain number of students and pay those; NC can find placements for the remaining students at other vineyards.

<p>HEVW will provide NC students with access to its vineyard and winery operations, and allow onsite visits by faculty and staff to ensure academic standards are met.</p>	<p>“Some of the students and instructors are not as careful as they should be and have damaged the plants. Though inconvenient, I feel the need to be present when they are onsite. And they sometimes arrive unannounced.”</p>	<p>To free up Andrew’s time, because he feels the need to be onsite with students and staff in order to ensure that plants are undamaged, the contract should more clearly define, and limit, student access and onsite visits by instructors.</p> <p>The program should include better training on how to handle vines; perhaps have NC compensate HEVW for vineyard damage.</p> <p>If some students do their practicum at other vineyards, as suggested above, the number of site visits to HEVW should be reduced.</p>
<p>Ownership of the buildings will transfer to HEVW at the end of the contract.</p>	<p>Should either party cancel the contract, the implications for ownership transfer are unclear.</p>	<p>Specify what happens if the contract does not run to full term (25 years as per the original agreement or shorter if renegotiated). Provide an option for HEVW to buy out NC, and a formula for price; alternatively, rent could be paid for the land until the contract term is over.</p>
<p>HEVW will provide five acres of land for the building and experimental vineyards.</p>	<p>Due to the 25-year contract, this limits grape production, winery capacity and long-term revenue.</p>	<p>Have the land used for experimental vineyards returned to HEVW for its own use after a short time period. HEVW can then plant more vines, as originally planned, and increase wine production. If not, depending on whether it purchases CW or builds a winery, HEVW will only have 30 to 35 acres.</p>
<p>HEVW will not compete with NC in offering vineyard and winery classes.</p>	<p>This interferes with HEVW adding the classes it wants for its existing clients, and for attracting new clients:</p> <p>“I am still waiting for approval from NC” and “if classes are added to accommodate the increase in students, we will have less opportunity to offer our own courses and other activities.”</p>	<p>Change the clause to allow HEVW to host its own members, OR clearly define what constitutes competition, such as length of program or student base, OR partner with NC in these ventures to obtain some benefit.</p> <p>As per Cap 1, these changes may be an issue for CW: “The Canadian Food and Wine Institute (CFWI) at NC includes a teaching winery, teaching brewery and teaching restaurant. It also offers food and</p>

		beverage seminars and team-building events as part of its community engagement programs (p. 42).”
HEVW will identify itself in all promotional material and on labels as a “Niagara College Teaching Winery.”	This results in the loss of HEVW’s identity. If NC gets bad publicity, HEVW could be impacted.	Have this clause be an option, not a requirement.
HEVW will make an ongoing commitment to invest in innovation and technology and comply with sustainability objectives of NC, which include LEED buildings and no use of herbicides, and complete sustainability reports, such as water usage, as requested by NC.	Although a fit with HEVW’s values, a large financial investment could be required. This could be costly and is not well defined.	Remove, or place limitations on, these requirements; for example, costs per year to a maximum dollar amount.
HEVW will provide NC’s research and industry liaison with a seat on HEVW’s board.	This slows down meetings and may hinder the decision-making process. There is a potential confidentiality issue.	Have the liaison as an observer, who only participates in discussions specific to the partnership. To ensure that information about HEVW is protected, have a confidentiality agreement signed.

Option of Cancelling the Agreement

As there is no cancellation clause in the agreement, if HEVW cancels the contract, there is the possibility that NC may sue HEVW. The legal implications are currently unknown.

If the agreement is cancelled, there is the question of what happens to the buildings on HEVW’s land:

- Will HEVW have to purchase them from NC? Will HEVW have a potential use for them, perhaps for its proposed restaurant?
- HEVW could potentially continue to let NC use the buildings under a new rental agreement. This should have been considered in the contract, and will require negotiation. Without proper negotiation, it is possible that NC could allow a competitor to use the building on HEVW’s land.

If HEVW cancels the agreement, some of the five acres provided for the building site and experimental vineyards will revert back for HEVW's use.

The key benefits of cancelling the agreement are as follows:

- It will eliminate the problems identified in the analysis of renegotiating.
- It will free up Andrew's time to focus on winemaking.
- HEVW can hire qualified employees instead of students; depending on contract renegotiations, it will likely have to pay some amount anyway. It might consider hiring Brock graduates; however, since production is mostly of Pinot Noir, hand picking is required, which is labour-intensive and which HEVW may have to pay more for.
- It will better fit with HEVW's business goals and "protect" the pursuit of the mission and vision in that it will free up Andrew's time to focus on the winery and therefore ensure that winemaking remains the priority.
- NC's research and industry liaison currently has a seat on HEVW's board; if the contract were cancelled, NC's influence in HEVW's board discussions and strategic direction would be eliminated.

The key drawbacks of cancelling the agreement are as follows:

- HEVW will lose the benefits of the contract, some of which fit with HEVW's goals and objectives:
 - Access to research
 - Promotion and awareness of HEVW
 - Revenue-generating opportunities; per Cap 1 (p. 17): "While I don't think Andrew ever imagined being an instructor, the marketing benefits would be fantastic. I also see the potential for other revenue-generating opportunities through the strategic partnership."
 - Per Cap 1 (p. 40): "CFWI [The Canadian Food and Wine Institute (CFWI) at NC] is able to draw upon all resources at NC including: agriculture and environmental technologies, advanced manufacturing, business and commercialization as well as digital media and web design. Students who complete the two-year winery and viticulture technician program at NC are granted transfer credit to Brock University's viticulture program."
- There are potential litigation issues, as mentioned above.
- It goes against Andrew's goal of wanting to help future generations learn.
- Although a minor benefit, HEVW will lose Andrew's contract fees of \$10,500 per section.
- Without NC support, it could potentially be more difficult to get grants.
- By not collaborating in the area, or in the industry developments, there could be damage to HEVW's reputation.
- Cancelling the agreement may harm HEVW's image. It may be more difficult to partner with other organizations and is not in keeping with HEVW's goal of supporting the local community.
- If there is "bad blood" between NC and HEVW, the loss of relationship with NC could mean more difficulty getting trained workers in the future.

Integration between Issues

- This decision will impact the requirements for a winery and the decision to buy versus build.
- Cancelling the NC agreement could increase the number of acres available for growing grapes.
- If HEVW decides to buy CW rather than build a winery, cancelling the NC agreement could free up space to use as a restaurant, wine-tasting room and retail location; ownership and costs would need to be considered.

Assessment Opportunity #4 (Strategic Issue #3 – Wine Bar)

Candidates are expected to discuss the qualitative factors that influence the decision, relating back to the mission/vision and objectives, and to critique the financial projections presented. Candidates are also expected to highlight any potential problems with the proposal and identify key items that should be included in the partnership agreement.

Qualitative Analysis

Pros:

- Some aspects of the wine bar’s proposal fit with HEVW’s mission/vision:
 - It will feature organic, local produce and wine from the region.
 - It fits well with HEVW’s idea of creating a full experience for its customers.
- It fits with industry trends, including what customers want (“creating an experience for clients”).
- The pop-ups would increase HEVW’s exposure within the region and could therefore drive more visitors to HEVW’s vineyard and winery.
- Sara seems committed to the environment, which aligns with HEVW’s desire to be environmentally responsible.
- Sara has a lot of experience on social media, and as trends in the industry indicate, social media has become an important marketing tool; Sara’s expertise could help promote HEVW.
- As Sara has apparently already financed the project, no additional financing would be required.
- There is a synergy between HEVW’s current heirloom vegetable crops and Sara’s desire for a garden bar (interrelationship between issues).
- Sara’s project could help initiate new revenue streams for HEVW, such as through the creation of an online store.

Cons:

- Under the current agreement, Sara would be the sole owner of this new operation; this may prohibit HEVW from making decisions related to the venture.
- Although it appears that minimal land is required, this space would otherwise be used for winemaking, which is the core of HEVW’s business.

- Given the cost of HEVW's premium brand, pop-ups at university and college campuses might not be the right market (as that market will be built largely of students); HEVW's wine may be cost prohibitive.
- As there are already a lot of new restaurants in the area, there might not be room for another.
- HEVW appears to be taking on a big risk in terms of its reputation:
 - The pop-ups may negatively impact HEVW's reputation as a premium wine producer.
 - As per Sara's proposal, the wine bar will be located onsite at HEVW, and Sara has suggested various joint promotions and projects between the wine bar, pop-ups and HEVW. This close association between Sara's business and HEVW's may imply that these businesses are one and the same; therefore, if Sara's business struggles, HEVW could be negatively impacted.
 - Sara is focused on a low-cost operation. While it is good to minimize costs, quality is important, especially if HEVW wants to maintain its reputation as a premium brand.
- The wine bar's mission and vision statements have some inconsistencies, such as to focus on low cost but also exceptional service, and to pay higher-than-average wages at the restaurant but to use "casual labour" at pop-ups and pay them less.
- Sara is a recent graduate, likely with little business experience, and may not be an effective business partner.
- It is not clear that the importance of staff having good knowledge of wines is recognized. The plan to use students may not make sense.
- There is a potential issue with internal controls: "To treat staff with respect, giving them autonomy and control of decisions"; HEVW must ensure that its standards are adhered to and that it retains an effective control environment.
- Regulations in the food industry can be complicated and standards, such as food safety, are important; inspections will be required and HEVW has no current experience in this area.

Integration of Issues

- This will integrate with the decision of whether to purchase or build a winery:
 - If purchasing CW, will HEVW want to build a building just for the wine bar in addition to a tasting room and retail store?
 - If building a winery, there will be an additional cost to include space for a wine bar.
- The plan to use student interns from NC's culinary program may be impacted by the decision that NC students currently working at HEVW must be paid.

Potential Problems	Improvements
Ownership by Sara: HEVW needs to have input into decision-making.	<ul style="list-style-type: none"> • Decisions should be made jointly. • If both parties cannot agree, it should go to mediation. • An exit strategy should be put in place.
The suggestion of “sharing HEVW’s accounting and merchant payment systems” may create issues with cash and accounting.	<ul style="list-style-type: none"> • Do not mingle the wine bar’s accounting and payment systems with HEVW’s. • If the same system is “shared,” ensure that it is set up properly and has controls over access to each company’s information.
The hiring of NC students for the wine bar may be an issue if the agreement with NC is cancelled.	<ul style="list-style-type: none"> • Based on the renegotiation with NC, more information is needed. • Given the current issues with NC, HEVW might not want to pursue any further agreement with NC until after renegotiation of the current contract.
The mission includes “treating staff with respect, giving them autonomy, and control of decisions.” This may indicate that Sara does not recognize the importance of controls in the restaurant business.	<ul style="list-style-type: none"> • Ensure that proper controls and oversight procedures are implemented over the wine bar /pop-up’s operations.
Other	<ul style="list-style-type: none"> • In addition to a share of profits, HEVW should receive payment for rent and operating expenses. • HEVW could consider receiving a share of revenue rather than profits. • An assurance report on financial results (profit or revenue, depending on the arrangement) should also be considered.

Conclusions and Recommendations

We recommend that you not proceed with the wine bar at this time. Although it ties in well with your vision and with trends in the industry, we recommend that HEVW establish the winery before adding a wine bar. Taking on too many projects may create problems. It may be possible to defer the project or undertake a similar venture in the future with a different entrepreneur.

Provided that it is consistent with the analysis, a different recommendation is acceptable.

Assessment Opportunity #5 (Strategic Issue #4 – Numeracy skills)

Relative to the winery decision, candidates should compare the upfront cost of the two options and discuss the capacity constraint that will result in 2024 and 2025 if CW is purchased and the proposed agreement is accepted.

Relative to the wine bar, candidates should identify what is missing from the projections presented or comment on the reasonableness of the assumptions.

Quantitative Analysis in Relation to A0#2 (Winery Decision)

1. Cost and Financing

Candidates should compare the upfront cost of the two options and the cash flow required to repay the debt of the build option. Their first step is to understand, and explain, that they cannot compare the \$1.2 million to the \$2.7 million directly; in order to be comparable, they will need to present value the CW payments.

A complete analysis of the options will need to consider the operating costs and revenue from using the extra capacity at CW. As candidates do not have the information to do this, they should recognize that their analysis will be incomplete.

Build (per Day 1):

- The cost to build is \$1.2 million.
- As this is an old estimate from 2018, the actual cost may differ significantly. Before an adequate assessment can be completed, this estimate needs to be updated.
- If nothing else, this number should be adjusted for inflation.
- The interest rate to finance a build is 8% per annum (Cap1 link: “Farm Plus will grant HEVW term-loan financing to a maximum of \$3,000,000, repayable over a 15-year period, with interest charged annually at a rate of 8%.”)
- The option to defer principal payments has been removed.
- The \$1.2 million is already the present value (PV); this is because the loan would be discounted at the same 8% as the interest rate that is paid on the loan.
- Annual principal payments on the \$1.2 million loan will be \$80,000 (\$1.2 million / 15 years) plus an extra 8% interest amount on the debt balance outstanding.
- Total payments per estimate will be \$1,920,000 (this is the principal \$1.2 million plus interest on the average balance of \$600,000 @ 8% = \$720,000 estimated interest).
- The amortization schedule will show total interest payments over 15 years of \$768,000 (PV of these payments is \$515,242).
- Payments will be higher in earlier years as the outstanding balance and interest will be higher; as principal is reduced, payment amounts will decrease.

Buy CW (per Day 1):

- The cost to buy is \$15,000 per month over 15 years = \$2.7 million.
- The interest rate is 8% per annum.

- The land lease cost is \$1.
- The \$2.7 million payment includes an implicit amount of interest.
- We can calculate an approximate PV of \$1,569,609, using 8% (same rate as the build option) of the \$15,000 payments.

Conclusion:

- The cost to build a winery that has a 10,000-case capacity will be \$1.2 million plus the added interest expense, given the financing required.
- The cost of purchasing CW’s 20,000-case capacity winery is \$1.57 million.
- Given the different capacities, the operating costs of the two facilities will differ.
- For an additional \$370,000, HEVW will double its production capacity; however, to perform a complete analysis, we would need to consider all cash inflows and outflows of both alternatives.

These additional considerations would include the following:

- The net cash flow from the use of the extra capacity at CW—will it cover the extra cost? Will it be more than the extra cost? We are told: “It is quite successful and ... would provide us with much needed cash flow.” *As there is no information for calculations, candidates should identify and discuss this only.*
- The difference in operating costs for the two facilities and the difference in cash flow that will be generated. *As there is no information for calculations, candidates should identify and discuss this only.*
- Under the current agreement framework, if HEVW buys CW, HEVW will bottle 10,000 of CW’s wines per year. In return, HEVW will be compensated \$80,000 plus all variable bottling costs.
- Under the current framework, if HEVW buys CW, HEVW will bottle 3,500 of Black Label’s wines per year. Given these bottling commitments, HEVW may run into capacity constraints in the later years of the agreement.

2. CW/HEVW’s capacity constraint under the current agreement framework

Candidates should identify that there will be a capacity issue here in 2024 and 2025 only—without getting out of the contract with Black Label, HEVW will not be able to process all HEVW grapes.

	2021	2022	2023	2024	2025
Total capacity (in cases)	20,000	20,000	20,000	20,000	20,000
CW’s production	10,000	10,000	10,000	10,000	10,000
Contract with Black Label	3,500	3,500	3,500	3,500	3,500
Available for HEVW	6,500	6,500	6,500	6,500	6,500
HEVW’s capacity needs	2,200	2,900	5,100	7,800	9,300
Capacity shortfall	Okay	Okay	Okay	1,300	2,800

HEVW will not have enough capacity to bottle its own wine in 2024 and 2025. Therefore, HEVW may want to consider changing this aspect of the proposed agreement.

Critique of the Wine Bar’s Proposed Net Income Projection

In their critique of the financial information, candidates should identify what is missing from the projections presented or comment on the reasonableness of the assumptions.

- The seasonality of the venture has not been considered; it may not be realistic to have two pop-up events per month during the winter.
- There is no support for the revenue projections; per Cap 1, the region gets over 750,000 visitors per year, but competition is increasing as 12 new restaurants are expected to open.
- The proposal assumes no salary for Sara or Jenny, which is unreasonable when evaluating the business’s profitability. These costs should be included in the projection.
- Sarah seems to have assumed no cost for facilities, either capital or operating. This may not be a reasonable assumption.

HEVW needs to make an assessment of the financial cost and contribution from the wine bar /pop-ups and negotiate a fixed fee and/or an appropriate percentage of revenue or profit.

Assessment Opportunity #6 (Strategic Issue #5 – Maintaining focus and Decision-making)

Candidates should identify these issues, supported by specific case facts and evidence from multiple different decisions areas.

Candidates are not specifically requested to address these issues in the case. Candidates should identify that the opportunities being considered and some of the recent decisions made appear to lack focus on the core business of winemaking and may risk HEVW’s ability to maintain its reputation as a quality winemaker.

In addition, Andrew and Jenny appear to be making quick, high pressure decisions, such as the decision to sign an unfavourable agreement with NC. The proposed deal with Sara and CW (with Jeremy’s proposed board seat) will once again dilute Andrew and Jenny’s ability to make strategic decisions that benefit HEVW and ensure that HEVW adheres to its original mission and vision.

Focus

- The time constraints imposed on Andrew (NC partnership), and potentially on Jenny (wine bar), could be hurting their core winemaking business, as both Andrew and Jenny may lack the time required to maintain and develop the vineyard and new winery.
- Partnering with Sara is related, but not core, to HEVW’s business.
- Partnering with Hearty Kitchens is outside of HEVW’s core business and limits the size of the vineyard.

Jenny and Andrew may be distracted from HEVW's main focus: "There always seem to be more exciting opportunities in our region."

HEVW's Image

Given the various partnerships that HEVW has entered into, the company may be at risk at losing its identity:

- Through its association with NC, "Niagara College Teaching Winery" is printed on labels and other joint promotional material.
- In the potential purchase of CW, the facility would have dual naming.
- In the potential partnership with the wine bar, there would be joint social media presence and other joint promotional material.

Governance and Decision-making at HEVW

- HEVW was influenced by the risk of someone else partnering with NC: "I felt I had to take advantage of this once-in-a-lifetime opportunity; if not, I was certain someone else would."
- HEVW seems to have accepted some terms that are not in its best interest: "We felt pressured to agree to NC's terms, even though some of them were undesirable."
- NC has a seat on HEVW's board; as NC's perspective must be included in the decision-making process, this could mean that Andrew and Jenny are less able to make strategic decisions that benefit the company.
- With the CW deal, HEVW is potentially making another hasty decision without the requisite due diligence.
- In the current agreement framework with CW, CW's current owner would have a board seat for 15 years; once again, this would dilute Andrew and Jenny's decision-making power.
- If HEVW decides to purchase CW, there is a concern that CW's current owner will not let Andrew take control of the winery.
- As a 100% owner of the proposed wine bar /pop-up business, Sara could have a great deal of influence over HEVW and seems to be already suggesting amendments to HEVW's business (online store, coupons, etc.) that could impact HEVW's future direction.

John provides some recognition of these issues: "I am concerned that it may divert HEVW from its primary goals of growing premium grapes and producing award-winning wines. With these partnerships, who is really in charge?"

The discussion about HEVW's partnership with Hearty Kitchens to grow vegetables on HEVW's available land, and Jenny's comment about whether to grow vegetables rather than grapes, are specific examples of the Heartwoods not focusing on the core business. (As this is a minor issue, it was not analyzed as a separate AO. Rather, candidates were expected to address this issue as part of their focus/governance discussion.)

Growing other crops brings in cash in the short term and is reasonable as long as the fields are not needed. However, it is not in line with HEVW's core business or mission, which is to grow the finest grapes and produce premium wines. Growing vegetables is not part of this and will seriously reduce the company's long-term profit, as there will be less area for growing grapes and therefore less wine produced. This initiative also takes time away from managing the vineyard and winery.

Recommendations

- HEVW should get its core business established before considering other ventures.
- It is important to protect HEVW's core interests by controlling the decision-making process; bringing on additional board members is not recommended at this time.
- As it is not in keeping with HEVW's core business or vision, HEVW should not proceed with the expanded growing of heirloom and exotic vegetables and should consider ceasing the current vegetable-growing operation.

Summative Assessment #3 (Conclude and Advise)

For Summative Assessment #3, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate provided reasonable conclusions/recommendations for each major issue and recognized the interdependencies of the issues. The conclusions/recommendations were consistent across the issues.

Unsure – The candidate attempted to provide reasonable conclusions/recommendations for each major issue and to recognize the interdependencies of the issues.

No – The candidate clearly did not provide reasonable conclusions/recommendations for each major issue or recognize the interdependencies of the issues.

Competencies

Enabling

2.1.4 Integrates information to investigate each potentially viable solution or conclusion.

2.1.5 Recommends and justifies a solution or conclusion based on an integrative view of information for the situation.

Competent candidates will provide logical recommendations consistent with their analysis and provide suggestions where requested.

The recommendations and suggestions should:

- *align with HEVW's vision, mission, objectives and constraints.*
- *be consistent with the analysis performed by the candidate.*

Conclusions/recommendations should be provided for each strategic alternative:

1. *Niagara College Contract:*
 - a. *Decision of whether to re-open, and change, the contract*
 - b. *Suggestions for renegotiation*
 - c. *Implications of cancelling the contract*
2. *Winery:*
 - a. *Decision of whether to build a winery or purchase the CW winery*
 - b. *Suggestions for changes to the agreement proposed by CW*
3. *Wine Bar:*
 - a. *Decision of whether to proceed with this venture*
 - b. *Potential problems and suggestions for improvements to the agreement*
4. *Maintaining Focus and Decision-making:*
 - a. *Consideration of the different initiatives in terms of the company mission and vision*
 - B. *Importance of taking time to make reasoned decisions*
 - C. *Maintaining control of the company's strategic direction by not bringing on any additional board members from the company's partnerships*

Overall Conclusions and Recommendations

Recommendations on specific issues

There are many benefits of the relationship with NC, which we believe outweigh the problems currently being experienced. To address and correct as many of the problem areas as possible, HEVW should renegotiate the contract with NC. The company should seek to obtain more control over the impact of the agreement on its vineyard and winery, and establish a process for resolving any future issues on a timely basis. If you are worried about being influenced by NC again, consider bringing BR to the negotiation table with you.

We recommend that you build the winery as originally planned. The new winery is in keeping with HEVW's mission and vision to be a premium estate winery, and should prove profitable over the long term. It is also in keeping with your goal of being a small- to medium-sized business that provides a comfortable living.

The wine bar /pop-up proposal is not recommended at this time. Given Andrew and Jenny's time constraints, we think this project could result in a loss of focus on the core business (vineyards and winery) and may jeopardize HEVW's reputation. Because it could help achieve the vision of attracting people to Prince Edward County, we recommend that it be considered in the future, after the winery is established and the issues with NC are resolved. However, before construction on the building is started, it would be prudent to consider the cost of providing space in the initial build versus adding it in the future.

Overall recommendations

The company is considering many different initiatives. It is important that HEVW maintains its focus on its mission and vision. After its core business is well established, the company can consider other opportunities.

It appears that HEVW has made rushed decisions and been pressured by outside organizations, such as NC. It is important that the owners do not allow this to happen again. Having a board can be helpful in terms of providing experience and advice, but you need to maintain control of HEVW. In any future contracts or joint projects, you must clarify that, as owners, Andrew and Jenny will have the final word on HEVW's strategic direction.

Provided that they are supported and consistent with the analysis, alternative recommendations are acceptable.

Integration

The candidate should explicitly identify the interrelationships between the decisions that HEVW is facing.

There are many interrelationships among the issues, including, but not limited to, the following:

- NC – CW:
 - NC's sustainability objectives require investment in innovation and technology. Given the outdated equipment, it is uncertain whether CW can meet this requirement; perhaps this should be considered as part of the renegotiations with NC.
- Wine bar – CW:
 - The wine bar partnership will be impacted by the decision of whether to build or purchase a winery; if HEVW purchases CW, it will need a separate building for the wine bar.
- NC – wine bar:
 - If HEVW cancels the NC agreement and keeps the building, it could convert the NC space on HEVW's property for use as a restaurant, wine-tasting room and retail location. Details about ownership and the cost of conversion would need to be determined.
 - Based on the new agreement made with NC, the use of NC culinary interns will need to integrate information about their required payment for work rendered, if any.
- Production issue:
 - The acres provided to NC for its building site and experimental vineyards will reduce the land available for HEVW's grape production.
 - The purchase of CW would free up land designated for the winery, which has the potential to increase HEVW's grape production.
 - The wine bar would reduce HEVW's grape production.
 -

Summative Assessment #4 (Communication Hurdle)

For Summative Assessment #4, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate adequately communicated their response.

No – The candidate clearly did not communicate their response adequately.

Competencies

Enabling

3.3 Adapts communications to meet audience needs.

Insufficient communication in a candidate's response would generally include some of the following:

- *The response is difficult to understand.*
- *The reader needs to re-read sections several times in order to gain an understanding.*
- *It is not clear what point the candidate is trying to make.*
- *The quantitative analysis does not make sense because of illogical ordering or a lack of labelling.*
- *There is an excessive amount of spelling and grammatical errors.*
- *The language used is unprofessional.*

Summative Assessment #5 (Overall Assessment)

For Summative Assessment #5, the candidate must be assessed in one of the following, based on their overall performance:

Clear Pass – Overall, the candidate provided an adequate response, clearly meeting the minimum standards for each of the summative assessments above.

Marginal Pass – Overall, the candidate provided an adequate response, with some errors or areas of omission, but including the underlying key concepts.

Marginal Fail – Overall, the candidate provided an attempt at a response, with several errors or an incomplete analysis.

Clear Fail – Overall, the candidate did not provide an adequate response because the response was deficient in multiple areas.

To be assessed a Pass, candidates are expected to perform adequately in all the summative assessments and demonstrate that they addressed the issues of importance in a cohesive, professional manner.

In making their overall assessment, markers were asked to consider the following:

- 1. Did the candidate step back and see the bigger picture, and then address the broader issues identified?*
- 2. Did the candidate prioritize the issues by discussing the major and minor issues in appropriate depth?*
- 3. Did the candidate use both quantitative (when available) and qualitative information to support their discussions and conclusions?*
- 4. Did the candidate use the appropriate tools to perform quantitative analysis?*
- 5. Did the candidate use sufficient case facts (current case and Cap 1 case) about the external and internal environment to support their discussions?*
- 6. Did the candidate communicate their ideas clearly, integrating and synthesizing the information?*

SAMPLE RESPONSE – HEVW VERSION 2

Below is an actual passing candidate response.

To: HEVW

From: CPA

Subject: Analysis of Strategic Issues

Situational Analysis

Mission and Vision

The mission and vision of HEVW has remained consistent with the inception of the company. HEVW continues to place a high focus on staying committed to growing the finest grapes, producing premium wine, attracting people to our region and providing a comfortable living for Andrew and Jenny's family.

Key Success Factors

Key success factors in the industry include:

1. Strong social media presence to create brand awareness
2. Ability to obtain financing
3. Diversified and unique product offerings
4. On-site sales of merchandise and wine
5. Knowledgeable and experienced wine grower, and staff working on-site
6. Producing premium wine using premium grapes
7. Located on a well-marked wine route, in a tourist area

The key success factors and mission and vision should be considered when analyzing strategic issues and providing recommendations.

Internal and External Environment

Strengths

- HEVW has generated \$65,000 in additional cash flow from their partnership with Hearty Kitchens. This cash flow has helped cover operating costs of the business.
- A board of directors has been formed. This indicates that there is strong oversight on all decisions that are being made.
- HEVW has benefited from the use of free student labour. This keeps operating costs low.

- Through the receipt of grants, and cash flow generated from operations, HEVW has been able to reduce the need to obtain additional financing to finance the operations of the vineyard.
- The Niagara College partnership continues to grow in popularity and is expected to continue to grow. If HEVW maintains their partnership, a benefit of this is that it generates brand awareness for HEVW.

Weaknesses

- All acreage has been either planted, or is being utilized for other projects (ie. 30 acres planted, 5 acres for NC partnership, and 5 acres for vegetable partnership). With the exception of the 5 acres of vegetables, HEVW cannot grow by just planting grapes. They will have to seek external growth opportunities.
- Andrew and Jenny's time appears to be stretched thin. This is important to consider when analyzing growth opportunities, as taking on too much, could result in burnout.
- The Niagara College partnership has not gone as planned. This is affected Andrew's ability to focus on their core operations.
- Through the planting of vegetables, and the Niagara College partnership, HEVW has not stayed true to their mission and vision.

Opportunities

- Customers are increasingly interested in the story behind the wine. This presents an opportunity for HEVW to target wine lovers in a unique way to be in line with this trend.
- Millennials and baby-boomers continue to hold the majority of the wine industry. This presents an opportunity for HEVW to place a focus on targeting these consumers.
- There is an increased focus for businesses to be active on social media platforms. This presents an opportunity for HEVW to increase their marketing efforts on these platforms.

Threats

- Weather continues to be a threat to the wine industry as it can negatively impact the grapes grown, which ultimately reduces potential revenues generated.
- The student union has challenged the status of unpaid work terms, and state that students are employees and should be paid. This has a negative impact on all wineries, including HEVW, that has student interns. Paying these students will increase their operating costs.

Objectives

- Andrew and Jenny want to pursue growth opportunities that will help them generate sufficient operating cash so they can use this in their personal lives.
- HEVW wants to pursue growth opportunities that are in line with their overall mission and vision

Financial Analysis

- With the planted grape yields increasing over the next few years, the annual production will increase, which will generate additional revenues for the business.
- The Farm Plus loan is still available to HEVW. These terms have remained unchanged, with the exception that they are not able to postpone principal payments.

Strategic Issues - Analysis

Option #1: Purchase or build winery

HEVW has been presented with an opportunity to either purchase CW's winery, or to build their own.

Purchase CW's Winery

Quantitative Analysis

In Appendix A, I have calculated the net annual cash flows of this opportunity with the information provided. I've calculated this to be net cash flows of \$67,001 annually.

Up-front costs and Financing

Under this option, the total payment will be \$2.7 million, in monthly instalments of \$15,000 for 15 years. This is a total of \$180,000 ($\$15K * 12$ months) per year.

HEVW will not require additional financing under this option, as there are no significant upfront costs. With the term of payment being over 15 years, this gives HEVW time to grow, and use their operating cash flows that are projected in the future to pay this down.

Additional Capacity

Under this option, HEVW will be required to fulfil County Wine's 10,000 cases, and Black Label Vineyards 3,500 cases until 2025. This leaves 6,500 ($20,000 - 3,500 - 10,000$) cases for HEVW's production. Looking at HEVW's projected production, by 2024, HEVW expects to be able to bottle 7,800 cases of wine. Therefore, under these terms, HEVW will have to find additional bottling capacity, which will increase costs, and therefore, reduce the margins on the sale of their wine.

Subsequent to 2025, HEVW will be able to outsource, or look at other opportunities for bottling wine (ie. purchasing grapes to bottle wine, etc.), which will provide additional revenues.

Other Costs to Consider

It is unclear of what the commission will be, and the variable costs will be. This should be negotiated before a decision is made.

Qualitative Analysis

Pros:

- Under this option, HEVW will not have to spend time looking for staff, or outsourcing contracts, etc., as the operations will remain the same, when ownership changes. As discussed in the situational analysis, time is a constraint for Andrew and Jenny, with their current operations, therefore, this would alleviate the time it takes to perform these tasks.
- The staff at CW are already experienced. This is in line with the key success factors in the industry.
- HEVW is very familiar with CW's operations and their space, given their current relationship with Andrew being the resident winemaker, and HEVW using CW as a virtual winery. This will make the transition more seamless, and less of a burden on Andrew and Jenny's time.
- All of CW's licensing is transferable. This will reduce the work associated with obtaining licensing, and give Andrew and Jenny time to focus on other areas.
- CW is close to HEVW's operations. As this is in Prince Edward County, and also on a well-marked wine route, it will attract tourists, consistent with the key success factors of the industry.

Cons:

- CW is not an estate winery, and sells VQA and non-VQA wines. HEVW places a primary focus on producing premium wines, therefore, this is incongruent with their current mission and vision.
- Under this option, HEVW would be required to be called "Heartbreak Vineyard & Winery at County Estates". This makes it difficult for HEVW to maintain their current brand reputation in the industry, without confusing their consumers. If this option is pursued, the name should be negotiated, as HEVW will want to be sure to keep their brand separate from CW's.
- Andrew and Jenny are concerned with the involvement of Jeremy Stiles. Having him be on the Board would further give him more ability to control the decisions and direction of HEVW.

Building their Own Winery

Quantitative Analysis

Sunk Costs

Jenny, you mentioned that you are concerned with the money that has already been put into drawing up plans, and researching equipment. These are considered sunk costs, as you are unable to get this time or money back. These costs should not be considered in the decision making process.

Financing

Under this option, the estimated cost to build a winery with a 10,000 case capacity was \$1.2M in 2018. It is likely that interest rates have increased since 2018, and therefore, in Appendix B, I have performed a sensitivity analysis to calculate the annual cost of borrowing would be at both rates.

This financing only covers the winery build, however, it does not take into consideration the cost of furnishing the winery. Therefore, the annual borrowing costs will be greater than what I've calculated in Appendix B.

Outsourcing Opportunity

Until 2026, HEVW would have additional capacity that could be outsourced. This would help generate additional funds.

Qualitative analysis

Pros:

- If HEVW built their own winery, they would have control of what they could do with the winery.
- Building a winery, would permit HEVW to operate all-in house. This reduces the risk that HEVW's mission and vision are not being attained.

Cons:

- Building a winery comes with significant costs, and would require a lot of Andrew and Jenny's time. Given the current constraints, mentioned in the situational analysis, you would be risking burn-out by attending to the winery.
- Currently, you are earning \$65,000 a year with the land being used for vegetables. This would no longer be generated each year.

Recommendation

Given the significant costs to build your own winery at this time, I would recommend not pursuing this option. However, before pursuing CW's proposal, I'd recommend negotiating the following:

- Term of the Contract: It is currently 15 years before HEVW would obtain the assets and land. This is a significant amount of time and increases the risk that HEVW would not want to maintain this partnership for that long, or that the assets and land would lose value over this time. I would recommend negotiating to have a smaller term.
- Jeremy's involvement with HEVW's operations. It is clear this is a concern for you, and given that CW's mission and vision are not congruent with HEVW's, this should be negotiated to ensure that Jeremy is not able to control the operations at CW.

Strategic Option #2

HEVW has received a proposal from Sara Sherbini to partner with her to establish a wine-bar at HEVW, and a pop-up bar. The options are to either pursue this opportunity, or to not.

Quantitative Analysis

I have looked at Sara's projected financial information and have a few comments about her assumptions:

- The projection assumes no salaries for Sara or Jenny. I question whether this is realistic for both Sara and Jenny. The restaurant will stay open for 10 hours each day, and will require a significant amount of time and effort put in by both Sara and Jenny. It is clear that Andrew and Jenny are both spending a lot of time without much financial gain, so I would think that Jenny would at least want to be paid a salary close to what she was making as a bartender, which was \$45,000.

- The projection assumes an average of two pop-ups per month. Given this is a new venture for Sara and HEVW, I would think that one pop-up per month would be more realistic.

- Occupancy costs are assumed to be nil, as space is provided by HEVW. Given that Sara would be operating this business under her own name, I would recommend leasing space to Sara rather than allowing her to use it for free.

As such, I have calculated the expected net income of this option in Appendix C in it's first year.

Percentage of Profits

Under this agreement, it is clear that Sara would be operating this on her own, and would be paying HEVW a percentage of the profits. Before this option is pursued, a reasonable percentage would have to be agreed upon, given that HEVW is seeking some financial gain from any growth opportunities, and given the amount of time it will take of HEVW's time.

Qualitative Analysis

Under this option, Sara would be operating this business on her own, in order to receive grants. With Sara having full control of the business, it increases the risk that Sara will operate the business in a way that fits her needs, rather than HEVW and her own as a whole. Andrew and Jenny would have no control over the operations.

Pros:

- Sara has a strong social media presence, and would be able to promote HEVW through her social media platforms. This would help HEVW be in line with the current trend in the industry, and help target additional wine lovers.

- Sara's vision of opening pop-up stores throughout Ontario and different regions, would be in line with HEVW's mission and vision to attract all discerning wine lover's palettes, and help target consumers that may not otherwise be targeted.

- Pop-up bars are popular amongst NC students - which fall under the Millennial age range. Given that Millennials take up a significant portion of the wine industry, this could help generate additional sales.

- Opening the wine bar, provides an opportunity for HEVW to host the various classes that they are currently struggling to host through their current partnership with NC.

- The wine bar would help HEVW diversify their revenues and product offerings.

Cons:

- Andrew and Jenny have not established a strong relationship with Sara. Therefore, pursuing this partnership could result in problems, which could be detrimental to the partnership.
- Andrew and Jenny's time is already a constraint. Pursuing this option, despite the role that Sara will play, will result in Andrew and Jenny having to spend a lot of time with Sara, and could result in burnout.
- Sara's mission and vision are not congruent with HEVW's. Having Sara's business on-site, whether at CW, or at HEVW, it may be difficult for HEVW to maintain their focus on their own mission and vision.
- Sara has asked for a restaurant garden to be grown at HEVW. If HEVW continues to grow vegetables, they would be losing out on a portion of their cash crops, and would likely not make as much if they were used at the restaurant. Additionally, agreeing to these terms, reduces HEVW's ability to use this extra space for more grapes if ever wanted.

Recommendation

Overall, I would not recommend HEVW pursuing this option. There is too much risk giving Sara full control of the company, when this is a new relationship. Regardless of what option is pursued regarding building or purchasing a winery, Sara's goals and overall mission and vision are not in line with HEVW's, and it could result in Andrew and Jenny diverting from their overall objectives.

Strategic Option #3: Niagara College Partnership

HEVW has partnered with Niagara College and are wondering whether to renegotiate the terms of the agreement or to terminate them.

Quantitative Analysis

Funds Received

Under this option, Andrew is paid \$10,500 on a per-section basis. As discussed in the situational analysis, It is clear that this program is seeing continued growth, therefore, Andrew will likely receive additional funds on an on-going basis.

If you were to cancel the agreement, you would no longer be receiving this amount of money. However, you are still working at County Winery, therefore, with the amount of time you'd be saving, you could focus your efforts elsewhere and likely generate the same if not more in revenues.

Capital Outlays

Under the current agreement, Niagara College has assumed all debt relating to the construction of the building and the clearing of the land. The building and land don't transfer ownership until the end of the 25 year contract.

If HEVW were to cancel this agreement, HEVW would likely have two options; either to buy back the land, or to have NC operate on their own land. Purchasing back the building would require additional financing to be obtained, and depending on whether or not you choose to pursue either winery option, you would be taking on a lot of debt, which may not be feasible.

Qualitative Analysis

You asked what the implications of terminating the lease would have on HEVW as a whole. I have analyzed these from a qualitative perspective below.

Cancelling Agreement:

Pros:

- Terminating the partnership would free up a significant amount of Andrew and Jenny's time, and allow them to focus on pursuing other growth opportunities.
- If you were to cancel the partnership, and the building became vacant, you may be able to buy back the building and use this as your winery, rather than building a brand new one.
- Teaching is not a part of HEVW's mission and vision, nor in line with your passion. Cancelling this agreement would allow you to focus your time on your passions.

Cons:

- The winemaking doesn't start until September 2021, therefore, terminating the agreement this early would likely result in significant sunk costs, and could be detrimental to HEVW's reputation.
- NC creates a significant amount of brand awareness for HEVW. Terminating this would result in Andrew and Jenny having to focus their efforts on marketing, and other communications regarding grants etc. Although they would free up a significant amount of time, their time would be filled making up for all of these lost areas.

Recommendation

Although cancelling the agreement would free up a significant amount of time for Andrew and Jenny, the benefits would likely not outweigh the costs. Therefore, I recommend negotiating the agreement further. I have provided some recommendations below:

- Involvement on the Board: You mention your concerns with an NC representative's involvement on the Board. This should be negotiated and have the representative not have full voting rights at board meetings. Given that HEVW is greater than just their NC partnership, having this individual there while discussing the business as a whole is clearly detrimental.

- Payment to students: You've mentioned that the student union's are trying to have students be paid. This would result in a significant cash outlay for HEVW if you had to pay all workers. Given that you are unhappy with some of the students and instructors not being as efficient, or careful, I would recommend negotiating the terms of student co-ops. For example, it would likely be more management and less costly if students had to apply for paid internships. By hiring students, you would be able to further control how students are acting, and likely reduce costs due to inefficiencies.
- Opening Hours: You mentioned that often times, students and instructors show up unannounced. I would recommend negotiating the opening hours for students and instructors. Having set hours would reduce your time commitment, and would allow you to focus on catching up on your business in other ways when the students are not around.
- The use of the facilities for classes: You mention that there is a non-compete agreement in place, which is preventing you from hosting classes. I would recommend negotiating these terms and discussing with NC whether they would be more up for the opportunity if they were to receive a portion of revenue that could be brought back into the studies to benefit both parties.

Operational Issues

Continuing Growth of Vegetables

During our discussion, Jenny, you mentioned that you were contemplating continuing the partnership with Hearty Kitchens. You have generated \$65,000 in cash flow last year, which, with you terminating your bar tending job, and HEVW terminating the lease with the farmer, provided you with additional cash flow to cover operating costs. The options HEVW has is to either pursue this, or to not.

Maintaining Partnership

If you continue to pursue this option, you will likely continue to receive this much in revenue on a year-to-year basis. However, like grapes, vegetables are impacted by the weather, so this amount could fluctuate year-over-year. However, by pursuing this, you are taking away from the core focus of the operations at HEVW. This land could be used to produce additional grapes, and therefore, increase the amount of production, which in turn would generate additional revenue.

Overall Recommendation

After reviewing the opportunities presented, I recommend HEVW pursue the following options. Firstly, I recommend keeping the Niagara College partnership, but negotiating the terms of the agreement with them. These negotiations should focus on having students apply for paid internships so HEVW is more efficient with the time spent with the students, the opening hours of the school at HEVW, and the use of the facilities. Additionally, I recommend that HEVW not pursue the wine bar option, as it is too risky of a business venture, and not in line with HEVW's core operations. Furthermore, I recommend that HEVW negotiate the terms of the County Winery before deciding on this.

From an operational standpoint, I recommend maintaining the partnership with Hearty Kitchens as you are generating cash flow that can be used to cover operating costs. Until your grapes are at full production and you require this land for further growth, I recommend staying with this.

Appendix A: CW Winery			
Purpose:	to determine the net present value of this opportunity		
Analysis:			
Cash inflows:	2021 - 2025		
Annual Bottling Fee:	80000		
Annual Variable Costs	33000	Assume variable costs of \$3.3	
Commission		Unknown at this time	
Cash outflows:	-180000	(\$15K * 12)	
Lease:	-1		
Net Annual Cash flows:	-67001		

Appendix B: Building Winery Financing			
Purpose:	to determine amount of interest and principal that will be required on loan		
Analysis:			
		Sensitivity Analysis if rate increased to 10%	
Total investment:	1,200,000	1,200,000	
Farm Plus Loan rate:	8%	10%	
Total Interest:	Investment * Rate	96000	120000
Principal	(term: 15 years per original terms)	80000	80000
Total Annual Payments:	176000	200000	

Appendix C: Wine Bar			
Purpose:	to determine the expected cash flow of the investment in it's first year		
Analysis:			
		Total	
Expected net income:	240480		
Less:			
Salary for Jenny and Sara:	-90000	Assume 45,000 per Sara and Jenny	
Start-Up Costs:	-210000		
Financing	210,000		
Revenue for Pop-Ups	-60000	Assume one per month (divide total of \$120K by 2)	
Total Expected Net Income for Year 1:	90480		

APPENDIX G

**RESULTS BY SUMMATIVE ASSESSMENT OPPORTUNITY FOR
DAY 1 VERSION 1 AND VERSION 2**

Results by Summative Assessment Opportunity

Marking Results – HEVW Version 1

Indicator	Papers	Did not meet standard ¹	Marginal ¹	Yes, met standard
Situational Analysis	6878	0.41	2.43	97.16
Analysis	6878	4.04	22.81	73.15
Conclude and Advise	6878	0.68	3.15	96.16
Communication	6878	0.22		99.78

Marking Results – HEVW Version 2

Indicator	Papers	Did not meet standard ¹	Marginal ¹	Yes, met standard
Situational Analysis	793	2.52	14.25	83.23
Analysis	793	9.09	53.97	36.95
Conclude and Advise	793	3.15	8.07	88.78
Communication	793	.13		99.87

¹Clearly failing were marked twice. All marginally failing or marginally passing papers were marked a second time to determine which ones met the passing standard. Only the clear passes were marked once, however they were audited.

APPENDIX H

**BOARD OF EXAMINERS' COMMENTS ON DAY 1 SIMULATION
VERSION 1 AND VERSION 2**

**BOARD OF EXAMINERS' COMMENTS ON DAY 1
(HEVW VERSION 1 AND HEVW VERSION 2)**

Paper/Simulation: Day 1 – Linked Case, HEVW Version 1
(on Sept 2018 CFE)

Estimated time to complete: 240 minutes

Simulation difficulty: Average

Competency Map coverage: N/A; Enabling Skills

Evaluators' comments by Summative Assessment Opportunity (SO)

SO#1 (Situational Analysis)

Candidates were expected to recap the important decision factors and highlight any significant changes from Capstone 1 (such as trends and operational) that would influence the decisions HEVW is contemplating. Candidates were only rewarded when they made links to their situational analysis in the body of their report in SO#2 and SO#3. Unlike previous Day 1 cases, HEVW Version 1 had few significant changes to the situation that required upfront identification; in other words, the mission and objectives of HEVW remained the same, and there were no significant economic changes. There were other key situational factors, however, that candidates should have identified and considered. In particular, HEVW invested in a state-of-the-art winery and, as a result, was now low on cash. Short-term cash flow would be a critical issue until HEVW reached full capacity, which would only happen in a few years, once all the vines had matured. The cash flow issue was also important because both owners had quit their jobs and were relying entirely on HEVW as their source of income. Most candidates recognized this issue and integrated it into their analysis in SO#2 and SO#3.

Most candidates provided an appropriate situational analysis. Unlike in previous CFEs, they did not spend excessive time on this part of their response, and they highlighted the key elements that had changed since Capstone 1 and were relevant to the decision-making (e.g., tight cash flow, loan repayments, need to protect their vines, etc.). Many candidates recapped the mission and key success factors and framed the situational analysis in a SWOT.

Strong candidates drew on their knowledge from Capstone 1 and provided full thoughts in their discussions by not only stating a case fact, but also explaining why it was relevant. For example, the Pinot Noir continued to sell out every year, showing that the popularity of HEVW wine boded well for the future. These candidates also focused their discussions primarily on elements that have changed since Capstone 1.

Many weak candidates spent an excessive amount of time on their situational analysis, writing four to five pages of SWOT points, without any focus on the significant factors. Other weak candidates simply restated case facts that had little to no value, such as the fact that Andrew quit his job.

SO#2 (Analysis of the Issues)

Candidates were expected to analyze four major issues from both a strategic and an operational perspective. There were also some minor issues that candidates could discuss at an operational level and in less depth. Candidates were expected to analyze the issues from both a qualitative and a quantitative perspective, and the case provided sufficient information to do both for all issues. Compared to previous Day 1 cases, this case contained more quantitative information and less qualitative information for the candidates to consider, which changed the nature of the analysis.

Major Issue #1: Equipment Purchase

HEVW lost a portion of its grape vines to a severe frost and was now evaluating different equipment options to protect the vines from future frost damage. Candidates were expected to discuss the pros and cons of each machine (wind machine versus oil heater). Quantitatively, they were expected to do a present value calculation of the machines using the initial cost, plus ongoing costs, and, more importantly, to recognize the different useful lives of the machines.

Most candidates were able to discuss several key elements of both machines, often linking the wind machines to HEVW's desire to be environmentally friendly. Most candidates also attempted to quantitatively compare the wind machines to the oil heaters and integrated the results of those calculations into their recommendation.

Strong candidates did a present value calculation and factored the oil heaters by three so that they were comparable to the wind machines. Within their discussion of the pros and cons of the different machines, many acknowledged the fact that HEVW was low on cash and that it would be difficult to finance the upfront cost of new equipment. Strong candidates also integrated the need for insurance, which was mistakenly overlooked by the owners.

Weak candidates did not recognize that the life of the wind machines was 24 years, whereas the life of the oil heaters was only 8 years. Consequently, their quantitative analysis, which simply compared the present value of an 8-year machine against a 24-year machine, had less value. Weak candidates also struggled to make links back to their situational analysis. For example, many often simply recommended buying the machines without linking back to HEVW's low cash availability (which many had noted in their situational analysis) with the investment required to buy the new machines.

Major Issue #2: Premium Wine

One of the owners of HEVW, Andrew, wanted to create a premium wine, which meant aging a batch of the regular wine for an extra year. Candidates were expected to discuss the benefits of premium wine while also recognizing the downside, which included a price-sensitive market, where one market (restaurants) was willing to pay a lot less than the general market, and, most importantly, the fact that HEVW would have to give up one year's worth of sales while the wine aged for the extra year.

Most candidates provided a good discussion of the pros and cons of proceeding with the premium wine and acknowledged, either in their calculations or in their discussions, that HEVW would have a loss in the first year. Most candidates did a reasonable margin comparison and calculated the correct incremental profit. Most also linked this issue with HEVW's vision and the owners' preferences.

Strong candidates completed their quantitative analysis, recognizing the \$115,000 loss in the first year in both their discussion and their calculations. They then integrated the short-term cash flow issue into their discussion, recognizing that HEVW currently could not afford to give up one year's worth of revenue. Many understood the benefits of the premium wine and recommended pursuing it in a year or two, when HEVW would be running closer to capacity and in a better cash position.

Weak candidates did not recognize that there would be a loss in the first year when the batch of regular wine was stored instead of sold. Whether or not they calculated the first-year loss, weak candidates missed the crux of this issue by not linking it to the cash flow problem and simply recommended that HEVW proceed with the premium wine.

Major Issue #3: D'Vine-on-Tap

HEVW was approached by a company, D'Vine-on-Tap (DOT), to form a partnership to sell its wine in kegs. DOT would use empty space in HEVW's new winery, but HEVW had planned to use that space to host events. Candidates needed to provide a qualitative discussion that considered information from Capstone 1 (link to the millennials market, market trends, and key success factors), as well as Day 1 information on the offer. Quantitatively, candidates could analyze the different margins, perform a sensitivity analysis, and calculate the cost savings of putting the wine into kegs instead of bottles.

Most candidates provided an appropriate discussion, linking to several Day 1 case facts and key success factors. Of the four major issues, the quantitative analysis of this issue was the most challenging for candidates. Generally, candidates attempted some form of quantitative analysis, but many only provided a surface-level analysis of the case facts (e.g., annual margin from kegs would grow from \$61,000 to \$185,000).

Strong candidates were able to link their analysis to many points (e.g., millennials, vision, key success factors) and complete more than one quantitative analysis. They made good use of the case facts and the information from Capstone. They also recognized that the projections were coming from DOT and were, therefore, biased, so they suggested HEVW should proceed with caution and recommended performing more due diligence on the projected sales. Strong candidates also recognized that hosting events was important to attracting people to the vineyard, which was a key success factor, so it was important that HEVW try to quantify that opportunity cost before moving ahead with DOT.

Weak candidates did not know how to use the figures provided in the case and simply restated the case facts in their qualitative discussion without explaining further the impact on HEVW's decision. Many also ignored the long-term benefits and costs and only focused on the money that HEVW would receive upfront (i.e., DOT would provide \$100,000 upfront). Some weak candidates limited their discussion to the quality of the wine in kegs and whether using kegs aligned with HEVW's vision.

Major Issue #4: Excess Capacity

Until HEVW's vineyard fully matured and was at 100% capacity, there would be excess winemaking capacity. Candidates were presented with two options to fill that capacity: virtual winemakers or buying grapes. Candidates were expected to compare the two options both qualitatively and quantitatively. Since HEVW's grapes would slowly use up the excess capacity, candidates needed to consider and calculate the long-term impact of their recommendation.

Most candidates did a reasonable comparison both qualitatively and quantitatively of the two options. Typically, candidates would link the options to HEVW's vision of having the finest wine. Virtual winemakers would use their own label on their wine, which would protect HEVW's brand. However, buying grapes could jeopardize the quality of wine under the HEVW label. Quantitatively, candidates incorporated the growth rate of the virtual winemakers to determine total margin and then compared that to the margin of the unlimited grapes available for purchase.

Strong candidates understood that all HEVW's excess capacity could be used and determined the optimal use between the virtual winemakers and buying grapes. Their calculations considered the limited demand from virtual winemakers and optimized the use of the capacity to maximize profits. Strong candidates also integrated their recommendation from the DOT issue; in other words, if they went ahead with DOT, then HEVW could use the excess capacity to buy grapes and use that wine to fill the kegs instead of using up the popular Pinot Noir grapes.

Weak candidates ignored the capacity figures and simply concluded that virtual winemakers provide a higher margin (which was a case fact) and that HEVW should not consider buying grapes. Weak candidates also did not understand what a virtual winemaker was (which was described in Capstone 1) and, consequently, provided unfounded discussions.

Minor Issues

There were several less significant issues within the case that candidates could have discussed. One issue was specifically directed to, since Jenny stated that she had some financing options to present to the advisory board and asked CPA to investigate these further. The financing options Jenny was considering were included in Appendix VII. Candidates were expected to evaluate these and recommend the best financing option. Most candidates appropriately addressed each of the five options in the appendix and made a recommendation.

The other minor issues were not directed, but most candidates saw and addressed them. Specifically, there were issues with poor communication between the owners, leading to overspending, missed insurance payments, and not applying for government grants. Also, HEVW had recently instituted an advisory board, and most candidates provided advice on best practices for a board.

Strong candidates provided a discussion of all the minor issues. They also provided calculations on the amount of grant money HEVW was eligible for. Their recommendations were reasonable (e.g., Jenny and Andrew should meet regularly to review financials against budget) and presented appropriately (e.g., advice on best practices that Jenny and Andrew could understand and consider).

Weak candidates did not plan their time as well, and as a result, they provided either too much or too little discussion of the operational issues. Many weak candidates acknowledged the need to discuss the financing options (there was a whole appendix dedicated to it); however, their discussion of the options was very brief and provided little value. Other weak candidates thought the financing options were a very significant issue and provided more discussion of the financing than the major issues.

Overall

Overall, strong candidates provided balanced discussions that were linked to several elements of their situational analysis. Their quantitative analysis was generally good on three of the four major issues, and they allowed sufficient time to address all the minor issues.

Weak candidates tended to just restate case facts in their analysis and focus too much on the less important elements of their response (SWOT or the minor issues). Weak candidates also struggled with the quantitative analysis, with many just restating numbers from the case and not demonstrating any numeracy skills.

SO#3 (Conclude and Advise)

Candidates were expected to conclude on each analysis they completed. Conclusions were expected to be consistent with the analysis performed. In their recommendations, candidates were expected to address the fact that HEVW had short-term cash constraints.

Strong candidates provided thorough conclusions for all the issues analyzed. There was no correct solution to the case, but strong candidates provided a persuasive recommendation that was consistent with their quantitative and qualitative discussions. They considered the cash flow constraint and understood it was a short-term issue that would resolve itself as capacity was reached.

Weak candidates were hesitant to give a clear recommendation and yet did not explain what additional information was required before a final recommendation could be made. Weak candidates were also more likely not to have seen that the cash problem was short-term.

SO#4 (Communication)

Very few candidates struggled with effective communication. The approach that nearly all candidates took was well structured and the language used was clear. However, some candidates' presentation of their exhibits in Excel was difficult to follow due to poor labelling or no formulas in the cells.

SO#5 (Overall Assessment)

Overall, candidates were expected to meet minimum acceptable standards in each of the four assessment opportunities listed in this report to obtain a "Pass" on the Day 1 linked case.

For each major issue, the BOE expected a high-level analysis before candidates proceeded to a reasonable conclusion. Candidates were also expected to step back, integrate the issues, and see the bigger picture (the short-term cash flow crunch), not just the issues in isolation (such as damaged vines or the desire to produce a premium wine). The BOE also sought evidence of candidates having incorporated information from Capstone 1 and the changes identified in their situational analysis.

BOARD OF EXAMINERS' COMMENTS (continued)

Paper/Simulation: Day 1 – Linked Case, HEVW Version 2
(on Sept 2019 CFE)

Estimated time to complete: 240 minutes

Simulation difficulty: Average

Competency Map coverage: N/A; Enabling Skills

Evaluators' comments by Summative Assessment Opportunity (SO)

SO#1 (Situational Analysis)

Candidates were expected to briefly outline HEVW's critical decision factors, that of mission, vision, trends, and objectives, and to highlight any significant changes that have taken place within the company since Capstone 1. This was an important step because these changes may affect the decisions facing HEVW. Candidates were rewarded when they made links to the situational analysis within their analysis in SO#2 and their conclusions in SO#3. The BOE noted that some candidates chose not to provide a situational analysis at all, proceeding immediately to their issue analysis. These candidates sometimes failed to discuss relevant considerations and trends in their analysis of the issues. Candidates are encouraged to take the time to perform this important step as there is a risk of missing key elements using this approach.

In the simulation, Andrew states that HEVW's goals have not changed. Moreover, the case did not provide any changes to HEVW's mission, vision, objectives or key success factors. Therefore, a brief statement with a summary of the company's main goals and aims was considered adequate. The case provided an update of HEVW's business and operations since Capstone 1. Elements of this update, such as the fact that HEVW had formed a board, were important factors that the candidates should have considered as part of their analysis in SO#2.

Strong candidates provided a SWOT analysis that highlighted any changes since Capstone 1 and stated how these changes might affect the company's decision-making process, and also pointed out that, although HEVW's goals have not changed, the company seemed at risk of deviating from these goals given the various partnerships and proposals it had already entered into or was considering.

Weak candidates tended to restate case facts and did not provide any indication of how those factors would influence the decision-making process. Weak candidates also had a far harder time providing coherent and valuable links back to the situational analysis within their SO#2 response. In addition, weak candidates restated elements of the company's situational analysis, often providing a complete transcription of the company's mission, vision and key success factors, which was not appropriate for this case.

SO#2 (Analysis of the Issues)

There were three major issues that candidates were expected to analyze from both a strategic and operational perspective: the winery decision; the Niagara College agreement; and the governance/focus issues. There was one additional issue that a candidate could have discussed: the wine bar proposal. Given that the proposed project fell outside of HEVW's core business, it was considered of lesser strategic importance. The quantitative elements of this case were also of lesser importance but candidates were still required to demonstrate a basic level of numeracy skill.

Many candidates provided a separate analysis of whether HEVW should continue growing vegetables instead of planting grapes. This was not intended to be a separate issue and candidates should not have spent time addressing it as such. Instead, the comment that Jenny made was meant as a hint toward the issue of loss of focus, which is described in detail below.

Major Issue #1: The Winery – Buy County Winery (CW) or Build Winery

HEVW plans to build its own winery. This decision aligns with HEVW's mission to produce premium wine and Andrew's desire to be a high-quality winemaker. As Jeremy has presented the opportunity to purchase CW, Andrew and Jenny are reconsidering their decision to build the winery. Candidates were expected to see that this was the most significant decision to be made, given that winery ownership was central to HEVW's stated mission, vision and goals. Candidates were expected to discuss the key decision factors for both options, suggest amendments to the proposed agreement that would benefit HEVW and align their recommendations with HEVW's goals and situational analysis.

Many candidates struggled to provide an analysis of both options. Instead, many candidates spent the bulk of their discussion on the option to purchase CW, with little beyond an identification of the build option. Many candidates provided a list of CW's pros and cons, based on the case facts presented, such as the experienced labour and older equipment, but did not always mention the more important strategic factors, such as CW not being an estate winery and selling non-VQA wines alongside VQA-approved wines. Given HEVW's commitment to quality and desire to be a premium estate winery, this was important to mention. In addition, as part of the proposed purchase agreement in Appendix III, Jeremy is to be granted a seat on HEVW's board until the final payment is received. This was also considered a very important point as this would further dilute Andrew and Jenny's ability to govern HEVW. Most candidates identified the capacity constraint issue related to the Black Label commitment, which was rewarded under numeracy skills.

Strong candidates understood the importance of this decision to HEVW and provided an in-depth discussion of both options. These candidates attempted to compare the cost of the two options, recognizing that the estimated cost to build the winery had likely increased since 2018. Some strong candidates tried to update this estimated cost figure in order to compare the cost to build with the cost to purchase CW. Strong candidates also realized that key quantitative information was absent from the case facts and stated what additional information was required, such as the estimated operating costs for both operations. Qualitatively, they identified that CW's current operations did not align perfectly with HEVW and that more resources would be required to ensure that the winery met HEVW's goals. For example, as the equipment at CW was "dated and less efficient," it was possible that HEVW would incur higher than anticipated maintenance expenses. They also provided relevant renegotiation points that HEVW should consider, usually related to the subcontracting or Jeremy's desire for a seat on the board.

Weak candidates did not understand how important this decision was to the future of HEVW and therefore did not provide the required level of depth within their analysis. Many weak candidates failed to discuss the build option and instead tended to solely evaluate the purchase of CW. Moreover, weak candidates tended to discuss the operational decision factors, such as the experienced labour force at CW, and fewer of the important strategic factors, such as how HEVW would be giving up a board seat in the deal with CW. The BOE reminds candidates that, on a Day 1 case, it is vitally important to assess the case from a strategic level rather than simply from an operational level. Weak candidates seldom provided useful renegotiation points, such as changing the transfer of ownership clause within the CW agreement to the beginning of the agreement rather than the end, or cancelling the Black Label commitment.

Major Issue #2: Niagara College (NC)

Since Capstone 1, HEVW has entered into an agreement with NC. Andrew and Jenny felt pressure to sign the agreement with NC because they felt that if they didn't, "someone else would," and the final agreement included some undesirable terms for HEVW. Andrew's teaching duties are already taking more of his time than was originally anticipated and, given increasing student numbers, this trend is predicted to only get worse. Given a dispute between NC and the student union, NC has requested that HEVW reopen negotiations. Candidates were expected to provide a qualitative analysis of two main issues: the implications of cancelling the agreement, and the terms within the existing agreement that HEVW should renegotiate, with recommended revisions.

Most candidates attempted a discussion of this issue; however, many candidates failed to address all of its components. Few candidates realized that, if HEVW reopened negotiations, there was a risk that the final agreement could be even worse for HEVW than the current agreement. Many candidates focused on the amount of time that Andrew would need to spend teaching as part of the NC contract, how much Andrew earned per course, even though this was a minor point, and the damage to HEVW's vines. Fewer candidates discussed the important student labour issue that was highlighted in the simulation.

Strong candidates understood that there were significant implications of cancelling the agreement and provided relevant renegotiation points. They discussed both the pros and cons of cancelling the agreement, making good links back to HEVW's mission, vision and goals. They realized that the agreement was taking Andrew's time and focus away from HEVW's core business of growing the finest grapes and producing quality wines. Their renegotiation points tended to focus on those that would have the biggest impact for HEVW's core business, such as reducing Andrew's teaching time commitment and reducing the damage to HEVW's vines.

Weak candidates tended to only discuss the cons of cancelling, such as the potential legal issues and expenses that could arise and the loss of free student labour. Weak candidates often provided the pros and cons of the existing agreement which, as part of Capstone 1, was not asked for and was not relevant, given that HEVW had already entered into the agreement. Sometimes their analysis led to realizing the implications of cancelling the agreement, but many times, these links were not made. Weak candidates' renegotiation points, when offered, also tended to focus on points that were less important to HEVW's core business, such as ensuring that Andrew/Jenny had access to NC's classrooms in order to run their own courses.

Major Issue #3: Loss of Focus/Governance Issues

Candidates were not specifically directed to these problems but were given multiple indications throughout the case that there were potential governance issues at HEVW, and that given all the partnerships, proposals and projects that HEVW had entered into and were considering, Jenny and Andrew were at risk of losing focus on HEVW's core business. Relative to the governance issue, there were many clues given throughout the case, such as rushed or high-pressure decision making, new board members via partnerships and John's comments. Relative to the potential loss of focus, there were also many clues throughout the case, such as the frequent, new and exciting opportunities, Jenny's heirloom vegetable business comments, John's comments and loss of Andrew's time to NC. Candidates were expected to recognize these "step-back" issues and recommend appropriate action for at least one of them.

Most candidates did not provide an in-depth discussion of the governance issues at HEVW. If this issue was mentioned at all, the comments were made as part of the candidate's qualitative analysis of one of the other strategic decisions.

Strong candidates recognized that HEVW had already entered into ventures with NC and Hearty Kitchens, which took Andrew and Jenny's focus away from the core business. Strong candidates also identified these issues within their situational analysis and then linked back to these points within their analysis of the issues. Many of these candidates recognized that Sara's wine bar proposal could also potentially limit Jenny and Andrew's ability to focus on HEVW's core business.

Weak candidates either did not discuss these issues at all or made a few brief comments within their analysis of the strategic decisions that HEVW was considering. Weak candidates also may have recognized these issues and tied them back to a violation of HEVW's mission and vision, but then recommended that HEVW update its mission and vision to accommodate the new direction of the company. Given that Andrew clearly stated in the case that HEVW's goals had not changed, this type of recommendation was not considered valuable.

Minor Issue #1: Numeracy Skills

Candidates could have illustrated numeracy skill in three ways: recognizing the capacity constraint of CW's winery within 2024 and 2025; providing a cost comparison discussion or analysis of the CW versus build option for the winery; or by critiquing Sara's projected financial information for the wine bar proposal.

Most candidates achieved a minimal acceptable level of numeracy skill, with most candidates recognizing the capacity constraint and attempting one of the other quantitative analyses. Strong candidates provided a concise and useful analysis of these issues. Some weak candidates did not realize that there was not enough information to perform a complete financial analysis in order to compare the winery options, and periodically attempted overly complicated quantitative projections. In addition, in the simulation, the build option's cost estimates were 2018 estimates and needed to be updated, and the CW payment figures needed to be calculated; weak candidates attempted to compare these figures without updating them in any way.

Minor Issue #2: Sara's Proposal (Wine Bar and Pop-ups)

Candidates were asked to assess Sara's wine bar and pop-up proposal and provide a recommendation as to whether HEVW should accept the proposal. Because this proposal and its implications fell outside of HEVW's core business of growing quality grapes and producing award-winning wines, this was considered a secondary strategic issue.

Most candidates provided an adequate analysis of this issue. Most candidates identified and discussed the commonalities between Sara's proposal and HEVW, such as how Sara's social expertise would help to market HEVW and how Sara's proposal would help to create the "full experience" that customers desired. Many candidates also recognized that Sara might lack the experience to run a company or to compile a reliable projection. Most candidates tended to question the reasonability of Sara's plan and projection, usually questioning the lack of a salary amount; less frequently, candidates recommended potential revisions to Sara's proposal.

Strong candidates recognized that the wine bar was outside the core business and stated such in their response. Strong candidates tied Sara's proposal to HEVW's mission, vision and goals, such as how Sara's proposal would likely attract more visitors to the region, which is in line with HEVW's goals. Strong candidates went beyond the details of Sara's forecast and not only questioned the need to include a salary but also recognized that HEVW should be charging rent, particularly since the proposed compensation arrangement was for HEVW to receive a percentage of the profits, which could be "nil" in the start-up years.

Weak candidates provided their most in-depth discussion of any of the strategic decisions on this issue. They typically accepted Sara's projections at face value and recommended that HEVW proceed with the arrangement, since it looked profitable, without further scrutiny or questioning of the underlying assumptions.

Overall

Many candidates failed to consistently provide a balanced qualitative discussion throughout their analysis, often focusing on one side of the issue only. Many candidates also failed to recognize or discuss the interrelationships between the issues presented. For instance, candidates were rewarded when they recognized that Sara's idea to use student interns from NC might be affected by the outcome of negotiations with NC's student union. Candidates were also rewarded when they recognized that the wine bar partnership would be impacted by the decision of whether to build or purchase a winery, such as, for example, if HEVW purchased CW, a separate building would need to be built for the wine bar. Candidates were rewarded when they recognized and discussed the interrelationships between each of the strategic decisions. Many candidates failed to acknowledge these interrelationships in any meaningful depth.

SO#3 (Conclude and Advise)

Candidates were expected to conclude on each issue analyzed in a manner that was consistent with the analysis they performed. There was no single correct strategic mix of decisions; therefore, as long as candidates provided conclusions or recommendations that were coherent and consistent with the analysis performed, they received credit. Candidates were expected, however, to express a need for HEVW to refocus on its primary business.

Strong candidates concluded on each analysis, recognized that some issues were more important than others, and highlighted this fact within their overall conclusion. They understood the interrelationships and were internally consistent when making their recommendation. For example, some candidates recommended that HEVW forgo Sara's proposal because it did not fit with HEVW's core business, and instead refocus efforts on the company's main focus, that of producing wine. These candidates also typically concluded that HEVW should continue with the NC agreement because the risks of cancellation were too great, and recommended renegotiation points. Some candidates recommended the build option for the winery whereas others recommended the purchase of CW. As long as it was properly supported, either recommendation was acceptable.

Weak candidates provided unclear and often inconsistent recommendations that were poorly supported, such as, for example, to not renegotiate with NC but to use the NC student labour for the wine bar. Weak candidates also tended to conclude on each analysis without considering how those conclusions would affect the company when brought together, failing to recognize the interconnectedness of the decisions. For example, weak candidates tended to recommend Sara's proposal alongside purchasing CW while still pursuing the NC partnership, without renegotiation points that would limit the amount of time that Andrew would need to spend on the project. At the start of the case, it was mentioned that Andrew and Jenny were already working long hours. Weak candidates failed to recognize the time constraint on Andrew and Jenny and tended to make recommendations that would only make this constraint worse.

SO#4 (Communication)

Most candidates approached their response in a coherent and organized fashion. Only a few candidates struggled to effectively communicate their ideas. These candidates tended to use poor sentence structure, confusing syntax and an unorganized response approach. Weak candidates sometimes tried to tie case facts back to the situational analysis but the links made were not logical and therefore lacked value. For instance, some candidates, making a link back to Andrew's goal of providing a comfortable living for his family, tried to negotiate a higher compensation rate for Andrew relative to the NC agreement. These candidates failed to recognize that their advice, and the idea of more teaching, detracts from Andrew and Jenny's stated goal of producing quality grapes and wines. Candidates are reminded that, although links to the situational analysis are important, these links must be consistent with the stated objectives of the company being assessed.

SO#5 (Overall Assessment)

Overall, candidates were expected to meet the minimum acceptable standards in each of the four assessment opportunities listed in this report in order to obtain a "Pass" on the Day 1 linked case. Candidates also had to demonstrate a minimum level of numeracy skill. For each major issue, the board expected an in-depth analysis before candidates proceeded to a reasonable conclusion. Candidates were also expected to recognize the fact that HEVW was at risk of losing focus on the company's core business. The board also sought evidence of candidates having incorporated information from Capstone 1, and the changes identified, in their situational analysis.

APPENDIX I

CPA COMMON FINAL EXAMINATION REFERENCE SCHEDULE

CPA COMMON FINAL EXAMINATION REFERENCE SCHEDULE

1. PRESENT VALUE OF TAX SHIELD FOR AMORTIZABLE ASSETS

Present value of total tax shield from CCA for a new asset acquired before November 21, 2018

$$= \frac{CTd}{(d+k)} \left(\frac{2+k}{2(1+k)} \right) = \frac{CdT}{(d+k)} \left(\frac{1+0.5k}{1+k} \right)$$

Present value of total tax shield from CCA for a new asset acquired after November 20, 2018

$$= \frac{CdT}{(d+k)} \left(\frac{1+1.5k}{1+k} \right)$$

Notation for above formula:

C = net initial investment

T = corporate tax rate

k = discount rate or time value of money

d = maximum rate of capital cost allowance

2. SELECTED PRESCRIBED AUTOMOBILE AMOUNTS

	2018	2019
Maximum depreciable cost — Class 10.1	\$30,000 + sales tax	\$30,000 + sales tax
Maximum monthly deductible lease cost	\$800 + sales tax	\$800 + sales tax
Maximum monthly deductible interest cost	\$300	\$300
Operating cost benefit — employee	26¢ per km of personal use	28¢ per km of personal use
Non-taxable automobile allowance rates		
— first 5,000 kilometres	55¢ per km	58¢ per km
— balance	49¢ per km	52¢ per km

3. INDIVIDUAL FEDERAL INCOME TAX RATES**For 2018**

<u>If taxable income is between</u>			<u>Tax on base amount</u>	<u>Tax on excess</u>
\$0	and	\$46,605	\$0	15%
\$46,606	and	\$93,208	\$6,991	20.5%
\$93,209	and	\$144,489	\$16,544	26%
\$144,490	and	\$205,842	\$29,877	29%
\$205,843	and	any amount	\$47,670	33%

For 2019

<u>If taxable income is between</u>			<u>Tax on base amount</u>	<u>Tax on excess</u>
\$0	and	\$47,630	\$0	15%
\$47,631	and	\$95,259	\$7,145	20.5%
\$95,260	and	\$147,667	\$16,908	26%
\$147,668	and	\$210,371	\$30,534	29%
\$210,372	and	any amount	\$48,718	33%

4. SELECTED INDEXED AMOUNTS FOR PURPOSES OF COMPUTING INCOME TAX

Personal tax credits are a maximum of 15% of the following amounts:

	2018	2019
Basic personal amount	\$11,809	\$12,069
Spouse, common-law partner, or eligible dependant amount	11,809	12,069
Age amount if 65 or over in the year	7,333	7,494
Net income threshold for age amount	36,976	37,790
Canada employment amount	1,195	1,222
Disability amount	8,235	8,416
Canada caregiver amount for children under age 18	2,182	2,230
Canada caregiver amount for other infirm dependants age 18 or older (maximum amount)	6,986	7,140
Net income threshold for Canada caregiver amount	16,405	16,766
Adoption expense credit limit	15,905	16,255

Other indexed amounts are as follows:

	2018	2019
Medical expense tax credit — 3% of net income ceiling	\$2,302	\$2,352
Annual TFSA dollar limit	5,500	6,000
RRSP dollar limit	26,230	26,500
Lifetime capital gains exemption on qualified small business corporation shares	848,252	866,912

5. PRESCRIBED INTEREST RATES (base rates)

<u>Year</u>	<u>Jan. 1 – Mar. 31</u>	<u>Apr. 1 – June 30</u>	<u>July 1 – Sep. 30</u>	<u>Oct. 1 – Dec. 31</u>
2019	2	2	2	
2018	1	2	2	2
2017	1	1	1	1

This is the rate used for taxable benefits for employees and shareholders, low-interest loans, and other related-party transactions. The rate is 4 percentage points higher for late or deficient income tax payments and unremitted withholdings. The rate is 2 percentage points higher for tax refunds to taxpayers, with the exception of corporations, for which the base rate is used.

6. MAXIMUM CAPITAL COST ALLOWANCE RATES FOR SELECTED CLASSES

Class 1.....	4% for all buildings except those below
Class 1.....	6% for buildings acquired for first use after March 18, 2007 and \geq 90% of the square footage is used for non-residential activities
Class 1.....	10% for buildings acquired for first use after March 18, 2007 and \geq 90% of the square footage is used for manufacturing and processing activities
Class 8.....	20%
Class 10.....	30%
Class 10.1.....	30%
Class 12.....	100%
Class 13.....	Original lease period plus one renewal period (minimum 5 years and maximum 40 years)
Class 14.....	Length of life of property
Class 14.1.....	5% For property acquired after December 31, 2016
Class 17.....	8%
Class 29.....	50% Straight-line
Class 43.....	30%
Class 44.....	25%
Class 45.....	45%
Class 50.....	55%
Class 53.....	50%

The CPA certification program prepares future CPAs to meet the challenges that await them. For more information on the qualification process, the common final examination (CFE), and the specific education requirements for your jurisdiction, contact your provincial/regional CPA body.

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