



A Report to the Premier's Advisory Council on Government Assets,  
Ed Clark, Chair, in respect to the Liquor Control Board of Ontario

*September 2014*



September 18, 2014

Ed Clark  
Chair, Premier's Advisory Council on Government Assets  
Cabinet Office, 1075 Bay Street, Suite 830  
Toronto ON M5S 2B1

Dear Mr. Clark:

The Ontario Public Service Employees Union represents 130,000 Ontarians who work in nearly every area of public service in this province. More than 7,000 of our members work for the Liquor Control Board of Ontario, a major government asset that falls within the scope of your council's review. Our members are proud to work for an organization that sells beverage alcohol in a socially responsible manner that reduces the harm associated with this highly popular and addictive drug.

The LCBO, described as a "revolutionary innovation" by Brock University professor Dan Malleck,<sup>1</sup> came into being because the two extreme alternatives that preceded it had failed so dismally. The first, the unregulated market, created so many domestic and social problems that it triggered a powerful temperance movement across North America, mostly led by women, who suffered "from the loss of income consumed in saloons, and from domestic violence and the general neglect of home and family."<sup>2</sup> The Prohibition era, which began in Ontario in 1916, created its own set of problems by criminalizing an activity enjoyed by much of the population. The result was "a state of lawlessness under an extremely restrictive legal regime."<sup>3</sup> As it turned out, public opinion would only tolerate this regime for 11 years.

Since 1927, the LCBO has continued to balance the social need to reduce harm with the popular desire to enjoy alcohol. As an arm of government, the LCBO has reduced harm from alcohol consumption in a number of ways: by limiting the number of retail outlets selling alcohol; through alcohol pricing policies designed to reduce alcohol consumption, especially among high-risk drinkers; by strong enforcement of the ban on alcohol sales to minors and the intoxicated;<sup>4</sup> and through other policies and procedures.

The design of Ontario's liquor distribution system may help explain why per capita liquor consumption in Ontario is the second-lowest among all provinces and territories in Canada (only residents of New Brunswick consume less).<sup>5</sup> And while there are many factors that have

an impact on impaired driving rates, liquor marketing regimes clearly play a role, and Ontario has the lowest rate of impaired driving charges per capita of any province in Canada.<sup>6</sup> LCBO staff routinely report impaired drivers to police, resulting in charges being laid and improved road safety.<sup>7</sup>

While emphasizing liquor control, the LCBO has also recognized public enthusiasm for alcohol by changing with the times, offering shoppers a retail experience that is second to none. Of course, the LCBO does, to some degree, facilitate – and even encourage – alcohol consumption through its marketing campaigns and merchandising. While undesirable in many respects, it is not at all clear that the LCBO would enjoy the popular support it does if it were to return to the much more restrictive booze-behind-the-counter approach that prevailed before the first “self-serve” store opened in 1969.<sup>8</sup> Acting like a sophisticated modern retailer may, in fact, be politically essential to maintaining the LCBO’s ability to contain alcohol consumption and fulfil its social responsibility mandate. The revolutionary innovation of 1927 has been updated to suit the needs and tastes of 2014.

The issues of social responsibility and the social costs of alcohol are typically ignored by those critics of the LCBO who routinely call for the liberalization of liquor retailing and/or the sale of the LCBO to private interests. Recent studies from the C.D. Howe Institute and the Ontario Convenience Stores Association, for example, have argued that government could increase its income from alcohol sales by allowing the sale of beer and wine in corner stores and other retail outlets.<sup>9</sup> In May, the head lobbyist for private liquor stores in British Columbia came to Ontario to make the same argument.<sup>10</sup>

All would-be privatizers base their argument on the same idea: that by introducing price competition and greatly expanding the number of outlets permitted to sell alcohol, alcohol sales would rise. The resulting surge in tax revenues, they all claim, would more than make up for any profits lost by government as a result of privatizing and liberalizing alcohol sales.

What the privatization pushers ignore, however, is the cost to government – and society as a whole – of increased alcohol consumption. The reality is that, from a societal point of view, the idea of “profit” from alcohol is an illusion. The evidence is clear: no society can ever actually profit from the sale of alcohol. When it comes to alcohol, “direct costs exceed direct revenue in most jurisdictions,” Ontario included.<sup>11</sup>

There is money to be made in selling alcohol, to be sure; alcohol has made the fortunes of many. But those profits, which accrue to alcohol sellers, come with costs – costs which are socialized across society as a whole. Alcohol consumption is indisputably linked to lost productivity at work and damaged relationships at home. Its negative health effects, from dementia to cancer, are well documented. Its role in fatal and property-destroying automobile

accidents is reported daily in news stories. And the cost of alcohol-related law enforcement is paid for by every citizen.

The most comprehensive study of the costs of alcohol abuse in Canada was published in 2006. That study, from the Canadian Centre on Substance Abuse (CCSA), put the social cost of alcohol abuse in Ontario (using 2002 data) at \$441 per capita, or, in 2014 dollars, \$560 for every man, woman, and child in the province.<sup>12</sup> With Ontario's population now topping 13.6 million, and assuming (based on steady consumption levels) that there has been no substantial change in the costs of alcohol abuse since 2002, the cost of alcohol abuse in Ontario would total more than \$7.6 billion in today's dollars. Based on CCSA calculations, some 49 per cent, or \$3.7 billion of this, would be lost by employers and employees because of reduced workplace productivity related to alcohol; about \$3.3 billion would be spent by government on direct healthcare costs, addiction treatment costs, and law enforcement; and an additional \$600 million would be lost directly as a result of fire damage, traffic accidents, workers' compensation, the cost of prevention and research programs, and the like.

The LCBO returns a large dividend to provincial coffers, and the tax and licensing revenues to government from the sale of beer, wine and spirits through its various channels are substantial as well. Nonetheless, these revenues do not equal the financial costs associated with alcohol consumption. Based on a 2012 CCSA study, the net cost to government of alcohol consumption in Ontario is approximately \$650 million a year (in 2014 dollars).<sup>13</sup>

From these numbers, it is evident that every penny earned by the LCBO is needed to offset the costs of alcohol consumption in Ontario. From a financial perspective, privatization of the LCBO would reduce *revenues* to government while boosting *costs* to government as a result of increased alcohol-related harm arising from a proliferation of retail outlets and the attendant increase in consumption.

Yet the real costs of liberalizing alcohol retailing cannot be measured only in dollars and cents.

The country of Sweden has an alcohol marketing system similar to Ontario's. In a recent study, researchers at the University of Stockholm estimated what would happen if all 8,000 supermarkets in Sweden started selling alcohol. In their most conservative scenario, consumption would increase by 17 per cent, resulting in 4.5 million more sick-leave days per year, 8,500 more assaults, 2,700 more drunk driving offences, and 770 more deaths."<sup>14</sup>

In Ontario, with a population 50 per cent greater than Sweden's, throwing open the alcohol marketing system would have even more devastating results. **The LCBO must remain 100 per cent publicly-owned and controlled, and must maintain its pre-eminent position in Ontario's alcohol market.**

The LCBO is uniquely situated to help improve public finances while mitigating the negative effects of alcohol consumption. There are many ways to do this, but at this time our union proposes one simple strategy that could increase revenues to government without increasing consumption of alcohol by Ontarians.

Currently, the LCBO sells alcohol through 216 private operators as part of its Agency Stores Program. Originally created in 1962 as a low-cost way to serve isolated communities, the program has broadened in scope to the point where it now serves many communities that could more profitably be served by directly-operated LCBO stores. In November 2010, a comprehensive study of the agency stores program indicated that returning 103 of these high-volume agency stores to direct operation by the LCBO could increase gross sales of publicly-owned LCBO stores by \$570 million over ten years, with a one-time investment required of just \$370,000 per store, or about \$38 million.

Pursuing this strategy would be good for social responsibility and good for government revenues. As part of your review, please recommend that the LCBO take a serious look at paring back the Agency Stores Program so that it once again serves its original – and limited – purpose.

The 2010 consultant's report paid for by OPSEU is attached here for the information of you and your colleagues on the Advisory Council. Please do not hesitate to contact us directly should you have any questions whatsoever.

Yours truly,



Warren (Smokey) Thomas, President  
Ontario Public Service Employees Union



Denise Davis, Chair  
Liquor Board Employees Division, OPSEU

## Notes

---

- <sup>1</sup> Malleck, Dan (2012). *Try to Control Yourself: The Regulation of Public Drinking in Post-Prohibition Ontario, 1927-44*. Vancouver: UBC Press, p.5.
- <sup>2</sup> Campbell, Robert A. (1991). *Demon Rum or Easy Money: Government Control of Liquor in British Columbia from Prohibition to Privatization*. Ottawa: Carleton University Press, p. 15.
- <sup>3</sup> Malleck, p. 11.
- <sup>4</sup> “LCBO staff challenged more than 11.4 million individuals in 2013-14 for failing to produce valid ID, appearing intoxicated or attempting to purchase for a minor or an impaired individual. Service was refused to more than 414,600 people, with 86.9 per cent for reasons of age. (Source: Liquor Control Board of Ontario, <http://www.lcbo.com/content/lcbo/en/responsibility/responsibility/challenge-and-refusal.html#.VBma4Gd0xMw/>)
- <sup>5</sup> Statistics Canada, CANSIM table 183-0019.
- <sup>6</sup> Perreault, S. [2012]. *Impaired Driving in Canada, 2011*. *Juristat*. Statistics Canada Catalogue no. 85-002-X Ottawa: Canadian Centre for Justice Statistics, Statistics Canada.)
- <sup>7</sup> On the relationship between LCBO staff and police in the fight against impaired driving, see for example Forrest, Ben (2014). *St. Thomas store named one of best at reporting suspected drunk drivers*. *St-Thomas Times-Journal*, July 4. Web edition: <http://www.stthomastimesjournal.com/2014/07/04/st-thomas-store-named-one-of-best-at-reporting-suspected-drunk-drivers>.
- <sup>8</sup> For the first several decades of its operation, the LCBO “forced people who wanted a drink to run a series of bureaucratic gauntlets before they could indulge and relax. In the liquor stores, the customer had to buy a permit book, fill in a form listing a substance he or she wanted to buy, and be evaluated by the liquor store employee” (Malleck, p. 9).
- <sup>9</sup> See, for example, Masson, Paul R. and Anindya Sen (2014), *Uncorking a Strange Brew: The Need for More Competition in Ontario’s Alcoholic Beverage Retailing System*. Toronto: C.D. Howe Institute, Commentary No. 414, August; also Sen, Anindya (2014), *An Economic Analysis of Increasing Competition in Retail Liquor Sales in Ontario*. Oakville, Ontario: Ontario Convenience Stores Association.
- <sup>10</sup> Baillie, Ian (2014). “BYOBC: Strategies from BC on How Ontario Can Better Retail Beverage Alcohol.” Speech to the Economic Club of Canada, Toronto, May 9.
- <sup>11</sup> Thomas, Gerald (2012). *Analysis of Beverage Alcohol Sales in Canada*. Ottawa: Canadian Centre on Substance Abuse, p. 2.
- <sup>12</sup> Rehm, J. et al (2006). *The Costs of Substance Abuse in Canada 2002*. Ottawa: Canadian Centre on Substance Abuse, p. 107.
- <sup>13</sup> Thomas, Gerald (2012). *Price Policies to Reduce Alcohol-Related Harm in Canada*. Ottawa: Canadian Centre on Substance Abuse, p. 29.
- <sup>14</sup> Norström, Thor, Ted Miller, Harold Holder, Esa Österberg, Mats Ramstedt, Ingeborg Rossow and Tim Stockwell (2010). *Potential consequences of replacing a retail alcohol monopoly with a private licence system: results from Sweden*. *Addiction*, Vol. 105, Issue 12, December, pp. 2113–2119.



# LCBO Agency Store Repatriation

Financial Update (Fiscal 2008-9)

November 2010

Prepared for:  
Liquor Board Employees' Division,  
Ontario Public Service Employees Union

Written by:  
Russ Christianson, President  
Rhythm Communications



Rhythm Communications



# Table of Contents

1.0	EXECUTIVE SUMMARY .....	1
2.0	KEEPING THE LCBO PUBLIC .....	2
	2.1 THE FINANCIAL VALUE OF THE LCBO.....	3
	2.2 ALBERTA'S PRIVATIZATION EXPERIENCE.....	4
3.0	PRIVATE AGENCY STORES .....	4
	3.1 THE BEER FRAMEWORK .....	6
4.0	2007 REPATRIATION REPORT AND 2009 UPDATE.....	8
5.0	METHODOLOGY .....	8
6.0	ASSUMPTIONS.....	10
7.0	FINANCIAL UPDATE - 2009.....	13
	7.1 REPATRIATED AGENCY STORE ASSUMPTIONS.....	13
	7.1.1 <i>Net Sales and Gross Sales</i> .....	13
	7.1.2 <i>Gross Margin</i> .....	13
	7.1.3 <i>Operating Expenses</i> .....	15
	7.1.4 <i>Capital Costs</i> .....	16
8.0	POTENTIAL AGENCY STORE REPATRIATION .....	17
	8.1 MARCH 2007 REPATRIATION REPORT – 89 AGENCY STORES.....	17
	8.2 JANUARY 2010 REPORT – 103 AGENCY STORES .....	18
9.0	FINANCIAL SCENARIOS.....	19
10.0	INCREMENTAL FINANCIAL RESULTS .....	21
	10.1 LCBO NET SALES .....	21
	10.2 LCBO NET INCOME .....	22
	10.3 LCBO RETURN ON INVESTMENT.....	23
	10.4 LCBO DIVIDEND .....	24
11.0	CUSTOMER AND COMMUNITY BENEFITS .....	25
	APPENDIX : RUSS CHRISTIANSON – RESUME .....	26



Rhythm Communications  
RR 4 Campbellford, ON K0L 1L0  
705-653-0527 p 705-653-2950 f  
russ.c@xplornet.com

### 1.0 Executive Summary

The Liquor Control Board of Ontario (LCBO) has been a publicly owned and operated business since 1927. The people of Ontario want to keep it that way: *Eight out of ten Ontarians oppose the sale of beer and wine in corner stores, and seven out of ten oppose privatizing the LCBO.*<sup>1</sup>

And yet, over the past fifteen years, the LCBO has increased the number of private grocery stores and corner stores that sell alcohol from 82 to 220. What does this mean for the people of Ontario?

First, it means that the LCBO is giving away hundreds of millions of dollars in sales and profits to private businesses. Profits that could help us pay for public healthcare, public education and other public services. *Each year, the LCBO brings over \$2 billion in profits and taxes to the public treasury.*

Second, it means that the LCBO is putting private financial interests ahead of its social responsibility. The main reason that most people don't want to see alcohol sold in corner stores is because they know that underage and intoxicated people will be able to buy it there. Last year, LCBO employees challenged 2.4 million customers for proof of age or sobriety, and they refused sales to 148,886 of these customers.

LCBO employees agree with their fellow Ontarians – they want to keep the LCBO public. Their union, the Liquor Board Employees Division (LBED) represents the 6,972 highly trained public servants who work at the LCBO. *LBED has identified over one hundred private stores that sell alcohol (under LCBO contracts) that could be brought back to public sales.* This would return an estimated \$570 million in gross sales to publicly-owned LCBO stores over the next ten years.

The repatriation of these alcohol sales can be done in an orderly fashion. As the contract expiry date approaches for a private store, the LCBO can make the necessary preparations to open a new publicly-owned LCBO store. To repatriate ninety stores over the next six years would cost approximately \$33 million, or an average of \$370,000 per store. This level of investment (\$33 million) represents a small fraction (2.4%) of the profit that the LCBO makes every year and would have a simple average annual return on investment of sixty percent.

The Globe and Mail recently estimated that the LCBO could be sold for \$10 billion.<sup>2</sup> This is the amount of dividends the LCBO is expected to earn in the next six or seven years. The LCBO is not just a valuable public asset. It is an important public policy tool that ensures the highest level of social responsibility and reduces the risk of alcohol-related harm.

---

<sup>1</sup> Submission to the Beverage Alcohol System Review Panel by: Addictions Ontario (AO), Association of Local Public Health Agencies (alPHa), Centre for Addiction and Mental Health (CAMH), Mothers Against Drunk Driving (MADD Canada), Ontario Drug Awareness Partnership (ODAP), Ontario Public Health Association (OPHA), Parent Action on Drugs (PAD), Toronto Public Health, *Alcohol and Public Health: The Implications of Changes to Ontario's Beverage Alcohol System*, February 25, 2005. *Oracle Research Public Opinion Poll, June 2010* (n=900, 3.3% margin of error at a 95% confidence level).

<sup>2</sup> Andrew Willis and Boyd Erman, "Ontario ponders sale of Crown corporations to beat down deficit", Globe and Mail, December 15, 2009.



### 2.0 Keeping the LCBO Public

*The LCBO's net sales and other income in 2007–08 was \$4.1 billion. The LCBO transferred another record dividend of \$1.345 billion to the Government of Ontario (excluding taxes). It was the 14th straight year the LCBO increased its dividend to the province and the fifth consecutive year the dividend topped \$1 billion. Revenue from the LCBO helps pay for health care, education and other important government programs and services.* Dwight Duncan, Minister of Finance, LCBO Annual Report 2007-08

The Liquor Control Board of Ontario (LCBO) is owned by the people of Ontario. It is a very successful business with over \$4 billion in annual sales. **The LCBO generates more than \$2 billion in dividends and taxes each year to help pay for public health care, education and other government services.**<sup>3</sup> Over the past ten years, the LCBO has contributed over \$10.9 billion in dividends (not including PST and municipal taxes) to the provincial treasury. In the coming decade, the LCBO is expected to generate over \$16 billion in dividends to its owners – the people of Ontario.

In December 2009, the Ontario government began floating the idea of selling or privatizing the LCBO along with other public assets. Seven months later, on July 12, 2010, the Minister of Finance, Dwight Duncan, announced that they would not proceed with the privatization.

The last time the Ontario government considered privatizing the LCBO was only five years ago. Finance Minister Greg Sorbara ordered a review of the province's liquor distribution system in 2005, under the supervision of John Lacey, a former LCBO board member and former CEO of Oshawa Foods (now Sobeys). Sorbara had stated that any option, other than the complete privatization of the LCBO, would be open for discussion. When Lacey's pro-privatization report was released (known as the Beverage Alcohol System Review or BASR), Sorbara rejected its recommendations and argued for the continued public ownership of the LCBO.

Ten years earlier, the Conservative government had also considered privatizing the LCBO. Shortly after being elected in 1995, the Harris government began privatization discussions. Just over a year later, Norm Sterling, the Minister of Consumer and Commercial Relations, called off the review of the LCBO.

The main reason that politicians have consistently turned their backs on the sale of the LCBO is obvious. The LCBO provides \$2 billion plus to the Ontario and municipal treasuries each and every year, and the LCBO consistently makes an annual return on investment (ROI) of 160% to 170% for the people of Ontario. To put this in perspective, the average Canadian business makes seven to nine percent ROI per annum.

---

<sup>3</sup> In 2008-09, annual LCBO revenue was \$4.27 billion and the dividend paid to the people of Ontario was \$1.4 billion. In addition, the LCBO paid \$398 million in PST, \$104 million in GST, \$346 million in excise taxes and import duties, and \$252 million in municipal taxes – for a grand total of \$2.5 billion. (*As of June 2009, these figures were unaudited.*) Quoted from: "Today's LCBO", at <http://lcbo.ca/aboutlcbo/todayslcbo.shtml>



### **2.1 The Financial Value of the LCBO**

On December 15, 2009, the Globe and Mail reported that the LCBO's valuation could top \$10-billion, based on the trading prices of private liquor stores in Alberta.<sup>4</sup> The conventional method of determining the value of a business is to calculate the net present value (NPV) of expected future cash flows, and then add the current net assets (assets minus liabilities on the balance sheet). Our calculation of the NPV of future LCBO cash flows<sup>5</sup> is \$13.54 billion. If we add this to the current net assets (from the LCBO 2008-09 Annual Report) of \$354 million, the result is a **total business value of \$13.9 billion.**

If the LCBO was sold to the private sector, the Ontario government would recognize a one-time capital gain in an attempt to balance its books for one year. However, it would give up the billions in revenue that it receives each and every year. This is like selling your furniture to pay off the mortgage.

The Ontario government's annual budget is \$90 billion per year. In 2007-08, \$38 billion was spent on health care (41% of the total budget) and \$18.5 billion (19%) was spent on education.<sup>6</sup> Publicly owned enterprises (including the LCBO, Hydro One, Ontario Power Generation, and the Ontario Lottery and Gaming Corporation) contribute \$4.3 billion per year to support health care, education and other public services.

Seventy-three percent<sup>7</sup> of Ontario citizens want to keep our liquor stores public. There are five reasons for the strong support of public ownership:

1. The LCBO generates over \$2 billion every year to support public health care, education, and other public services.
2. Selling the LCBO is short-term gain for long-term pain.
3. LCBO stores provide excellent service and great product selection.
4. As a public body, the LCBO makes sure that under-aged or intoxicated people are not allowed to purchase alcohol.
5. The LCBO supports the growth of small local wine and craft beer producers by buying and promoting their products.

---

<sup>4</sup> <http://www.theglobeandmail.com/report-on-business/ontario-ponders-sale-of-crown-corporations-to-beat-down-deficit/article1401807/>, December 15, 2009.

<sup>5</sup> The NPV calculation was made using the forecasted net income (plus depreciation) for the ten fiscal years from 2010 to 2019, with a conservative 3.2% sales increase per annum, and expenses increasing in proportion. A 4% discount rate was used.

<sup>6</sup> Government of Ontario, "2009 Economic Outlook and Fiscal Review, October 22, 2009; [www.fin.gov.on.ca/en/budget/fallstatement/2009](http://www.fin.gov.on.ca/en/budget/fallstatement/2009)

<sup>7</sup> **Oracle Research Public Opinion Poll, June 2010** (n=900, 3.3% margin of error at a 95% confidence level).

"Of specific relevance are recent surveys of representative samples of Ontario adults, which showed that 73% of were opposed to the privatisation of retail alcohol sales. Most felt there were already enough or too many, places to buy alcohol in their communities and 79% of the public does not want alcohol sold in corner stores." (Anglin et al., 2001; see also Anglin et al., 2003). Quoted from: *Retail Alcohol Monopolies and Regulation: Preserving the Public Interest*, Centre for Addiction and Mental Health, 2004, page 11.



### 2.2 Alberta's Privatization Experience

The Province of Alberta privatized the Alberta Liquor Control Board in 1993, without any public consultation. After more than a decade, the results do not live up to the promises of its proponents. A number of studies have confirmed the following results of privatization:<sup>8</sup>

- higher prices (even after private alcohol retailers received a provincial tax cut),
- decreased product selection in most outlets (particularly in smaller communities),
- higher warehousing and distribution costs,
- decreased government revenue (approximately \$500 million over ten years),
- increased regulatory and police enforcement costs,
- decreased employee wages from a living wage of \$14 per hour (\$27,000 per year @ 37 hours/week) to a working poor wage of \$7 per hour (\$13,500 per year @ 37 hours/week).

While the wholesale privatization of the LCBO grabs the news headlines, successive Conservative and Liberal governments in Ontario have been quietly privatizing the LCBO through the back door by giving away sales to contracted private Agency Stores. These privately owned stores have increased from 82 in 1995 to 220 today.<sup>9</sup> Over the same period, the LCBO has only increased the number of publicly-owned stores by seven.

### 3.0 Private Agency Stores

When the LCBO introduced the agency store program in 1962, the idea was to provide service to small communities in **northern Ontario** that did not have a nearby LCBO store. Rather than building stand-alone stores, the LCBO signed five-year contracts with existing privately-owned grocery stores, general stores and outfitters to sell spirits, wine and beer. The LCBO supplied (and still does supply) all of the alcoholic beverages to these private Agency Stores. The program grew slowly, and by 1995 there were 82 contracted Agency Stores with average store sales of \$207,000 per year. At these sales levels, it makes sense to have a private Agency Store in these northern communities. And today, 79 of these stores are still operating, with average sales per store of \$344,000 (almost half of this increase is due to inflation).

After the Conservatives' LCBO privatization bid failed in the fall of 1996, they began to aggressively expand the private Agency Stores into **southern Ontario**. From 1996 to 2001, they opened 25 new private Agency Stores. In 2001, the government increased the pace, approving a plan to open 150 new Agency Stores over the next several years. A total of 50 new Agency Stores were opened in 2003.

---

<sup>8</sup> Bronwyn Mackenzie and Norman Geisbrecht, "The Alberta Experience with Privatization: An Exemplary Model or Cautionary Tale", Chapter 11 in *SoberReflections: Commerce, Public Health and the Evolution of Alcohol Policy in Canada, 1980-2000*; Edited by Norman Geisbrecht, Andree Demers, Alan Osborne, Robin Room, Gina Stoduto, and Evert Lindquist, McGill-Queen's University Press, Montreal and Kingston, 2006, pages 150 to 174. Greg Flanagan, "Sobering Result: The Alberta Liquor Industry 10 Years after Privatization", Canadian Centre for Policy Alternatives and the Alberta-based Parkland Institute, 2003. "Retail Alcohol Monopolies and Regulation: Preserving the Public Interest, Centre for Addiction and Mental Health, 2004. Douglas S. West, "The Privatization of Liquor Retailing in Alberta", The Fraser Institute, January 2003.

<sup>9</sup> The LCBO's website (<http://lcbo.com/aboutlcbo/todayslcbo.shtml>) states the following (December 2009): *The number of Agency Stores at the end of fiscal 2008-09 was 216, representing 2.1 per cent of total LCBO sales.* However, the list of Agency Stores provided by the LCBO through OPSEU's Freedom of Information Requests for the fiscal year ending March 31, 2009 includes a total of 220.



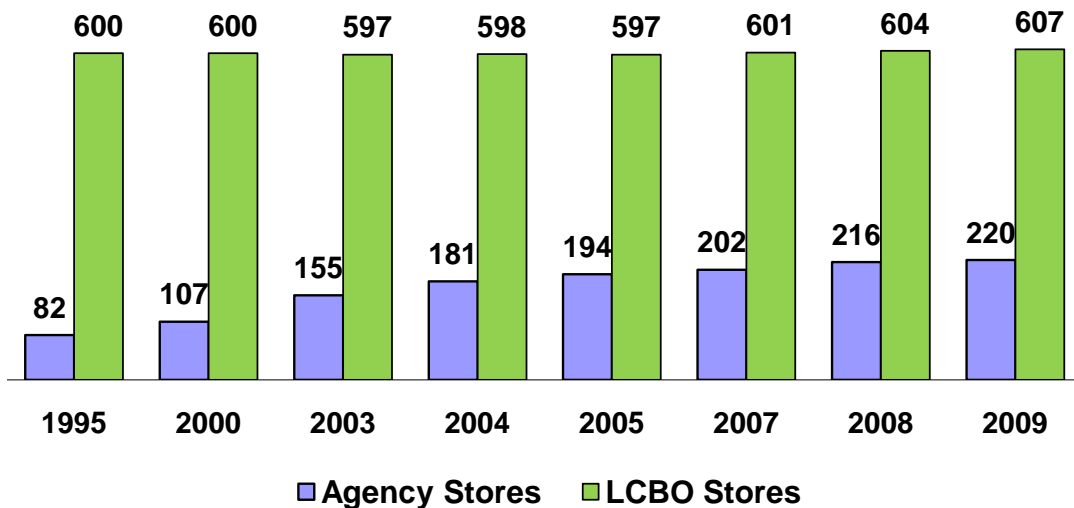
## LCBO Agency Store Repatriation – Financial Update

The rapid expansion of the agency store program continued after the election of the Liberal government in October 2003, with 39 new stores opening in 2004 and 2005. In May 2006, the government announced plans to open another 20 Agency Stores; all of them in southern Ontario. And, over the past three years, an additional 26 private Agency Stores were opened. Today, there are 220 Agency Stores in operation, with average sales of \$936,000 per annum (a four-fold increase since 1995).

Of the 113 new private Agency Stores contracted by the LCBO since 2000, **103** of these could be repatriated by the LCBO as their five-year contracts expire. No doubt, a number of them could have been opened as stand-alone LCBO stores from the beginning. This represents \$161 million in gross sales per annum (fiscal 2009 figures).

Chart 1 shows the rapid increase in the number of private Agency Stores since 1995, in comparison with the stable number of publicly-owned LCBO stores. All of the new private Agency Stores are located in southern Ontario markets, most of which could support a real LCBO store.

**Chart 1: Private Agency and LCBO Store Growth**  
Number of Stores - 1995 to 2009





### 3.1 The Beer Framework

Until the year 2000, Agency Stores were mostly supplied by the LCBO. On June 1, 2000, the LCBO signed an agreement with Brewers Retail Inc. (the foreign-owned Beer Store)<sup>10</sup> called: *Serving Ontario Beer Consumers: A Framework for Improved Co-operation and Planning Between the LCBO and BRI*. The agreement could have been called: *Serving the Beer Store Shareholders: A Framework for the Further Privatization of Ontario Beer Sales*.

In the agreement, the LCBO gave away the sales of beer to all Agency Stores as well as LCBO “combination stores”. At the time, the LCBO supplied and operated 177 combination stores that sold a full selection of spirits, wine and beer. According to the Beer Framework agreement, over time, these LCBO combination stores will be “converted” to non-combination stores. Beer Stores will open in those communities and the LCBO combination stores will stop selling 12s and 24s of beer (the most popular case sizes).

After almost a decade of operating under the “Beer Framework”, the result is that two-thirds of Agency Stores (141/220) now receive their beer from the foreign-owned Beer Store. All of these 141 stores are “new” Agency Stores that operate in the growing southern Ontario market. The LCBO has given those sales away, and now only provides most private Agency Stores with spirits and wine. The LCBO calls these “TBS Retail Partners” (“TBS” stands for The Beer Store).

The LCBO says it is unable to provide the beer sales statistics for these Agency Stores; however, The Beer Store Operational Report 2008 states the following:<sup>11</sup>

*Volume sales to TBS Retail Partners and LCBO Agency Stores increased for the fifth straight year growing by approximately 13,000 hls or 4.3 per cent in 2008. Sales in this channel have shown significant growth since 2004 (up 61.5 per cent). This growth has been driven largely by an increase in the number of Retail Partner outlets. Retail Partners/agency store outlets totaled 181 in 2004 and increased to 216 by 2008.*

TBS Operation Plan states that total sales in 2008 were just over \$2.6 billion. TBS sales to Agency Stores in 2008 were approximately 4.2% of \$2.6 billion, or \$109 million. Table 1 shows the Agency Store sales for northern and southern Ontario communities from the detailed store-by-store financial information gained from OPSEU’s 2007 Freedom of Information request.<sup>12</sup>

---

<sup>10</sup> The Beer Store (formerly known as Brewers’ Retail) was founded as a co-operative in 1927 by Ontario’s numerous regional brewers. Since then the brewing industry has been consolidated, and now The Beer Store is owned by three foreign-controlled companies: 49% of TBS is owned by the [Labatt](#) arm of [Anheuser-Busch InBev](#) of [Belgium](#); 49% is owned by [Molson Coors Brewing Company](#) which has headquarters in both the [United States](#) and [Canada](#); and the remaining two percent is owned by [Sleeman Breweries](#), a subsidiary of [Sapporo](#) of [Japan](#). [http://en.wikipedia.org/wiki/The\\_Beer\\_Store](http://en.wikipedia.org/wiki/The_Beer_Store)

<sup>11</sup> The Beer Store Operation Report 2008; [http://www.thebeerstore.ca/AboutUs/Operational\\_Report.asp](http://www.thebeerstore.ca/AboutUs/Operational_Report.asp)

<sup>12</sup> OPSEU filed a Freedom of Information request on June 6, 2007. It took two years to receive the information from the LCBO.



## LCBO Agency Store Repatriation – Financial Update

**Table 1: Northern and Southern Ontario Agency Store Sales**

<b>Agency Stores (AS) Summary</b>	<b>Northern AS</b>	<b>Southern AS</b>	<b>Total AS</b>
Number of Agency Stores 1995	82	0	82
Gross Agency Store Sales 1995	\$17,000,000	\$0	\$17,000,000
Average Sales per AS 1995	\$207,317	NA	\$207,317
Number of Agency Stores 1996	82	4	86
Gross Agency Store Sales 1996	\$17,680,000	\$2,620,000	\$20,300,000
Average Sales per AS 1996	\$215,610	\$655,000	\$236,047
<b>Number of Agency Stores 2009</b>	<b>79</b>	<b>141</b>	<b>220</b>
Gross Agency Store Sales 2009	\$27,149,005	\$178,722,544	\$205,871,550
Average Gross Sales per AS 2009	\$343,658	\$1,267,536	\$935,780
% Sales Increase 1996 to 2009	53.6%	6721.5%	914.1%
Average % Sales Increase/Year	4.1%	517.0%	70.3%
Average Percentage Beer Sales	60.4%	60.0%	60.0%
LCBO Net AS Sales 2009	\$24,434,105	\$64,340,116	88,774,221
TBS Net AS Sales 2009	\$0	\$96,510,174	96,510,174
Total AS Net Sales 2009	\$24,434,105	\$160,850,290	\$185,284,395
% of Total Net Sales	13.2%	86.8%	100.0%
% LCBO of Net Sales	100.0%	40.0%	47.9%
% TBS Net Sales	0.0%	60.0%	52.1%

According to the store-by-store FOI (2008-2009) information, the net domestic beer sales to Agency Stores was \$110 million: \$96 million was supplied directly by TBS to the new southern Agency Stores, while \$14 million was supplied by the LCBO to old northern Agency Stores. LCBO's net sales of wine and spirits to Agency Stores was \$75 million in 2009 (including some imported beer). Therefore, total net sales for Agency Stores in 2009 was \$185 million (\$110 million + \$75 million), with TBS enjoying 52% of these sales.

The new southern Ontario private Agency Stores now represent 87% of total net Agency Store sales (\$161 million per annum). The Beer Store's share of this private grocery and convenience store market is 60% (\$96 million). Meanwhile, the original 79 northern Ontario Agency Stores represent a shrinking percentage at 13% (\$24 million per annum), and are still supplied by the LCBO.

When we look at the numbers, it becomes clear that the Ontario government has been privatizing alcohol sales by stealth. From 1996 to 2009, the average annual sales increase to southern Ontario Agency Stores was 517%. Any business would be very pleased to experience this kind of growth. The first four new southern Ontario Agency Stores had average sales of \$655,000 in their first year. This level of sales could have supported stand-alone LCBO stores or LCBO kiosks.





### 4.0 2007 Repatriation Report and 2009 Update

In 2007, the Liquor Board Employees Division (LBED) of the Ontario Public Service Employees Union (OPSEU) contracted Russ Christianson, President, Rhythm Communications to analyze the economic implications of the rapid growth in contracted, privately-owned Agency Stores.

For this original report, LCBO management provided the required financial information in a very timely and co-operative manner. Once the report was released publicly, the information flow came to an immediate halt, and OPSEU was forced to file a Freedom of Information (FOI) request on June 6, 2007. Two years later, on June 2, 2009, LCBO management partially fulfilled the FOI Request, and on Friday December 11, 2009, they provided the last piece of information requested.

There are three objectives for the 2007 repatriation report and this 2009 update:

1. Perform a financial analysis of the LCBO and its commercial relationship with privately-owned Agency Stores and The Beer Store.
2. Determine the potential for agency store repatriation and the financial implications for the LCBO and the Province of Ontario.
3. Update the original 2007 report with current (2009) financial information.

Russ Christianson is a management consultant with over twenty-five years of experience in various sectors, including retail, wholesale distribution, manufacturing, and service industries. He graduated from Queen's Commerce in 1981, and completed a Masters of Industrial Relations at the University of Toronto in 1983. (Please refer to Appendix 1 for Russ Christianson's Resume).

### 5.0 Methodology

The financial analysis began with a review of the sales and other financial information regarding LCBO stores and contracted Agency Stores, using data supplied by the LCBO. This information was supplemented with a review of the following:

- *LCBO Annual Reports: 2008-9, 2007-8, 2006-7, 2005-6 and 2004-5.*
- LCBO, Ontario Government, and The Beer Store websites.
- *Standing Committee on Government Agencies – Report on Agencies, Boards and Commissions, The Liquor Control Board of Ontario, Legislative Assembly of Ontario (December 2006).*
- *Protecting the Public Interest, The Threat of Privatization and the LCBO's Agency Store Program, Ontario Public Service Employees Union (September 2006).*
- *Beverage and Alcohol System Review (BASR), Report to the Honourable Greg Sorbara, Ontario Minister of Finance (July 2006).*
- *Sober Reflections: Commerce, Public Health and the Evolution of Alcohol Policy in Canada, 1980-2000; Edited by Norman Geisbrecht, Andree Demers, Alan Ogborne, Robin Room, Gina Stoduto, and Evert Lindquist, McGill-Queen's University Press, Montreal and Kingston, 2006.*
- *Alcohol and Public Health: The Implications of Changes to Ontario's Beverage Alcohol System, Addictions Ontario, Association of Local Public Health Agencies, Centre for Addiction and Mental Health, Mothers Against Drunk Driving, Ontario Drug Awareness Partnership, Ontario Public Health Association, Parent Action on Drugs, Toronto Public Health (February 2005).*
- *LCBO Operational Review, Report to the Internal Audit Division of Management Board Secretariat (MBS), Deloitte & Touche LLP (March 2005).*



## LCBO Agency Store Repatriation – Financial Update

---

- *Insights into the Food, Beverage, and Consumer Products Industry*. Grocery Manufacturers Association (GMA), Food Products Association (FPA), and Price Waterhouse Coopers (2006).
- *Retail Alcohol Monopolies and Regulation: Preserving the Public Interest*, Centre for Addiction and Mental Health (2004).
- *Sobering Result: The Alberta Liquor Industry 10 Years after Privatization*, Canadian Centre for Policy Alternatives and the Alberta-based Parkland Institute (2003).
- *The Privatization of Liquor Retailing in Alberta*, The Fraser Institute (January 2003).
- *Serving Ontario Beer Consumers: A Framework for Improved Co-operation & Planning Between the LCBO & BRI* (June 2000).
- *Ontario's Changing Population*, Institute of Agri-Food Policy Innovation (October 2006)
- "Immigration Critical to Canadian Population Growth: Census", CBC News, March 13, 2007.

In early 2007, an initial financial analysis was completed by Russ Christianson and was presented at a joint meeting with LBED/OPSEU representatives and LCBO executives on February 8, 2007. A follow-up meeting was held with LCBO executives and LBED/OPSEU on February 26, 2007, at which LCBO representatives provided additional financial data. Over the following weeks, Russ Christianson reviewed the new information provided by the LCBO and integrated it with his original analysis, resulting in the financial model contained in the original 2007 report.

This 2009 report provides an update of the economic model and an analysis of the accuracy of the financial forecasts from the 2007 report based on actual LCBO financial information from the three most recent fiscal years (ending March 31, 2007, 2008 and 2009).



## 6.0 Assumptions

The financial model was guided by the following principles:

1. The model should be financially conservative, realistic and attainable.
2. The financial forecasts should be based on the most accurate information and benchmark data available from the LCBO and other expert sources.
3. The model should provide a measure of the *incremental* financial benefits that could result from the repatriation of Agency Stores in comparison to the status quo.

There are a number of underlying assumptions that form the foundation of this financial analysis. Table 2 provides a summary of the benchmarks that were used for the 2007 report to determine the financial results of agency store repatriation on a store-by-store basis. These benchmarks were based on a sample of LCBO stores with sales in the range of the private Agency Stores being considered for repatriation.

**Table 2: Financial Benchmarks for Repatriated Agency Stores 2005-06**  
(Expressed as a percentage of Net Sales)

Range of Gross Sales: Agency Stores (2005-06)	Gross Margin	Operating Expenses	Depreciation Expense <sup>13</sup>	Total Expense	Net Income
\$500,000 - \$749,000	45.9%	16.3%	4.3 to 6.5%	20.6 to 22.8%	23.1 to 25.3%
\$750,000 - \$999,000	45.9%	13.9%	3.3 to 4.3%	17.2 to 18.2%	27.7 to 28.7%
\$1 to \$1.499 million	45.9%	11.8%	2.6 to 3.9%	14.4 to 15.7%	30.2 to 31.5%
\$1.5 to \$3 million	45.9%	10.5%	1.5 to 3.0%	12.0 to 13.5%	32.4 to 33.9%

Table 3 provides updated information based on the complete data for all of the 607 LCBO stores (Fiscal 2008-09) received through the FOI request. The LCBO stores were grouped by gross sales level and benchmarks were calculated as a percentage of net sales by store.

**Table 3: Financial Benchmarks for Repatriated Agency Stores 2008-09**  
(Percentages calculated on Net Sales)

Range of Gross Sales: Agency Stores (2005-06)	Gross Margin	Operating Expenses	Depreciation Expense	Total Expense	Net Income
\$700,000 to \$999,000	47.1%	18.9%	1.4%	20.3%	26.8%
\$1 million to \$1,999,999	49.0%	13.8%	1.4%	15.2%	33.8%
\$2 million to \$2,999,999	50.6%	11.2%	1.4%	12.6%	38.0%
\$3 million to \$3,999,999	51.4%	10.1%	1.3%	11.4%	40.0%
\$4 to \$5 million (plus)	51.6%	10.0%	1.3%	11.3%	40.3%

<sup>13</sup> The LCBO calculates depreciation for its consolidated operations, including all stores, warehouse operations and the head office. For the 2007 report, we used estimates for the depreciation expense based on a reasonable assumption for the capital investment required to support the various sales ranges for LCBO individual stores. For this 2009 update, we received actual capitalization figures for new, relocated or renovated stores and applied the LCBO's straight-line depreciation formula to these amounts



## LCBO Agency Store Repatriation – Financial Update

When tables 2 and 3 are compared, the benchmarks developed for the 2007 report were conservative and fulfilled the objective of keeping the financial forecasts reasonable and attainable. Indeed, the LCBO's actual financial results over the past three years exceeded the repatriation report forecasts. Table 4 provides a year by year comparison of the actual results with the repatriation forecasts for the fiscal years ending March 31, 2007 to 2009.

**Table 4: Comparison of Actual LCBO Results with 2007 Repatriation Reports Forecasts**

\$ are expressed in 000s	Actual LCBO Results - Annual Reports				2007 Repatriation Estimates			Variance
	2006	2007	2008	2009	2007	2008	2009	+/-
LCBO Gross Sales	\$4,284,222	\$4,530,392	\$4,724,138	\$4,883,764	\$4,455,591	\$4,633,815	\$4,819,167	\$229,722
% Increase Sales	4.5%	5.7%	4.3%	3.4%	4.0%	4.0%	4.0%	1.5%
# of Stores	598	601	604	607	599	600	601	
Change in LCBO Stores	1	3	3	3	1	1	1	6
Average Sales/LCBO Store	\$7,164	\$7,538	\$7,821	\$8,046	\$7,438	\$7,723	\$8,019	\$27
GST & PST	\$603,444	\$581,097	\$604,793	\$615,354	\$627,582	\$652,685	\$678,792	-\$157,814
% Gross Sales	14.1%	12.8%	12.8%	12.6%	14.1%	14.1%	14.1%	-1.3%
Discounts	\$30,245	\$31,713	\$33,069	\$34,186	\$31,455	\$32,713	\$34,022	\$779
% of Gross Sales	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.0%
Net Sales	\$3,677,193	\$3,894,596	\$4,107,286	\$4,267,305	\$3,796,554	\$3,948,416	\$4,106,353	\$417,863
Cost of Goods Sold	\$1,909,113	\$1,989,297	\$2,099,405	\$2,205,128	\$1,974,208	\$2,053,177	\$2,135,304	\$131,142
Gross Margin	\$1,768,080	\$1,905,299	\$2,007,881	\$2,062,177	\$1,822,346	\$1,895,240	\$1,971,050	\$286,721
% of Net Sales	48.5%	48.9%	48.9%	48.3%	48.0%	48.0%	48.0%	0.7%
Salaries & Benefits	\$337,969	\$352,960	\$373,854	\$389,159	\$348,939	\$362,897	\$377,413	\$26,724
% of Net Sales	9.2%	9.1%	9.1%	9.1%	9.2%	9.2%	9.2%	-0.1%
Store Salaries	\$257,404	\$272,622	\$279,295	\$290,177	\$265,759	\$276,389	\$287,445	\$12,501
% of Net Sales	7.0%	6.8%	6.8%	6.9%	7.0%	7.0%	7.0%	-0.2%
Total Operating Expenses	\$592,963	\$632,750	\$659,429	\$682,526	\$626,431	\$651,489	\$677,548	\$19,237
% of Net Sales	16.1%	16.2%	16.1%	16.0%	16.5%	16.5%	16.5%	-0.4%
Operating Income	\$1,168,875	\$1,272,549	\$1,348,452	\$1,379,651	\$1,195,915	\$1,243,751	\$1,293,501	\$267,485
% of Net Sales	31.8%	32.7%	32.8%	32.3%	31.5%	31.5%	31.5%	1.1%
Add: Other Income	\$19,610	\$28,052	\$25,905	\$30,337	\$20,247	\$21,056	\$21,899	\$21,092
% of Net Sales	0.5%	0.7%	0.6%	0.7%	0.5%	0.5%	0.5%	0.1%
Net Income	\$1,204,344	\$1,300,601	\$1,374,357	\$1,410,174	\$1,216,161	\$1,264,808	\$1,315,400	\$288,763
% of Net Sales	32.8%	33.4%	33.5%	33.0%	32.0%	32.0%	32.0%	1.3%
Dividends (Province + Municipalities)	\$1,200,000	\$1,279,700	\$1,345,000	\$1,400,000	\$1,195,915	\$1,243,751	\$1,293,501	\$291,533
% of Net Sales	32.6%	32.9%	32.7%	32.8%	31.5%	31.5%	31.5%	1.3%
New Capital Investment	\$54,535	\$54,217	\$63,659	\$54,000	\$59,000	\$60,000	\$61,000	-\$8,124
<b>Agency Stores (Gross Sales)</b>	\$81,111	\$86,667	\$95,247	\$100,580	\$84,001	\$87,361	\$90,856	\$20,276
# of Stores	194	202	216	220	199	204	209	11
Change in Agency Stores	0	8	14	4	5	5	5	2
Average Sales/Agency	\$418	\$429	\$441	\$457	\$422	\$428	\$435	\$22
% Increase Sales	4.1%	6.8%	9.9%	5.6%	4.0%	4.0%	4.0%	12.0%
% of Gross Sales	1.9%	1.9%	2.0%	2.1%	1.9%	1.9%	1.9%	0.2%

Beginning with LCBO gross sales, the three year forecast (2007 to 2009) was \$230 million lower than the actual results. This includes a lower forecast for the number of new LCBO stores opened, although the average sales/LCBO store are very consistent between the actual results and the forecast.



## LCBO Agency Store Repatriation – Financial Update

---

The actual private Agency Store sales (gross) were 12% higher over the three year period compared to the 2007 Repatriation Report forecasts. The addition of eight new private Agency Stores in 2007 and fourteen in 2008 (compared to the 2007 estimates of five per year) added significantly to Agency Store sales.

LCBO's actual Net Sales were also higher than the forecast because of the combined effects of higher than budgeted gross sales, higher Agency Store sales, and lower forecasts of sales taxes and discounts.

The Gross Margin is a key variable because any significant change directly impacts the bottom line income, and therefore dividends to the Province. The actual gross margin was higher both in absolute dollar terms (\$287 million over the three year period) and as a percentage of net sales when compared to the financial forecasts.

One of the main reasons that the LCBO has such a healthy gross margin (particularly as a retailer), is because of the price premiums charged to discourage over-consumption of alcohol. This price premium also provides the billions in dividends that accrue to the people of Ontario to help pay for public health care and education. In this way, alcohol pricing is a public policy tool.

The LCBO plays a very important societal role in controlling this potentially dangerous and addictive substance while also running a successful retail business. As privately owned for-profit businesses that are focused on their bottom line, the Agency Stores do not share this same level of societal responsibility.

Forecasted LCBO salaries and benefits and store level salaries also came in under the actual results; however, as a percentage of net sales, the forecast and actual results were very comparable.

The total operating expense forecast (over three years) was \$19 million lower than the actual. As a percentage of net sales, the forecast was 16.5% per annum, while the actual results saw operating costs drop from 16.2% to 16.0% over the period from 2007 to 2009.

The combination of higher actual sales and higher actual gross margins compared to the forecasts, resulted in a higher level of actual operating income of \$267 million over three years. When the higher level of "Other Income" (\$21 million) is added, the end result was a higher net income (\$289 million) and a higher dividend (\$291 million) paid to the province compared to the 2007 Repatriation Report forecast.

Finally, regarding new capital investment, the forecasted amount over three years was a modest \$8 million higher than the actual results.

**The conclusion that can be drawn from the comparison between the actual LCBO results and the 2007 Repatriation Report forecasts: The forecasts were very accurate, reasonable and conservative.**



### 7.0 Financial Update - 2009

The financial forecasts included in this updated economic analysis are more robust than the original 2007 forecasts because they are based on more detailed and refined information. And, the same conservative forecasting principles were used for this update. For example, the LCBO has the following forecast for the coming five years on its website: Sales will grow “from \$4.21 billion in 2007-08 to \$5.3 billion in 2012-13 and net income from \$1.4 billion in 2007-08 to \$1.7 billion in 2012-13”.<sup>14</sup> In comparison, the forecast used in this report has net sales increasing to \$4.7 billion by 2013, with net income of \$1.5 billion.

Compared to many other businesses, alcohol retailing is relatively recession-proof. Given last year’s global economic collapse, this is quite apparent given that the LCBO increased its gross sales by 3.4% in the fiscal year ending March 31, 2009.

The contracted Agency Stores that have been identified for repatriation in this economic model sell a full range of products – domestic and imported wine, spirits, and beer. Agency Stores are located within existing retail stores, usually grocery stores or corner stores. As these Agency Stores are repatriated, and stand-alone LCBO stores are opened with enhanced selection and service, it is reasonable to assume that sales will increase.<sup>15</sup> This economic model assumes that sales will increase by five percent in the first year of repatriation. Like the other assumptions in this economic model, this is considered to be conservative.

#### 7.1 Repatriated Agency Store Assumptions

This section provides a discussion of the key variables used to determine which private Agency stores could be repatriated, based on their financial results. The assumptions are consistent with the original 2007 Repatriation Report, and are more refined because more complete information was received through the Freedom of Information request.

##### 7.1.1 Net Sales and Gross Sales

Net sales for the LCBO and the contracted Agency Stores do not include GST and PST. Gross sales for the Agency Stores include the 11.1% mark-up that is provided by the LCBO. The gross sales benchmark categories for Agency Stores identified for repatriation have been changed because Agency Store sales have increased significantly since 2007. Stores that fall within each of these sales volume categories have similar financial benchmarks expressed as a percentage of net sales (please refer to Table 2 on page 9 of this report).

##### 7.1.2 Gross Margin

The gross margin is the difference between the purchase cost of products and their selling price. In this economic model, the gross margin assumed for the Agency Stores that are repatriated by the LCBO is 45.4% (a 0.5% decrease from the 2007 Report). This is a conservative forecast. It is lower than the overall LCBO margin forecast at 48.4% because the Agency Stores have a higher percentage of beer sales than wine and spirits, and beer is a lower priced product. Table 5 shows the LCBO’s average gross margin for various store sizes over the past three fiscal years.

<sup>14</sup> <http://lcbo.com/aboutlcbo/todayslcbo.shtml>, December 2009.

<sup>15</sup> According to LCBO financial information received through OPSEU’s Freedom of Information Request, when a new LCBO store is opened or an old store is expanded, the average sales increase is forty percent.





## LCBO Agency Store Repatriation – Financial Update

While the product category margins do not vary significantly between various sizes of LCBO stores, the overall gross margin (the last column in Table 4) increases with store size. Table 6 provides the explanation. Larger stores have better selection and a significantly higher proportion of sales in higher priced (and higher margin) spirits and wines.

**Table 5: Gross Margin Benchmarks by Product Category and Gross Sales (LCBO Stores)**

Range of Gross Sales	Spirits	Wine	Beer	Overall
<b>Average 2007-2009</b>	<b>56.5%</b>	<b>50.1%</b>	<b>39.5%</b>	<b>50.0%</b>
\$700,000 to \$999,999	55.8%	50.0%	39.1%	47.1%
\$1,000,000 to \$1,999,999	56.4%	50.0%	39.7%	49.0%
\$2,000,000 to \$2,999,999	56.6%	49.9%	39.9%	50.6%
\$3,000,000 to \$3,999,999	56.6%	50.2%	39.2%	51.4%
\$4,000,000 to \$5,000,000 +	56.8%	50.1%	39.8%	51.6%

**Table 6: Category Sales as a Percentage of Gross Sales (LCBO Stores)**

Range of Gross Sales	Spirits	Wine	Beer	Vintages	Total Wine
<b>Average 2007-2009</b>	<b>47.3%</b>	<b>22.7%</b>	<b>28.6%</b>	<b>1.3%</b>	<b>24.1%</b>
\$700,000 to \$999,999	37.5%	14.9%	47.1%	0.5%	15.4%
\$1,000,000 to \$1,999,999	43.6%	18.0%	37.6%	0.8%	18.9%
\$2,000,000 to \$2,999,999	49.9%	22.8%	26.3%	1.0%	23.8%
\$3,000,000 to \$3,999,999	53.0%	27.7%	17.6%	1.6%	29.3%
\$4,000,000 to \$5,000,000 +	52.6%	30.1%	14.6%	2.7%	32.8%

As stated on page 7, beer sales represent sixty percent of total Agency Store sales. This percentage was used in this updated economic model (the 2007 model assumed 54% beer and 46% spirits and wine) for the Agency Stores.

The 45.4% gross margin in this model was calculated by adding the contribution margin for each product category. The contribution margin is calculated by taking the sales volume for a product category and multiplying it by the gross margin for that product category. On average, Agency Stores have 60% of their sales from beer, and 40% from wine and spirits. The gross margin on beer is 39.5% and the combined gross margin on wine and spirits is 54.3%.<sup>16</sup> Therefore, the gross margin for a newly repatriated store is:  $60\% \times 39.5\% + 40\% \times 54.3\% = 45.4\%$ .

<sup>16</sup> The combined spirits and wine margin calculation =  $(56.5\% \times 47.3\%) / 71.4\% + (50.1\% \times 24.1\%) / 71.4\% = 54.3\%$



## LCBO Agency Store Repatriation – Financial Update

**Table 7: Repatriated Agency Stores – Gross Margin  
(Expressed as a percentage of net sales)**

<b>Spirits Gross Margin</b>	<b>56.5%</b>
<b>Wine Gross Margin</b>	<b>50.1%</b>
<b>Combined Spirits &amp; Wine</b>	<b>54.3%</b>
<b>Beer Margin</b>	<b>39.5%</b>
<b>Overall Margin</b>	<b>45.4%</b>

As Agency Stores are repatriated by the LCBO, wine and spirits sales will increase due to better selection and customer service. Because the margin on spirits and wine is higher than beer, an increase in proportionate sales of spirits and wine (compared to beer) will increase the gross margin in each repatriated store. As sales and gross margin increase, so does profitability.

### 7.1.3 Operating Expenses

Operating expenses on a LCBO store basis include salaries and benefits, occupancy costs and other expenses. Depreciation is accounted for on an overall corporate basis, but for the purposes of this report it was included on a store-by-store basis using actual figures provided through the FOI request.

Table 8 shows the benchmark assumptions used to determine the private Agency Stores that can be repatriated while meeting the LCBO’s “hurdle” rate of 12% (minimum rate of return) on capital projects.<sup>17</sup> These benchmarks are based on actual LCBO financial results for stores within each of the sales categories.

**Table 8: Repatriated Agency Store Financial Benchmarks 2008-09  
(Percentages calculated on Net Sales)**

<b>Range of Gross Sales: Agency Stores (2005-06)</b>	<b>Gross Margin</b>	<b>Operating Expenses</b>	<b>Depreciation Expense</b>	<b>Total Expense</b>
\$700,000 to \$999,000	45.4%	18.9%	1.4%	20.3%
\$1 million to \$1,999,999	45.4%	13.8%	1.4%	15.2%
\$2 million to \$2,999,999	45.4%	11.2%	1.4%	12.6%
\$3 million to \$3,999,999	45.4%	10.1%	1.3%	11.4%
\$4 to \$5 million (plus)	45.4%	10.0%	1.3%	11.3%

The benchmarks for salaries and benefits are based on actual LCBO stores’ financial performance with regular LCBO hours. On average, the repatriated Agency Stores will require one permanent, full-time store manager and casual staff. (Store managers in smaller LCBO “C” and “D” class stores and LCBO casual employees are members of the OPSEU bargaining unit and are paid according to the collective agreement between OPSEU and the LCBO).

<sup>17</sup> <http://lcbo.com/aboutlcbo/todayslcbo.shtml>





## LCBO Agency Store Repatriation – Financial Update

Like salaries and benefits, occupancy costs are greater as a percentage of sales for smaller stores, because larger stores benefit from economies of scale. This economic model assumes that repatriated LCBO stores will lease local premises. Occupancy costs (including rent, taxes, utilities, insurance, and repairs) are based on actual LCBO store benchmarks.

Other expenses (including freight, packing material, shortages, maintenance, etc.) are also based on actual LCBO store performance.

### 7.1.4 Capital Costs

The last piece of information received from the FOI request was the capital investment required for building new LCBO stores, and relocating or expanding existing LCBO stores (for each of the three fiscal years ending March 31, 2007 to 2009). On average, the capital cost per square foot for leasehold improvements in fiscal 2008-09 was \$129, with a range of \$105 to \$151. The economic model in this report uses a capital cost of \$140 per square foot, while the 2007 Repatriation Report used a range of \$130 to \$160.

Table 9 shows the capital costs required to develop an LCBO store location when an agency store is repatriated. In most cases, the LCBO would lease an existing building and would invest approximately \$140 per square foot in leasehold improvements. In some cases, the LCBO may bring in a modular building at a similar cost.

**Table 9: Estimated Capital Costs Required for Agency Store Repatriation**

<b>Range of Average</b>	<b>Gross Sales 2007-2009</b>	<b>Number of Square Feet</b>	<b>\$ Cost per Square Foot</b>	<b>Capital Cost Required</b>
\$700,000	to \$999,999	2,000	\$140	\$280,000
\$1,000,000	to \$1,999,999	2,500	\$140	\$350,000
\$2,000,000	to \$2,999,999	3,000	\$140	\$420,000
\$3,000,000	to \$3,999,999	3,500	\$140	\$490,000
\$4,000,000	to \$5,000,000+	4,000	\$140	\$560,000



## **8.0 Potential Agency Store Repatriation**

### **8.1 March 2007 Repatriation Report – 89 Agency Stores**

When the 2007 Repatriation Report financial benchmarks (based on fiscal 2005-6) were applied to the 2005-6 list of 194 Agency Stores, 89 stores were identified for potential repatriation. In fiscal 2005-6, these 89 private Agency Stores had annual sales in the range of \$575,000 to \$3.3 million per year, for total sales of \$107 million per annum, or average sales of \$1.2 million per store per year. For the year ending March 31, 2009, these 89 stores now have \$150 million in gross sales (a 40% increase in three years) and average sales per store approaching \$1.7 million per annum.

LCBO's net sales to these 89 Agency Stores in fiscal 2006 were \$44 million per annum, including wine, spirits and imported beer, or 41% of the total sales of these stores. All Agency Stores in Ontario operate on the basis of a five year contract, and the LCBO provides a 10% discount (equivalent to an 11.1% mark-up) off the retail price. The 2006 level of profits for LCBO sales to these 89 Agency Stores was approximately \$20 million per annum.

Like all Agency Stores in southern Ontario, the 89 stores identified in the 2007 report purchase domestic beer directly from the foreign-owned Beer Store.<sup>18</sup> For this analysis, it is assumed that the repatriated Agency Stores will operate as LCBO combination stores, with domestic beer sales revenue flowing through the LCBO. This will require renegotiating or withdrawing from the "Beer Framework Agreement" between the LCBO and The Beer Store.<sup>19</sup>

If these Agency Stores had been repatriated by the LCBO in 2007, the LCBO would have recognized an additional \$16 million in profit in 2007, an estimated \$19 million in 2008, and another \$21 million in 2009, for a total of \$56 million over three years. In other words, the LCBO could have doubled its profits from these sales for the benefit of the people of Ontario.

---

<sup>18</sup> Note: The Beer Store is a foreign-owned business.

<sup>19</sup> The "Beer Framework" agreement between LCBO and The Beer Store was signed on June 1, 2000, and had a five year time frame. After May 31, 2005 the contract could be terminated by either party giving six months written notice.



### **8.2 January 2010 Report – 103 Agency Stores**

The March 2007 Repatriation Report was based on LCBO's fiscal 2005-06 figures because the numbers for the fiscal year ending March 31, 2007 were not yet available. During the three fiscal years since, twenty-six new private Agency Stores have been opened, for a total of 220. Agency Stores' annual gross sales of products supplied by the LCBO now equals over \$100 million (compared to 194 Agency Stores with gross sales of \$81 million in 2006). This represents a 12% increase in sales, compared to the overall LCBO sales increase of 1.5% over this same three-year period. The LCBO has continued to give away sales to privately owned businesses, when they could have made the decision to keep these sales and the resulting profits for the public purse.

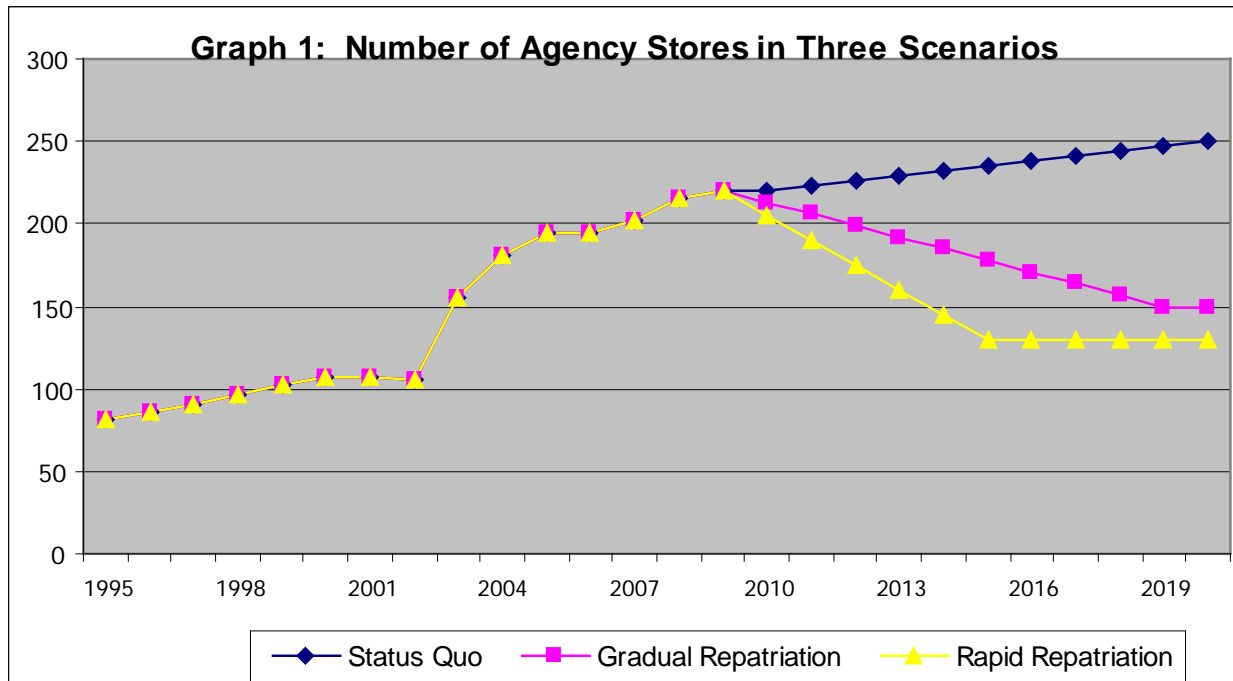
Three years ago, the return on investment that the LCBO decided to give away to the 89 private Agency Stores identified for repatriation was 43.1%. Now, there are 103 private Agency Stores that have annual gross sales over \$700,000 in southern Ontario. If the LCBO had decided to keep these sales for the people of Ontario, the incremental return on investment would now be 59.7%. By any measure, and certainly within the context of the recent global financial collapse, this is an attractive ROI. The estimated capital investment required to open publicly-owned LCBO stores in place of these privately-owned Agency Stores is \$36.3 million. This represents 2.5% of the LCBO's annual net income. Any business person would jump at the chance to grow their business using profits or retained earnings to do so. The LCBO did not.



## 9.0 Financial Scenarios

On pages ten to twelve of this report, the integrity of the financial forecasts for the 2007 Repatriation Report are strongly supported. This 2009 Update benefits from more detailed information received through an FOI request. These new financial forecasts are more refined than the previous report, and they are also conservative in nature. In other words, they can be interpreted with a high degree of confidence.

Like the 2007 report, three financial scenarios were developed to evaluate the potential impact of repatriating the identified Agency Stores over the next ten years. The first scenario, *Status Quo*, is used as the financial benchmark. In this scenario, the agency store program grows by three additional stores each year over the next decade (it was five stores per year in the 2007 report). As shown in Graph 1, by the end of 2020, there will be 250 Agency Stores in Scenario One. The LCBO will also add one new LCBO store per year in Scenario One.



Scenario Two, *Gradual Repatriation*, has seven (it was six in the 2007 report) Agency Stores being brought home to the LCBO each year, bringing the total number of Agency Stores down to 150 by 2020. The third scenario, *Rapid Repatriation*, is more ambitious, with 15 Agency Stores being repatriated in each of the next six years (the same at the 2007 report). This would bring the total number of Agency Stores back to 130 by 2015, a number more consistent with the original intention of the agency store program.



## LCBO Agency Store Repatriation – Financial Update

Each of the scenarios takes into account that the Ontario population is forecasted to grow modestly by 1.5% per year in urban areas, and 1.0% per year in rural areas.<sup>20</sup> Inflation is also assumed to be modest, with a rate of 1 to 1.5%.

Table 10 shows the financial benchmarks that were used for each scenario. These benchmarks are expressed as a percentage of net sales, and are based on the LCBO's overall historical financial performance combined with conservative assumptions applied over the coming ten years.

**Table 10: Financial Benchmarks for Three Scenarios**

Financial Benchmark	Scenario One: Status Quo	Scenario Two: Gradual Repatriation	Scenario Three: Rapid Repatriation
<b>LCBO Gross Sales (before repatriation)</b>	3.2% increase/year	3.2% increase/year	3.2% increase/year
<b>Agency Stores (+ or -)</b>	+3/year; 30 more	- 7/year; 70 fewer	-15/year for 6 years; -90
<b>LCBO Stores (+ or -)</b>	1 new store per year; +10	7/year, +70	15/year, +90
<b>Discounts</b>	0.7%	0.7%	0.7%
<b>Gross Margin</b>	48.4%	48.4% to 48.9%	48.4% to 48.9%
<b>Salaries &amp; Benefits</b>	9.1%	9.0% to 9.1%	9.0 to 9.1%
<b>Store Salaries</b>	7.0%	6.9%	6.9%
<b>Total Operating Expenses<sup>21</sup></b>	16.2%	16.2%	16.2%
<b>Other Income</b>	0.6%	0.7%	0.7%

In each scenario, LCBO gross sales (before repatriation) are assumed to grow by 3.2% per annum (4% was used in the 2007 report), and operating expenses (including salaries and benefits) are kept at a constant percentage of sales at 16.2%. Again, using conservative benchmarks, the discounts and other income are also kept constant across the three scenarios. It could be argued that the discounts would decrease as Agency Stores are repatriated, thereby increasing the LCBO's gross margin and net income.

In the repatriation scenarios, the gross margin is increased by 0.05% per year, starting in 2010 for gradual and rapid repatriation. This modest gain in margin is a result of improved employee motivation due to the agency store repatriation program. Employees will not only be more productive (thereby helping to control expenses and waste), they will also more readily contribute ideas to improve LCBO operations as a positive response to the concrete expression of the LCBO's commitment to its employees.

<sup>20</sup> *Ontario's Changing Population*, Institute of Agri-Food Policy Innovation (October 2006).

<sup>21</sup> This includes depreciation expense.



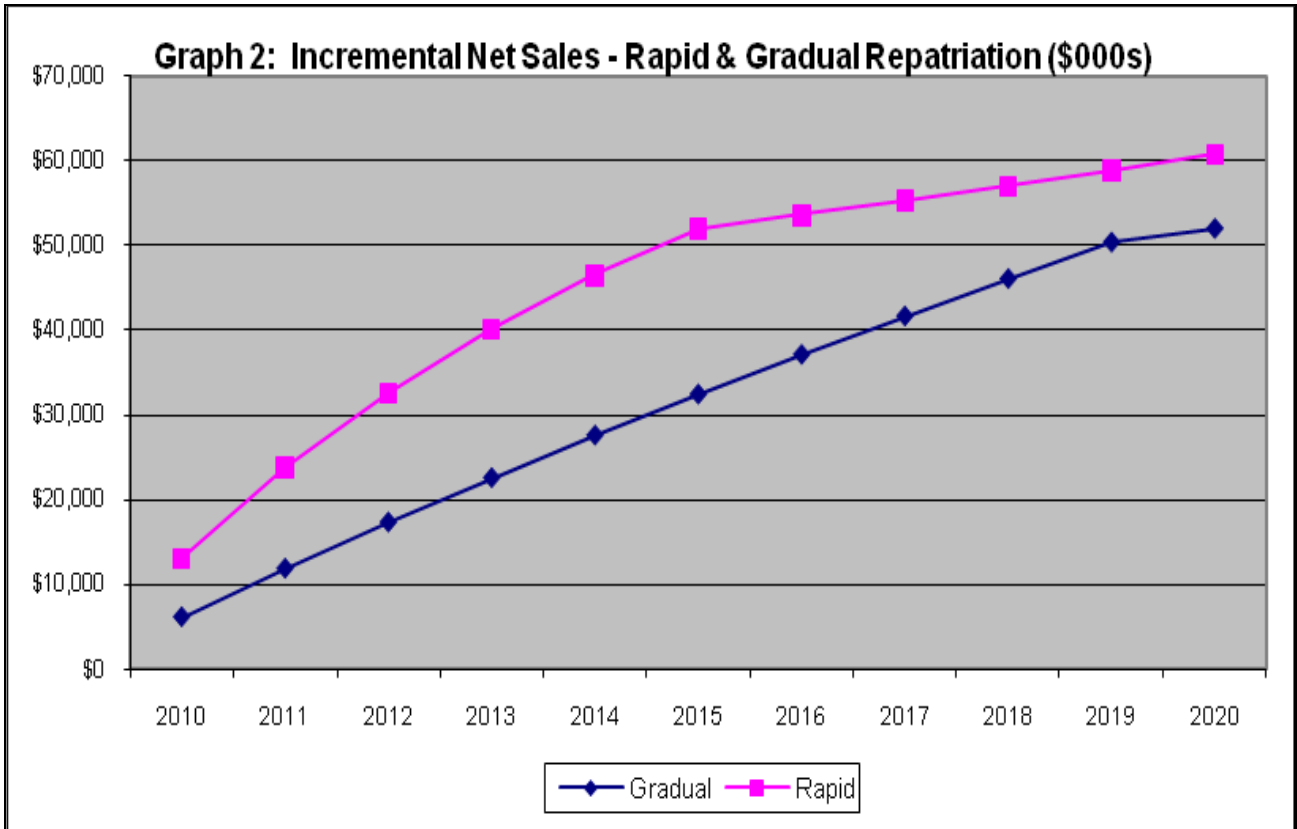
## 10.0 Incremental Financial Results

Using the *Status Quo* scenario as the benchmark, the incremental improvements in financial performance are shown in the graphs below. For each financial variable, the difference between the Status Quo and each of the repatriation scenarios (Gradual and Rapid) is calculated. In other words, the numbers from the Status Quo scenario are subtracted from the numbers in Scenario Two (Gradual) and Scenario Three (Rapid).

### 10.1 LCBO Net Sales

In Scenarios Two and Three, the LCBO’s net sales have been increased by the current average net sales revenue per Agency Store (\$1.56 million for the 103 stores identified for repatriation) for all Agency Stores repatriated in 2010. For each subsequent year, the average sales per Agency Store this figure declines in step with the overall sales decline for private Agency Stores as they are repatriated.

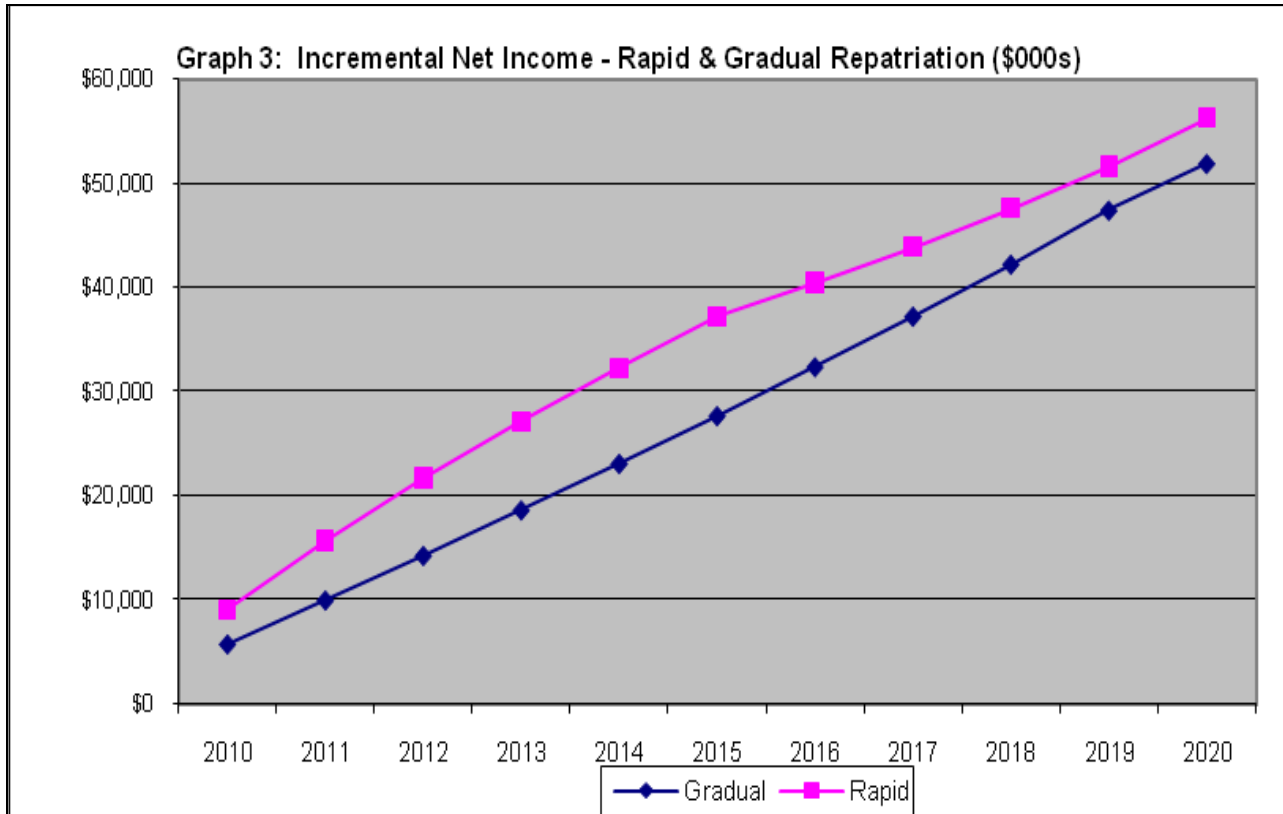
Graph 2 shows the year-by-year increase in incremental LCBO net sales from repatriation. Rapid repatriation results in an additional \$61 million in net sales by 2020, while gradual repatriation adds \$52 million in sales by the tenth year. Of course, the rapid repatriation scenario has a steeper curve as the stores are repatriated more quickly (fifteen stores per year for six years compared to seven stores per year for ten years).



### 10.2 LCBO Net Income

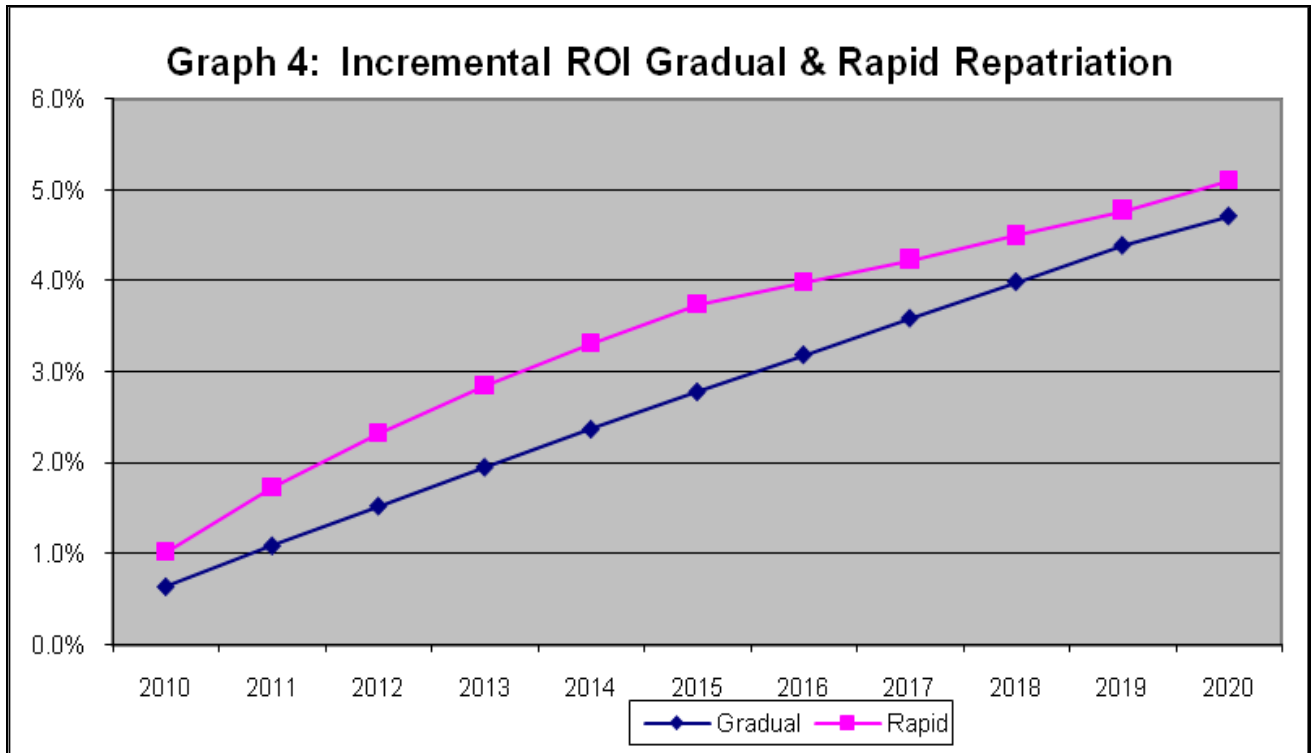
Given the increase in net sales, the modest increase in gross margin, and expenses increasing with sales (but remaining at a constant percentage of net sales), Graph 3 shows the incremental increase in LCBO net income each year.

Again, the rapid repatriation scenario naturally has a steeper curve that begins to level off after the sixth year (2015). By the end of the tenth year of agency store repatriation, the LCBO will gain an additional \$52 to \$56 million per annum in net income (and therefore dividends to the people of Ontario).



### 10.3 LCBO Return on Investment

All three scenarios assume a similar level of new capital investment from retained earnings each year – increasing by \$1 million per year, from \$55 million in 2010 to \$65 million in 2020. As stated in section 7.1.6, the capital cost of repatriating the stores will be in the range of \$280,000 to \$560,000 per store (\$140 per square foot). In the gradual repatriation scenario, this will require \$2 million to \$3.5 million per year for ten years. Rapid repatriation will require \$5 to \$7 million per year for six years. Again, the average return on investment for agency store repatriation is 59.7% (a range of 19.7% to 165% depending on the sales volume of the particular store).



Graph 4 shows the incremental, annual return on investment for the overall operations of the LCBO, resulting from repatriation. While these numbers may appear small (especially when compared to the store-by-store return on investment average of 59.7%), it is still a significant improvement on the overall return on investment for the LCBO. And, Agency Store repatriation strengthens the LCBO’s social responsibility mandate.

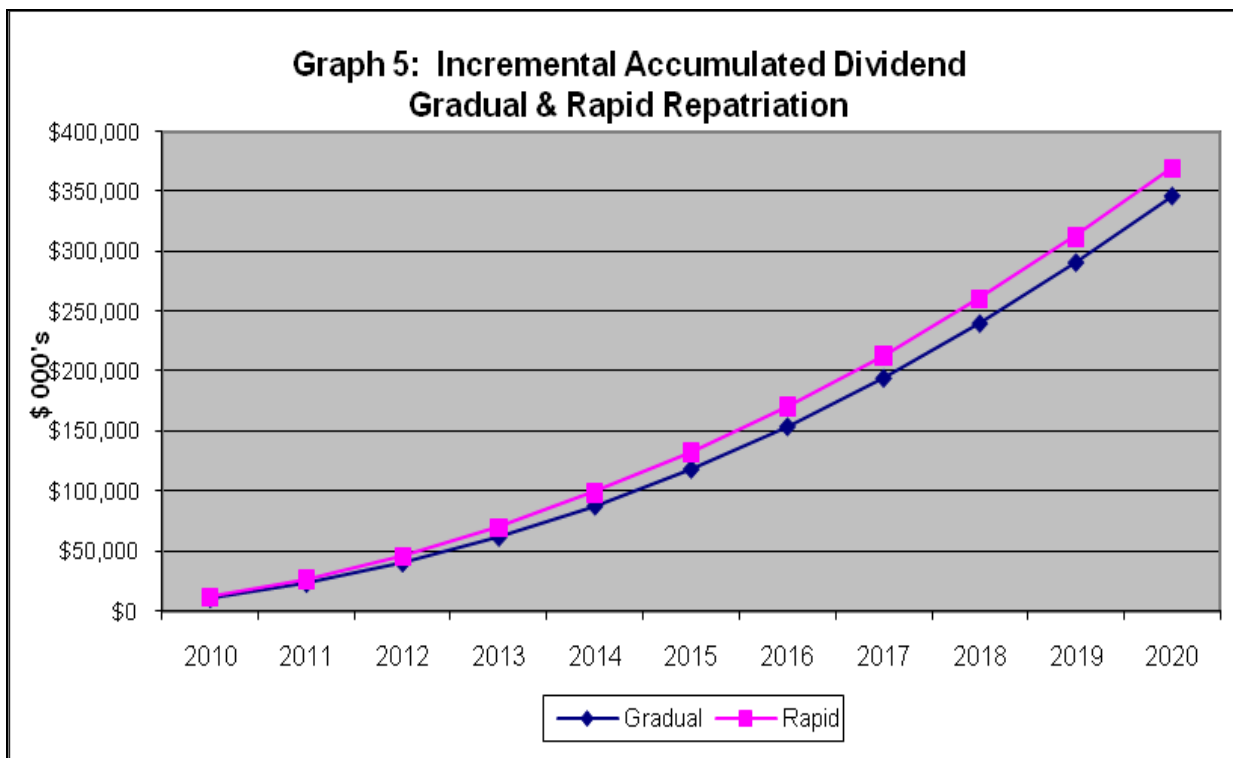




### 10.4 LCBO Dividend

As the name states, the Liquor Control Board of Ontario has been set up to provide an effective method of controlling an addictive and potentially socially-destructive substance. Moreover, the people of Ontario benefit financially from the public ownership of this business. Every year, the LCBO provides a generous cash dividend to the government of Ontario.

The chart below shows the incremental, accumulated dividend that will result from the repatriation of the Agency Stores in the two scenarios. By repatriating the sales from these privately-owned stores, the LCBO will provide \$346 to \$369 million more in cash dividends to the provincial government over the next 10 years.



### 11.0 Customer and Community Benefits

In addition to the financial benefits detailed above, repatriation of these Agency Stores will also deliver significant benefits to the each community, including better selection and customer service, enhanced social responsibility, and an increased investment in the local economy:

- **Selection** – Most Agency Stores carry fewer than 500 products. Smaller LCBO stores typically carry between 500 and 1,000 products, while larger LCBO outlets carry 1,500 to 3,000 products or more.
- **Service** – People enjoy shopping at LCBO stores. Seventy-eight percent of LCBO shoppers provide exceptional satisfaction ratings of 8 or higher (on a 10 point scale).
- **Social Responsibility** – The LCBO’s social responsibility mandate is integral to its organizational culture. In 2008-09, LCBO employees challenged 2.4 million customers who appeared to be underage or intoxicated and refused service to 149,000 customers, most for being unable to produce valid proof of legal age. Public health research around the world always comes to the same conclusion: ***Government controlled distribution and retailing of alcohol is the most effective system for ensuring the highest level of social responsibility and reducing the risk of alcohol-related harm.***

Communities across Ontario that gain a new LCBO store from repatriation will directly benefit from the capital investment (\$280,000 to \$560,000) and jobs created. The LCBO provides a good wage (\$18 to \$26 per hour) and secure employment, and it has an excellent employee training program.

In addition to these direct economic benefits, the repatriation of LCBO stores will also create economic multipliers of two to three times. This means that the money the new LCBO stores spend on rent, wages, municipal taxes, utilities, and other products and services will multiply from:

- \$189,000 to \$567,000 per year for a store with \$1 million in sales
- \$276,000 to \$828,000 per year for a store with \$2 million in sales
- \$336,000 to \$1,008,000 per year for a store with \$3 million in sales
- \$404,000 to \$1,212,000 per year for a store with \$4 million in sales
- \$500,000 to \$1,500,000 per year for a store with \$5 million in sales



## Appendix : Russ Christianson – Resume

### EXPERIENCE

**President**, Rhythm Communications. Working together with co-operative, corporate, public, and not-for-profit organizations to position products and services, create strategic business and communications plans, and revitalize team spirit. Clients have included: Canadian Co-operative Association, Ontario Co-operative Association, CUPE, OPSEU, Canadian Media Guild, Gay Lea Foods, World Wildlife Fund, Zurich Insurance, Toronto Hydro, Ontario Ministry of Agriculture and Food, Environment Canada, Ontario Ministry of the Environment, The Pembina Institute, MedicAlert, City of Toronto (Rhythm Communications, 1995 to present).

**Management Consultant** - Providing management consulting services in the areas of Business Start-up, Organizational Development and Revitalization, Leadership, Marketing, Financial Planning, Human Resources Management, Control Systems and Communication Skills. (Sumac Consulting, 1988 to 1997).

**President** - Founding member of an organic food product development and marketing business that distributed across Canada. (Origins Co-operative Incorporated, 1989 to 1995).

**General Manager** - Responsible for the profitable operation of a wholesale food business with an annual growth rate of 25%. (Ontario Federation of Food Co-operatives and Clubs, Inc., 1984 to 1988).

**Compensation Analyst** - Assisted in the preparation and implementation of a formal job evaluation system for managerial and professional-technical positions. (Canadian Tire Corporation Ltd., 1984).

**Industrial Relations** - Participated in collective bargaining, prepared arbitration cases and wrote "Technological Change and Plant Closures", a negotiating position paper. (Brewery, Flour, Cereal and Soft Drink Workers Union, 1983).

**Chartered Accounting** - Articled with a national chartered accounting firm. (Collins Barrow, 1981/82).

### VOLUNTEER ACTIVITIES

**Recipient – Co-operative Spirit Award:** *Outstanding Contribution to the Ontario Co-operative Association 2003*, for twenty years of dedicated service in the co-operative business sector.

**Steering Committee Chair and Board Member** - founding member of Canada's first community foundation based on the transfer of capital funds (\$6.4 million) from the sale of a public utility commission. (Campbellford/Seymour Community Foundation, 2000 to present).

**Chair and Member** - Public Education Committee, Canadian Co-operative Association, Ontario Region. (1991 to 1995).

**Co-chair** - Representing organic food system constituents on the Toronto Food Policy Council (TFPC). The TFPC's mission is to develop a just and environmentally sustainable food system for all Torontonians. (1990 to 1994).

### EDUCATION

**Master of Industrial Relations** (M.I.R.), University of Toronto, 1982 to 1983. Vice-President of Student Council. Awarded U of T graduate Open Fellowship, Rockefeller Foundation Award and Canadian Tire Corporation Fellowship Award.

**Bachelor of Commerce (honours)**, Queen's University at Kingston, 1977 to 1981. Member of Commerce House Committee, Archery Club, Scuba Club.



