HANSARD

NOVA SCOTIA HOUSE OF ASSEMBLY

COMMITTEE

ON

PUBLIC ACCOUNTS

Wednesday, November 26, 2014

LEGISLATIVE CHAMBER

Nova Scotia Liquor Corporation

Printed and Published by Nova Scotia Hansard Reporting Services

Public Accounts Committee

Mr. Allan MacMaster, Chairman
Mr. Iain Rankin, Vice-Chairman
Ms. Margaret Miller
Ms. Suzanne Lohnes-Croft
Mr. Brendan Maguire
Mr. Joachim Stroink
Mr. Tim Houston
Hon. Maureen MacDonald
Hon. David Wilson

[Mr. Terry Farrell replaced Mr. Joachim Stroink for a portion of the meeting.]

In Attendance:

Mrs. Darlene Henry
Legislative Committee Clerk

Mr. Gordon Hebb
Chief Legislative Counsel

WITNESSES

Nova Scotia Liquor Corporation

Mr. Bret Mitchell, President and CEO
Mr. David DiPersio, Vice President, Finance and IT
Ms. Heather MacDougall, Director, Policy and Public Affairs

House of Assembly
Nova Scotia

HALIFAX, WEDNESDAY, NOVEMBER 26, 2014

STANDING COMMITTEE ON PUBLIC ACCOUNTS

9:00 A.M.

CHAIRMAN
Mr. Allan MacMaster

VICE-CHAIRMAN
Mr. Iain Rankin

MR. IAIN RANKIN (Chairman): Good morning, I'd like to call the meeting to order. I am Iain Rankin, the MLA for Timberlea-Prospect. I'm the vice-chairman, filling in for the chairman.

Before we begin, I would ask that all cellphones be placed on silent or vibrate. We will start with the introduction of members.

[The committee members and witnesses introduced themselves.]

MR. CHAIRMAN: Today on the agenda is the Nova Scotia Liquor Corporation, here to discuss a financial update and the structure of the corporation.

We'll start now with opening remarks from the witnesses. Mr. Mitchell.

MR. BRET MITCHELL: Thank you and good morning. Thank you for inviting us here today to provide you with an update on our performance. Joining me today is Dave DiPersio, our vice-president of Finance and IT, and Heather MacDougall, our director of Policy and Public Affairs and our corporate secretary. Both are members of our executive team and they're here to answer any of the really tough questions you might have.

The NSLC is having a strong year in relative terms to both our planned results and in comparison to some of our most recent trends. Despite long-term challenges within the Nova Scotia economy, we've worked hard to continue delivering value to the province as well as to our customers. In fact, over the last five years we've grown our income from operations, from $219 million in 2009 to $228.2 million this past fiscal year, or $230.5 million in comprehensive income basis. That represents an improvement of $11.2 million annually per year and $6.2 million, or almost 3 per cent over the prior year, despite a soft economy, challenging population demographics, and changing consumption patterns.

We've achieved this growth in several strategic ways. We are moving our customers toward more premium products that deliver a greater return for the corporation, and we're using innovative programs and systems to better engage and connect with our customers and build those relationships. We continue to revamp our store network to better serve our communities. We've expanded our agency store network to better serve under-serviced rural areas, we've become champions of local products and local industry, and we're focused on controlling costs while we make strategic investments.

By all accounts these strategies appear to be working. This year, despite a $2.7 million decline in sales in the first half, net income is $2.8 million over plan. So even though we're selling less, we continue to drive more value to our bottom line by effectively managing product margin, assortment mix and controlling costs. Overall, customer transactions, our measure of customer purchases, were down 2.1 per cent; however, the average dollar value of each transaction grew by 1.7 per cent.

Through strong category management executions, significant gains were made at improving our gross margin, an increase from 54.5 per cent to 55 per cent. As a result, even though sales are down compared to last year, gross margin has grown by $218,000. Payroll and benefits, by far our largest expense, have increased $437,000 or 1.5 per cent, but given the general wage rate increase of 3 per cent, we've been effectively managing labour hours and head count to minimize our overall expense growth. Our non-payroll expenses have decreased by $217,000, or 1.1 per cent. This saving is achieved across several categories.

We monitor our performance in a number of ways; we compare ourselves to other Canadian liquor boards and other private sector retailers. When you examine key performance indicators, NSLC trends favourably. We know our performance is not driven by consumption; Nova Scotia is ninth among the 10 provinces in terms of volume per capita consumption, and 12^{th} out of 13 if you include the three territories. Consumption has been falling steadily since 2009. Simply put, it's not consumption that's driving our profitability, but smart investments and cost-effectiveness.

In terms of consumer trends, the NSLC continues to see declines in beer and spirit sales, which is consistent with trends across North America. However, more recently we've been able to counter those declines, specifically in beer, with gains in our ready-to-drink category, which was up 19.5 per cent thanks in part to another record-breaking year in ciders. Growth in local products is now seen as a key driver not only for our brand but for future revenue growth as well. In the past six months alone Nova Scotia wine sales are up 5.7 per cent to $6.5 million; sales of Nova Scotia cider have increased 66 per cent, which is almost $600,000; and sales of Nova Scotia craft beer were up 28.8 per cent, to $2.7 million.

This growth has led to an important and growing sector of the Nova Scotia economy. Currently the NSLC partners with 19 farm and cottage wineries, 16 microbrewers and five brew pubs, seven distilleries, three commercial wineries, and two commercial breweries. Combined, these businesses contribute millions to the local economy and employ hundreds of Nova Scotians, and the NSLC is pleased to be an active participant in their economic development.

Our contributions to these industries would not be possible without the performance of a robust network of 105 retail stores and 60 agency stores. We also procure the product for the region's four private wine stores and supply the restaurants and bars, and the culmination of these two retail channels constitutes almost 90 per cent of our business and they are basically flat to last year in sales.

We do these things always in balance with our legislated mandates. They are the promotion of social objectives around responsible drinking, the promotion of economic objectives regarding the beverage alcohol industry, the attainment of suitable financial revenue for government, and the attainment of acceptable levels of customer service, all the while operating as a viable commercial enterprise.

Looking ahead to the second half of 2014-15 fiscal year, we continue to look for new ways to innovate, drive margin and carefully manage expenses. We are forecasting that by doing so, we will exceed our targeted net income for the year. I would be more than pleased to try to answer your questions. Thank you.

MR. CHAIRMAN: We'll start with the PC caucus for 20 minutes. Mr. Houston.

MR. TIM HOUSTON: Thank you for that introduction. I might have to circle back to some of it; there are a lot of statistics there. I think you said the gross margin is about 55 per cent right now. I'm just wondering how that compares to other Crown corporations across the country that are in the same business as you. Would it be on par or would it be - I think like Newfoundland . . .

MR. MITCHELL: I'll get Dave to pull out the actual numbers for you, but in terms of our ranking, we're third highest in terms of gross margin across the country.

MR. HOUSTON: Third highest across the country, okay. How does the NSLC's overall profitability compare to similar Crown corporations across the country?

MR. MITCHELL: It's a wonderful question, but it's very difficult to compare them exactly because we all have such very different models across the country. The measure that I like to use is volume per capita per litre consumed. At that level we're number two in the country in terms of contribution.

MR. HOUSTON: Number two most profitable?

MR. MITCHELL: Yes.

MR. HOUSTON: I was just looking at the income statement there, so for the most recent year published, the bottom-line profit is about 38 per cent of net sales?

MR. MITCHELL: Yes.

MR. HOUSTON: I did a quick calculation - well obviously, that means that 62 per cent goes to cost of product and all other overhead. Is that 38 per cent profitability kind of steady over the last few years?

MR. MITCHELL: Yes, it has been flat around that level for a long time. Over 10 years, I believe the number is basically . . .

MR. HOUSTON: I think you said even though the top-line sales are fluctuating, the profitability is still kind of holding in there.

MR. MITCHELL: We moved basically around 2004 - if you go back 10 years - from 37.7 per cent up to where we are now, about 38.5 per cent or 39 per cent.

MR. HOUSTON: So very steady then, yes. Has the government expressed satisfaction with that level of profitability or do they have questions about it?

MR. MITCHELL: I'm very fortunate to have had the opportunity to work with governments of all three political stripes. There's always pressure on that line to improve it - to improve net income contribution, but I think there has been a fair reflection by all Parties that that's a very significant amount of money that we're delivering. It always has to be done in balance as we try to improve it without necessarily either damaging the consumer offer - the consumer potential of putting too much pressure on our vendor suppliers.

MR. HOUSTON: I started to say, I looked at Newfoundland and Labrador and New Brunswick in preparation for today, at their bottom line profitability, and Newfoundland and Labrador's liquor corporation sales were about - their profit is about 51 per cent and in New Brunswick it is about 42 per cent. We're 38 per cent here. Newfoundland and Labrador, particularly, seems like a much higher profit margin. Do you have any comments on why that might be?

MR. MITCHELL: Again, we are three very different models and you have to understand in Newfoundland and Labrador's case they also have a manufacturing capability as well, which tends to be a higher contributing part of any business - especially when you're the sole retailer of most of the product.

They also have a very highly concentrated corporate store network. Their corporate stores are primarily in the St. John's area and then again on the west coast. They have a high degree of distribution with very good profitability from beer through convenience stores and gas stations, and so on, across the province; there's a much higher level of consumption in Newfoundland and Labrador than we have here in Nova Scotia - almost 30 per cent higher. So it's a significantly different model.

In New Brunswick, which on the surface may look more like us, they in fact are much more of a discount-style operation. They have a much lower percentage of corporate stores in their overall portfolio of offerings; they have a lot of agency stores in relative terms. They are also an organization that frankly has not invested into their corporation and I think they're feeling some of those trends now. It's very challenging to run a network like theirs which is completely different in terms of service and assortment and effectiveness.

Our net income number, or the percentages that you're referring to of net income to sales, is not the only measure that we look at for success, but certainly we're quite pleased at the level that we're at and it's our intention to continue to deliver at that level.

MR. HOUSTON: Okay, so Newfoundland and Labrador actually manufactures some of the alcohol that they sell in their chain and New Brunswick has kind of a different distribution model, that's kind of really the reasons behind it.

MR. MITCHELL: That's correct.

MR. HOUSTON: I'll probably come back - I do have a bunch of questions about agency stores so I'll probably come back to that.

One of the things that we've heard from the Minister of Finance and Treasury Board is that they've asked all government departments to reduce expenditures by 1 per cent. I don't know if that's extended to you guys or not. Have you had any talk about whether to reduce expenditures by 1 per cent?

MR. MITCHELL: Our approach is really about controlling the expenditures. We are also a bit different than most other government departments because we are revenue-generating so all the investments we make, whether they be operating expenses or capital, are designed to increase our revenue, increase that dollar contribution in some fashion if we can. So while we're always trying to be cost effective and manage expenses effectively, there are only so many ways we can do that before we start hurting the performance of the business.

I guess to answer the question directly: we're not specifically trying to drive a 1 per cent cost reduction through the business. The vast majority of our expenses are in the retail network, in our retail stores and in our retail employees. Our model is based on their performance, as opposed to cutting them.

MR. HOUSTON: Okay, that does answer the question, I appreciate that. So demographics obviously play a role in the future of any business and we have a shrinking population and an aging population here in Nova Scotia. How has that impacted your forecast going forward for revenue? Do you expect sales to - I think you referred to sales already kind of decreasing, but the product mix changing so that the profit goes up, is that kind of the trend you see going forward in the next five years?

MR. MITCHELL: Yes, absolutely. I mean the demography of the province, it's no secret to anyone, is certainly challenging for a business like ours, not unlike any other business I guess. Specifically within our world what happens as the population ages, obviously consumption definitely falls, the mix of what we sell changes also. So we are forecasting for the foreseeable future that we will see volume declines consistently for the next three, four or five years.

MR. HOUSTON: So you'd see volume declines but you're still expecting the profits to kind of hang in there, would that be a fair statement?

MR. MITCHELL: That's certainly our objective. I mean it's our ability, we think we've been able to do it since 2009 so we don't see any reason why we can't, going forward, if we can manage our mix appropriately, make the right investments and we should be able to maintain our net income.

MR. HOUSTON: Okay, thank you. Has there been any talk about privatizing the Liquor Corporation?

MR. MITCHELL: There's always talk of privatizing the Liquor Corporation, a popular topic of the day, I think every day.

MR. HOUSTON: It's not something you've specifically discussed with the minister or the deputy minister? Have you been asked to prepare any reports or anything like that?

MR. MITCHELL: Not on privatization, no.

MR. HOUSTON: How much does the NSLC spend on travel per year?

MR. MITCHELL: Our travel, which is primarily driving around to stores supervising the 160 outlets that we deal with, is just over $600,000.

MR. HOUSTON: So the travel is mostly inside the province. There may be a few trade shows or something?

MR. MITCHELL: Yes.

MR. HOUSTON: So according to the annual report, there were 51 agency stores in the province and I think you referred to 60 in your opening comments.

MR. MITCHELL: Yes.

MR. HOUSTON: So there are nine new agency stores over the last few months. What is the projection for agency stores going forward for the rest of the year; do you intend for that to increase, continue to increase?

MR. MITCHELL: We don't have any direct plans at this point to add any more agency stores to the network. There will be, if I can call it that, there's always a bit of flux in the number because some will close that are either unsuccessful or for whatever reason decide to get out of the business, and then we may replace them, or we may not, based on their performance, how they're doing.

It is not an easy game to be rolling out agency stores so we'd like to make sure we're doing it in a structured and meaningful manner. We don't like to do multiple rollouts of agency stores as a general rule. We look at our retail network as we go through our business planning process every single year, and we're in a five-year planning process right now so we're looking at it even longer.

At that time we'll identify if there are any communities we think are underserved that still require an agency store, but there's nothing in our plan at the moment.

MR. HOUSTON: There's none, okay. So there wouldn't be any communities on your map that you think are underserved?

MR. MITCHELL: I wouldn't say there are any that we've identified that we think are underserved. We get a lot of input from people that even though we're out in the province and we're driving around, every now and then we'll get one recommended or suggested to us and we'll go and make an investigation to see if it makes sense, but there's nothing that we're aware of that would say we have a community that we think is underserved.

MR. HOUSTON: So that process, if somebody brought something to your attention, you could, if you agreed with them, put an agency store there - put a tender out and put an agency store there. But you don't have to have a plan where you say we've targeted 15 agency stores, or whatever, this year. It's just kind of as it happens it happens?

MR. MITCHELL: I wouldn't say it's quite as arbitrary as that. The program itself is a well-defined program and you have to understand that it's part of how we treat the entire network. We consider them our agency stores and they're intended to be complementary to the network of retail stores that we have and other agency stores that are out there.

The process itself has fairly well-defined criteria, and in order for us to go down the road of putting one in play, it has to be complementary; it has to be accretive to the overall performance of the supply chain of beverage alcohol. If it isn't, then it's very difficult for us to justify - we are a commercial enterprise - why we would do it.

We are quite dutiful in making sure we understand what's happening in communities around the province and it's one of the reasons we feel there aren't communities that we think are underserved, but again, we're not perfect; we're not in every location all the time. We're flexible enough that if someone brings us an opportunity we're definitely going to consider it.

MR. HOUSTON: How does the NSLC profit from agency stores? Is it just by selling the alcohol to them?

MR. MITCHELL: Well, they operate on what's called a retail discount level so their operating margin or what we get out of agency stores is basically an 8 per cent discount off the retail price - between 5 per cent and 8 per cent, depending on the community. The way we save is that that is a more effective way of delivering that service to a particular community. What that means is there is a little bit of a consumption lift by having that particular location. It's small, but in our world it's enough that it makes it financially feasible for them and it's financially feasible for us to do it.

In the beginning stages of the program, these were designed - with that 8 per cent gap, it's about the same percentage or slightly better than the percentage of our store operating costs. If it goes above that, it's much more effective for us to just open a corporate store in that environment. At that level, we're virtually saving 1 per cent in terms of the operating expense of the particular sale of beverage alcohol going through that outlet. Again, for us, we love them; we think they're great and they've served us very well.

MR. HOUSTON: I appreciate that. I didn't want to jump to the conclusion that because New Brunswick has more agency stores, that's why they're slightly more profitable, but it does seem like where the mix is right, it would be more profitable, I think. Did you say it's 1 per cent more profitable to the corporation?

MR. MITCHELL: It's 1 per cent more profitable than a corporate store would be in that location. If we moved to a - with larger volume stores our operating costs shrink dramatically from that number. So just that type of delivery is not necessarily what consumers are expecting when we normally go into a beverage alcohol retailing environment. They have a high standard of expectation for us in terms of what we deliver.

An agency store does not necessarily deliver that. What they deliver is convenience, and they deliver access in a geography that we potentially can't serve efficiently.

MR. HOUSTON: Thank you, that's helpful. The agency store model has been a success. It's a good business plan.

MR. MITCHELL: Yes, it is.

MR. HOUSTON: I've been through some of the applications and stuff on the criteria you have to meet to apply for an agency store. I'm just wondering if there's any movement inside the corporation to give some weight to distinct communities as opposed to just the geographic distance that they look at now. I forget what it is - it's 10 kilometres maybe, it can't be within a certain distance of an existing corporate store. I'm just wondering how rigid that is. I think I heard you say distinct communities as well, you weren't aware of any communities out there that were under-serviced. Are you looking at changing the criteria around agency stores at all?

MR. MITCHELL: We aren't at this point and maybe I'll elaborate to have a bit more clarity for you. The rules around how close they can be to an agency store are well designed within our own cannibalization model. We know, based on our research and our history, that customers will change their traffic patterns at about 11 kilometres.

We know that at the 13-kilometre range it's just enough that that convenience, if they're that far away from us will add a little bit of incremental purchasing or a little bit of incremental consumption - nothing damaging but just enough for the community that it makes sense. If we go any closer than that, it really cannibalizes the local corporate store. What that means is that those sales will actually become unprofitable for us, as a commercial enterprise.

You can argue, well, you should just be reducing your labour in those corporate stores but in many of these locations our corporate stores run so lean that there's not any more room for us to do that, so it's a combination. Again, we're managing the entire network so it's the balance between those two, both the corporate store and the agency store, that's really important for us.

The notion of distinct community, though, I think for us is very dangerous because the definition of "distinct" is then what we'd have to apply to the model, which today is commercially based. If we add the notion of a particular community in a particular geography with some other kind of criteria that's not necessarily commercial in nature, I'm not sure how we would ever be able to defend that this community is distinct and this one isn't.

When I use the word "distinct" I mean a specific community that's underserved. I don't foresee us going down that road at this point.

MR. HOUSTON: Okay, and obviously I'm thinking of an area in my own constituency, Thorburn.

MR. MITCHELL: I know the location well; it's actually a wonderful location. You may not know but I lived in Pictou County myself for seven, eight years and I know the place well. I know they are a great little retailer and they do a wonderful job. Unfortunately, their challenge is they are just too close to one of our locations in Stellarton. It's one of those opportunities that if the corporate store environment changes that maybe that store might become a better one down the road a little bit.

I certainly feel for the young operator that's in there, who I think is going to do a wonderful job - a great family and a great operator. At this point though, it's just too close.

MR. HOUSTON: The reason I'm asking is he's kind of right on the fringes and I do believe he's on a traffic pattern for people who head out to their cottages out at the lake and stuff like that. But anyway, I wanted to ask that question. So it sounds like there's really no - the rules are the rules and there's really no move afoot to try to take a look at those, how they impact certain areas.

MR. MITCHELL: That's true.

MR. HOUSTON: So in terms of agency stores that you have opened, in particular the nine that have opened just this year, how do you determine what the impact on your stores is? Do you do a follow-up study for the next few years that says, well, we saw a change in sales at the corporate store or we didn't? Again, I'm backing in to why you're so rigid on your geographic rules.

MR. MITCHELL: We do a modelling before we start to determine what we think the commercial impact is going to be. Then about six months after we've opened the location and they've had a chance to get their business under their belt, we look at the impact on the corporate environment. We'll be looking at those particular stores in the kind of January or February timeline, after we get past Christmas.

It's critical that these stores really need to be open for a summer before you can really tell what the impact is going to be. These are, quite frankly, a little bit late to the game, if you will, we would have much preferred to have them open earlier. We'll probably take a snapshot of it in January, after Christmas, and we'll probably wait until we get to next September before we make an absolute call on what their performance is.

Having said that, we have not gone in and closed an agency store because the model has ended up not being accurate in terms of our projection, but at least it allows us to know what the return of that particular location has been.

The biggest concern we have, frankly, with these locations and why we do this is that we know when they get down to a certain level of volume they become highly at risk themselves. It costs a significant amount of money to operate one of these, we demand a certain standard of execution in the store, which many of them are not set up for before they get into the game in terms of separation of goods and receiving docks and safety and all those sorts of things; if they add refrigeration, which is a big part of what consumers expect - and then they have to carry inventory of anywhere from $35,000 to $50,000 per year.

So we get very nervous when we get into some of these smaller ones and that's where we are right now. Most of these stores that we're bringing on are quite small in terms of volume.

MR. HOUSTON: In terms of the closest distance you can be to an existing store, is that something that has increased over time? At one point in time did you used to have agency stores that were closer and you said, well that's too close, that's impacting our business, let's move it out or did it go the other way or has it always been that same kilometre distance?

MR. MITCHELL: The only change we've made is that we realize that the hard rule of the community itself actually got in the way of where the store actually was. In some communities the distance between - it was 15 kilometres and the community might have been 15 kilometres away, but the store that was going to service that community was less than 15, but not as far as 11. We decided to put some flexibility in that at 13 kilometres, it would still not cannibalize the closest corporate store too much, but at the same time allow it to service a community that might not be right in the centre of. That's the only change that we've made in my time.

MR. HOUSTON: So you changed it so that you're measuring to the actual store point as opposed to the community point?

MR. MITCHELL: Yes.

MR. HOUSTON: So there are some stores that were just in the community. That's helpful . . .

MR. CHAIRMAN: Order, the time has expired for the PC caucus. We'll move to the NDP caucus and Ms. MacDonald.

HON. MAUREEN MACDONALD: I apologize for my lateness. I have to get the winter tires on before the storm comes so there you go. It's nice to see you again.

I have a number of questions as well around privatization and agency stores and so forth. The first thing I would start with is that back in 2013 during the election, the Premier made a commitment that a Liberal Government wouldn't privatize or sell off the Liquor

Corporation. That was part of the Liberal platform. My question is, was that message ever conveyed or discussed with the board or yourself?

MR. MITCHELL: To the best of my knowledge, that conversation or that position of the Premier has not been discussed with the board. I can tell you, in my case it has been made very clear that the Premier has no intention of privatizing the NSLC.

MS. MACDONALD: So when you say in your case, does that mean you've had conversations with him?

MR. MITCHELL: Through our minister.

MS. MACDONALD: Through your minister, that's explicit in that direction.

MR. MITCHELL: Yes.

MS. MACDONALD: Around the agency stores, we've had a number of new agency stores added, bringing the total to what exactly? How many do we have now?

MR. MITCHELL: Sixty.

MS. MACDONALD: I think I heard you indicate as I came in, there is no plan to add any additional - that's kind of it for the moment, did I hear that?

MR. MITCHELL: That is correct.

MS. MACDONALD: I'm wondering if you could elaborate a bit on the whole model of the agency store and how it fits into the business plan for NSLC.

MR. MITCHELL: Certainly, great question. Agency stores are really designed to provide a similar access to product that the NSLC particularly offers, in a service area or a community which the NSLC cannot afford to service. They're designed to let consumers shop close to home without necessarily having to drive long distances to reach us.

Their primary purpose is to increase access in a safe way in communities that the NSLC cannot afford to be in. Their original design was a competitive process so the amount of discount that they get in order to be successful operating had some variation in it. It was a wide open RFP-type call, and operators could come in and bid whatever they wanted to potentially win their location or their community.

What has become clear over the years is that we needed to limit that amount of competitive activity on the discount or the portion that we're going to get out of it, because they were definitely putting some of these operators in jeopardy. So the program has become a little bit more, I'll call it restrictive in that sense, in that we will not allow an operator to bid below 5 per cent in a competitive situation and we put the ceiling at 8 per cent, for the reasons we've already said. Anything more than that, we'd be better to operate one of our own stores.

So the combination of that and now a well-defined program in terms of operating standards, in terms of what they need to do to be successful, I think has set the program up to do what it's doing quite well, which is complement the NSLC's ability to satisfy the largest portion of the population.

Today's environment, the NSLC through its corporate store network, sells 91 per cent of the beverage alcohol for Nova Scotians, that's the highest level of corporate store performance in the country. There are much more corporate stores per capita, in terms of delivering sales, than there are anywhere else in the country and the agency stores have been a great complement to that. We've tried very hard not to set them up completely as entrepreneurs but we want them still to be independent, do their own thing. They have the unique opportunity to bundle other services with their stores, which we think is very helpful in these rural communities.

I look at some of them, such as at Albert Bridge in Cape Breton, which is a wonderful location. It's a combination of gas bar, convenience store, Sears outlet, Canada Post outlet, and it's got a video store. It's got a whole number of things attached to it, as well as the opportunity to buy beverage alcohol in that location. So they provide a great service for that community up there, which we would never be able to build a corporate store to do even what we do, let alone build all those other services for rural communities.

It's a model that derives its assortment completely from ours so unlike at the private wine stores, which are expected to be unique and interesting and somewhat exclusive, the agency stores must buy their assortment from the NSLC assortment. Again, it's supposed to be a delivery of the NSLC model or the NSLC package in rural Nova Scotia, as far as they can take it.

They still have the option that they can carry anything they want from that assortment and we now have 7,000 items in our assortment. So these small stores that are carrying 60 to 80 products have a wide breadth of things to choose from, but we just do not let them go outside that, there really is no need for them to do so. To be quite frank, these operators are entrepreneurs and they've figured out what's right for their own communities. Again, I think they are doing a wonderful job in delivering that.

MS. MACDONALD: In the overall sales of NSLC, what is the percentage of the agency store sales?

MR. MITCHELL: Just over 6 per cent, they do about $37 million a year, as a group.

MS. MACDONALD: Has NSLC been cutting hours in rural communities in the last year?

MR. MITCHELL: Not specifically just in rural communities but we've been adjusting our workforce - we do it every year - to reflect the transactional changes that are happening in the environments. We're always trying to get more efficient and more effective. I think this year we're running slightly down in terms of overall - about 2 per cent down in hours in the overall network.

The rural Nova Scotia stores are very efficient now; they run with very lean staff so most of that change is actually happening in our large corporate stores in the centres. These stores are basically running skeleton staff. We have cut operating hours in some of these locations, so instead of being open on Sundays, we had to close some of them on Sundays as there just weren't the transactions to support it.

We also looked at Mondays, Tuesdays and Wednesdays during the week; with virtually no customers in the stores, there's no reason to keep them open, so we have closed a number of those as well. But in terms of the absolute number of hours, specifically at our rural stores, there is no direct intention to just cut them.

MS. MACDONALD: Are you doing a review of class one stores? Is there a review underway?

MR. MITCHELL: A review in what regard?

MS. MACDONALD: Well, any form of a review in terms of the hours, the number of staff, those kinds of things.

MR. MITCHELL: Not specifically for class one - we do this all the time for all our stores. We are running about 50 less people in the retail network today than we did last year, but that's just the normal pulse and flow of when we have casuals hired and RPTs and how that moves through the network. Labour review is something this organization does ongoing all the time. So the short answer is, not just for class one, but for all stores we review our labour costs.

MS. MACDONALD: I think you're aware that there has always been a concern that agency stores may allow more minors to have access in the rural communities. What is the monitoring with respect to this, and is it true that there is a greater potential for minors to have access in some of the agency stores versus your larger corporate stores?

MR. MITCHELL: It's a hypothetical so I'm not really quite sure how to answer that. I will tell you that the agency stores are required to do all the training and execute exactly the same way as the NSLC stores are supposed to do. Our We ID program requires anyone who looks under the age of 30 to be asked for ID by the retail staff, and we expect that to happen within the agency stores as well. They receive our full training packages and they have to complete it. They have to keep records of that training. They have to be able to verify it.

We also mystery-shop those stores exactly the same way as we mystery-shop the NSLC stores, and we report those results back to them. We have a team of people that work with the agency stores - not just on their social responsibility side, but also on their operating side. It's one of the key measures, in fact, of how those stores are actually doing.

I have to say myself, having been in many of these stores, I think there's probably a lower risk of over-served minors in those locations simply because everybody knows everybody in those towns. I think it's very unlikely - assuming you don't have an agency store operator that is just not executing well - I think their potential is probably less than it is in one of our corporate stores here in the city where you just don't know everybody.

They are doing much better in terms of their checking of IDs, and as I said, we have mystery-shoppers in them just like we have in our own stores; their scores are getting better and better all the time. I always hesitate to share that a bit because everybody says, wow, they're not 100 per cent, that's terrible. That doesn't mean that they're serving people. It just means they have a bit more work to do in terms of their focus and energy on it.

I think the risk is, as I suggested, probably not as great as it would be in a corporate store where everybody doesn't know everyone. We're going to ensure that - and it's a big part of our mandate - to make sure that all retailers are executing the We I.D. programs.

MS. MACDONALD: What is the data showing in terms of the rate of minors when you do your mystery tours?

MR. MITCHELL: The agency stores are about a 75 per cent score, which I'll say is okay historically. It's not great. Our corporate stores would be over 90 per cent as a group - so they have some work to do. Again, we use that really as a learning and educational tool. You have to appreciate it's one person showing up in a store at one time over a three or four month period and then reporting back. It's definitely lower than our corporate stores are performing at, but I don't necessarily think the risk is any higher.

MS. MACDONALD: Does the corporation have a policy with respect to the proximity of agency stores to schools?

MR. MITCHELL: No, we do not.

MS. MACDONALD: Are you aware of the proximity of some of the agency stores to schools?

MR. MITCHELL: We track the proximity of our corporate stores to schools, but not necessarily agency stores. I'll say it's a bit challenging - I mean you folks know Nova Scotia certainly as well as I do but 75 per cent of our corporate stores are within a kilometre of a school. So my estimation would be that in many of these rural communities if they have a school, chances are these agency stores are going to be close to them. Communities are communities and they tend to have all their services somewhat centralized.

MS. MACDONALD: How about right across from a school? Like not a kilometre but across the street from a school, do you have any knowledge of that?

MR. MITCHELL: I do not.

MS. MACDONALD: I know of at least one that is right across from a school, in the Monastery area. Would that be something that the corporation would look at? I mean it seems to me if you have data that tells you the percentages or the incidences of selling to minors in a general sense, then the work that would flow from that data, improving the ID programs and training and what have you, may only be part of the puzzle. You'd be able to identify if a particular agency store had consistently higher rates, would you not? Do you mine the data for that kind of information?

MR. MITCHELL: I'm not sure it is statistically deep enough that we could do that on an analytical basis, which would tell us much more than how that agency store performed on the mystery shop on that particular point in time. I think what it does indicate to me - again we have probably as many or more corporate stores as close to schools - we need to be absolutely diligent on our training and monitoring of all our retail opportunities or retail channels, to make sure that young people are not getting access to alcohol.

I think that's really our responsibility to do that. I think the proximity issue - while it's something we have to perhaps be more aware of, I'm not sure it's necessarily going to indicate whether or not people are actually getting access to the product. That's more a duty and a discipline within the retail execution, as opposed to a geographic location issue.

MS. MACDONALD: I'd like to move off this topic now and just talk about the business side of things more generally. I know that a couple of summers ago, beer sales were kind of on the skids; it was a bad summer. Last summer the weather was much nicer, I'm presuming that sales were better and are heading in a better direction. Can you give us some sense of the trajectory of the revenues around the various components of the corporation - beer sales, wine, spirits? What has that trajectory been looking like, let's say in the last year or two years?

MR. MITCHELL: A great question. Yes, absolutely I can do that. We are still feeling the same challenges that we've been experiencing, I'd say really since 2009. Weather definitely is a factor within the beer environment. We talk about really having two seasons at the NSLC. We have the summer season which is primarily driven by beer and some of the refreshment categories, and then we have the other half which is really driven by wine and spirits.

The reality is that within that environment, beer is still performing poorly. I think the only change that has happened in the last three or four years is that the acceleration of the ready-to-drink categories, primarily driven by ciders, is growing at a rate that is now almost offsetting the declines in beer.

It's a phenomenon that's specifically in beer that is not unique to Nova Scotia, it's happening everywhere, not just in Canada but in the United States and basically everywhere internationally in the developed world. Mainstream beer is in significant decline and has not stopped declining. I can say that the weather elements that you are referring to have become very concerning that the actual date, time and hour almost matter now with beer. It's really a weekend issue, it's really almost a Friday afternoon to Friday drive home issue for people. It seems to set the confidence and tone for the weekend plans, and a rainy Friday afternoon will virtually destroy a week that has been sunny and bright for the rest of the time.

The point we're at now in the season or in the year, those weather factors really don't matter anymore. So at this stage of the game the best thing that can happen is a storm that gets threatened that never shows, but in the grand scheme of things it will all weigh out in the wash in terms of the purchasing within the category.

Spirits are a much different animal. Spirits are in a serious decline mode; we're talking high single digits in many cases, 3 per cent, 4 per cent, 5 per cent, and that's a very large decline in our world. We've had a little bit better performance this year; we're declining at about 2.2 per cent. Spirits is a category that has virtually no innovation in it whatsoever. With our demography we know that as people age - primarily men - they switch away from spirits. They either go to really premium spirits or they move into wine. That's definitely happening in our marketplace. The combination of no innovation and demography and all these things, the spirit performance will continue to be negative and we forecast it will be for the foreseeable long future.

In the beer balance we also have craft beer to consider. Craft beer is doing wonderfully well. In Nova Scotia it's a little bit behind the rest of Canada and the rest of the U.S., in that craft beer really is a local craft beer opportunity. While it's doing very well, it's not yet big enough here to reach what it's reaching in the other places. In the U.S. now craft beer is like 14 per cent of the entire beer category. We're nowhere near that now but it's a great opportunity for these craft and microbreweries that are popping up all over Nova Scotia. We think that's going to be a real opportunity.

It won't necessarily be an opportunity for the NSLC; they will be selling most of their product direct and through their other channels. When we do set up, we don't make very much margin on it, but it's still a good thing for the economy and a good thing for the category.

I mentioned refreshment; it's definitely about ciders right now. Ciders are doing incredibly well. It's a combination of: it's new, it's innovative, and it's modern. It also appeals to female consumers, it's gluten-free, so all of those elements are making it a really interesting category with lots of excitement and lots of local execution as well.

The big - if I can call it big - growth engine is really wine. Wine's growth is driven by a number of factors. It's growing at about 1 per cent overall, in terms of volume, again with a declining overall consumption trend. That's not a huge number but it's certainly a great number for us and we're very pleased that it's doing that. For us it's being driven across the board, consumers are just drinking more wine - the same issue, those people who are switching away from beer are drinking wine. They're drinking better wine so the combination of drinking better and drinking more wine is really moving that category along nicely.

Nova Scotia wines are a real popular element within this province. I mentioned earlier how well they're doing; they're growing at a great rate.

MR. CHAIRMAN: Order - sorry to cut you off. I went over a minute there - they were interesting comments.

We'll move to the Liberal caucus for 20 minutes. Mr. Stroink.

MR. JOACHIM STROINK: Thanks for coming and I'll just get right into a couple of questions; actually, it's a bunch of lead-on questions. I guess my first question is really to understand the distilleries, the local distilleries here in Nova Scotia. Presently my understanding is that Nova Scotia wineries get kind of a higher margin to work with than distilleries so they're able to sell directly to you much easier than, say, Ironworks would. Is that being looked at so that Ironworks would have a potential to sell into your stores?

MR. MITCHELL: Yes, absolutely. We are in the process of launching a new distillery program. It's going to have a number of components to it. We will be equalizing what we call the retail store margin allowance, which is what happens at the actual location that they're distilling and retailing specifically. We will be equalizing that with the Nova Scotia wine RSMA amount which will be a big help specifically for Ironworks, which does a huge amount of their business right out of their Lunenburg facility.

We are looking at a blended/distilled/Nova Scotia product combination markup structure which we'll be announcing - I think we've announced it to them already. The players all have it and that will be launching in the new year. So we're looking at a markup reduction, if I could call it that, for a series of steps. So if you distill the product in Nova Scotia, you'll get a certain markup. If you just blend the product in Nova Scotia, you'll get an improved markup. If you distill and then blend with Nova Scotia agricultural products, you'll get another break as well.

We're very excited that this is going to help these distilleries that are all coming on board. Today we really have only one that is commercially viable and that is Glenora. This will certainly help Ironworks get there and, as I mentioned, we have five others that are coming on very quickly.

MR. STROINK: I guess I kind of want to go into the private wine stores a bit to have a discussion there. My understanding right now with the private wine stores is that they can only own one private wine store. Each individual can only own one wine store, is that correct?

MR. MITCHELL: That is correct.

MR. STROINK: How does it work now - you have Bishop's and then you have the other three. The other three are owned by Mickey MacDonald, Colin MacDonald and Rod Levy - they're all pretty much connected. Just so I can understand, how were they able to do that when it's supposed to be all individual?

MR. MITCHELL: Great question. Private wine stores come with a lot of history to them and they were an original - I call it a pilot or a test program done back in the days when privatization was on the table and there was a desire, if you will, to have a private enterprise model tested just in case, when the NSLC incorporated, it was not able to fix itself and turn itself into what it is today. There would be this model that we could potentially - or that the government could - roll out in some fashion.

The challenge with that is that it never estimates all the unanticipated consequences that can come from a program such as that. I'll be fair to say that I don't think the NSLC at the time was all that receptive to having a program like that. Having said that, I think over the years we've all grown and evolved to a point where we recognize that it's a viable channel providing a great level of service primarily to licensees, a level of service that certainly the NSLC would never do. We're not going to run a case of wine up to someone on a Friday night at 10:30 to a bar. It's just not in our ability to do that.

What happened in the process of designing and evolving the organization, the actual operating agreements and the definition and standards of what ownership constituted was, quite frankly, not very clear. So there was no distinction between another family member owning a particular outlet. There was no distinction about related companies. There were no distinctions that would necessarily prohibit a business that could look at different ways of structuring themselves to either have the ability to own or influence multiple outlets.

Having said that, we've historically tried to get the four of them to work together because they're so small as a group that their ability to acquire product, to get these exclusive listings that they really require, is really limited. We still do all their procurement for them; all their sourcing. We bring everything in for them along when we're bringing our own products in, but it is very difficult for them to be able to do it effectively. Buying 10 cases from some weird winery in Argentina is very hard to get here in a cost-effective way.

That kind of allowed the other three private wine stores that you mentioned to organize themselves as a group. The acquisition that Mickey MacDonald made of the first one was done at a time when that previous owner was probably going to go bankrupt and no one wanted to see that, and he was able to make that happen. He was so pleased with that business, then his son got involved with the second one. Then Rod, who is running the one from Jim Foster, Premier Wine & Spirits, saw the opportunity to work closely with those two guys to actually do things effectively. They have their own warehousing space now.

So that's kind of the history of why it is where it is. It isn't a pretty history, to be honest, but it is what it is.

MR. STROINK: Are you going to allow the expansion of private wine stores outside of HRM?

MR. MITCHELL: There is no plan for it at the moment. Again, these are very expensive operations for us. If you figure at a 30 per cent discount, which is what they operate at - the group of them do $12 million a year so you're talking a $4 million cost ultimately to the Treasury. There's no incrementalism that's happening on the performance of the sales. It's basically 70 per cent of the business or more is licensee business, which is coming directly out of the NSLC. There's not necessarily anything wrong with that, but to do them is very expensive. If you think about, they probably carry 1,000 or maybe 1,200 unique SKUs in the marketplace. They spend $4 million per year to get 1,200 SKUs in the province is a very expensive thing to do.

If there was a market for one and if we could see a market that looked like it would be viable, I'm sure we would consider it, if the government of the day decided that was something they would like to do. But we have no reason to believe that there is any market anywhere that could support one of these stores.

MR. STROINK: I guess from there - and I look at product sharing from you guys - so my understanding that the rules that are in place right now is that if a Bishop's Cellar has a wine that they'd like to bring in, but you guys already sell it, they're not able to do that. Is that correct?

MR. MITCHELL: That's correct.

MR. STROINK: So those brands cannot expand or grow or get a bigger footprint in HRM specifically. Why do you do that?

MR. MITCHELL: Again, the original purpose of these operators was to have a completely unique and exclusive offering that the NSLC wouldn't have. So it was about expanding the assortment and service to Nova Scotians - not just about taking the product that the NSLC was selling and maybe offer it cheaper or in some different fashion. The whole purpose of that store is to be unique and different and interesting. If all they do is sell the same products as the NSLC, there's no real reason for them to do it.

Having said that, what we've done over the years because wine comes in both ways, oftentimes when a product will be started at one of the private wine stores, the supplier would much rather be in 105 NSLC corporate stores. We've developed over time kind of this mutual sharing approach that once a product has been built by a particular private wine store, they get an exclusivity, so two years, maybe more, will allow them to keep that product on their own and the vendor cannot move that product to allow them to reap the rewards of the hard work that they've done.

Depending on the product, we'll also make allowances that if it's in a licensee channel already, we'll let them keep it in the licensee channel and just move it into our retail channel, and vice versa. We carry, as I mentioned, 7,000 products now, and the vast majority are wine. We're delisting products all the time; we're moving products in and out all the time. If we have a product that has mediocre success for us and we're going to get rid of it, they're more than willing and sometimes wanting to take it because a mediocre wine for us would be a barnburner for them.

There is a bit more back and forth on the listings than the actual model would indicate, but we do want them to be as exclusive as they can.

MR. STROINK: That's great. One other question and then I have a quick one just on how these guys work. In my business in retail we usually get 90- to 120-day terms within my business, in my world. My understanding is that these wine stores have pretty to much pay for their product up front before it can leave your facility. Is that correct and why won't you guys give them terms so that they can better manage their money?

MR. MITCHELL: We have given them terms. They're now getting 30 days.

MR. STROINK: Is that new?

MR. MITCHELL: That's fairly new, yes. That would have been as of July. Historically the original program was cash on the barrelhead so once a product showed up in our facility, before you could take it out, you had to pay for it cash up front. The original design was not only that but when the product showed up at the port, before it came through customs, we'd expect to know when you were going to pull it and we'd want the money then.

It became pretty clear that would have bankrupted all of them so we went to a program where we'll take it, we'll sit on it, we'll warehouse it for you and when you take it out, you pay by credit card or cash or whatever.

That went on for a number of years until we got to the point where these four little stores were approaching 6 per cent of our inventory in our warehouse and entire rows and rungs of inventory that we just could not afford, we would have to expand our warehouse to the tune of $10 million or $15 million just to house private wine store inventory.

So we came to an agreement that what we required them to do is to take the inventory as it came in. Our original thought was we'll just take it as it comes. But then we decided as long as they were moving it out in 30 days, it would help their cash flow a little bit and we figured we could manage that amount of inventory ourselves as it moved through. So they're getting 30 days now.

MR. STROINK: Great, thank you very much.

MR. CHAIRMAN: Okay, we'll move on to Ms. Miller. We've got about 10 minutes left for the Liberal caucus.

MS. MARGARET MILLER: Okay, thank you, very nice to see you here today. In my past life with MADD Canada we certainly had a good association with the NSLC and your social responsibility. Now I know you've been very active in the multimedia shows that go out to all schools to encourage students not to drink and drive. How is that going right now?

I know that you've been building on that over the years, how many schools do you think you'll have for that multimedia showing in this year?

MR. MITCHELL: I believe we're over 60 now. I don't have the exact number in my head but we're well over 60 stores that we're funding. The total number, I'm not sure - do you have that by any chance?

MS. HEATHER MACDOUGALL: We're reaching 70 junior and senior high schools and over 50,000 students, through the partnership with MADD.

MS. MILLER: Excellent. Is that a role that's going to keep expanding? Do you see that moving forward to encompassing basically all schools in the province on a yearly or semi-yearly basis?

MR. MITCHELL: That's our plan, yes.

MS. MILLER: Excellent, that's wonderful. It certainly does a lot of good because the local chapters just don't have that ability to fund these expensive shows, so I think that's a great addition to your program.

The other thing I want to talk about is the agency stores. I do have some concerns with the agency stores - not prohibitionist, it didn't work; it can't work. I really don't believe in privatization. I've argued that many times in the past with different media outlets that argue for it simply because of the statistical information that we know - areas that do have privatization of the liquor sources have more deaths and injuries. So with the monitoring that you're doing, it's doing a good job to keep our youth safe.

The agency stores, I have a little bit of pause with. I don't mind the agency stores. I think some of them are doing a really good job. I look at Masstown Market and how they have it as a separate little retail outlet. It's got the walls; things are not joined. Yet, I'll go somewhere else that's a smaller unit and I'm almost seeing the spirits next to the ketchup on the same shelf. I have a little bit of concern about that.

What kinds of regulations are in place for the display purposes? Could we be doing a better job in keeping the agency store part of those corner stores more of a separate unit so that we don't have the beer next to the Red Bull or the single serving alcohol servings next to the Diet Coke? Is there a way that we can make that a little more of a distinct section of the store?

MR. MITCHELL: Well, it's a great question. To answer the first question, there are no regulations that require that to happen other than within the operating agreements that we have with the agency stores. There is supposed to be separation. I will say that when we first were rolling the program - first of all in the expansion of the program - we actually required separate cash registers and separate rooms off to the side. What we found is that it became incredibly onerous for those individuals, both on a labour standpoint and a capital investment standpoint. It just didn't make sense for these small operators in these small towns.

We still have the requirement that the product needs to be distinct and I'll absolutely agree with you - I think we can do a better job and they can do a better job of organizing their stores so that we don't run into some of those situations.

Where I see one of their bigger challenges right now is on the refrigeration side. They have such little refrigeration and their customers are demanding refrigeration. It's not often, but we sometimes see products will get too close together so you'll see cans of beer next to Red Bull or something else that's in a refrigerated environment. Our operators are very sensitive to it, so the folks that work with these agency stores to make sure that they are being effective and holding up their end of this bargain are doing a better job of it as well.

So I think we can do a better job. I'm not sure regulation or anything else formal is going to make it any better than what it is. I also think we have to remember that even beyond the capital side and the costs of actually doing the separation to an extreme - many of these stores are really small so to actually force them to have a two-foot gap between the beer and the Red Bull - it is going to be so small, I'm not sure it's going to be meaningful to what I know most people are concerned about, which is the notion of the association being one of a very normalized way. I think we can do a better job of helping them make sure those separations, where at all possible, are meaningful and distinct. I don't think we're necessarily doing that well yet today.

MS. MILLER: It's something to work on. Also, what about the agency stores staffing? I think that has always been a concern too. Do they require the same staffing? Do they have to be of legal age actually to be able to work in a corner store that has an agency store involved?

MR. MITCHELL: They have to be of legal age to sell the product.

MS. MILLER: So the same as it would be in a normal NSLC store. You talked about the mystery shoppers. That really makes me feel good to know that people are being monitored when they're not expecting it. Do you also have inspectors who go in on a regular basis or do the mystery shoppers pretty much take care of that type of thing?

MR. MITCHELL: We have a team of individuals who service, monitor and support the agency store network.

MS. MILLER: Thank you. I'll turn it to my colleague.

MR. CHAIRMAN: We'll go to Ms. Lohnes-Croft for three minutes.

MS. SUZANNE LOHNES-CROFT: I'm going to ask you questions about the Air Miles program. I'm sort of curious that being a monopoly, why have you brought in Air Miles? I think of it as a way of competing with another business, so why the Air Miles program?

MR. MITCHELL: I think this is on my frequently asked questions list. Most people on the surface think of us, as you say, as a monopoly so why have this? On our agency store front, sometimes they ask, why are we competing with them with Air Miles? The answer is, we're not. The issue of Air Miles for us is that it is currency for customer insight. So it's very, very important for us in declining sales mode where declining volumes are happening, where we're seeing no economic growth in the province, that we need to understand how consumers are purchasing in as sophisticated a way as we can, so we can influence that mix and the premiumization that has been the backbone of our business for a long time for us to enhance our profitability.

When I say it's virtually currency for insights, we virtually pay customers, through Air Miles, to let us see, not their particular name but we get to see their purchases. With our SAP environment, we've always had great visibility into our systems and into our environment, into our business. We could see what customers were purchasing and combinations within a particular basket. So you come in, you buy your products, we could see it physically what people were buying in conjunction with another and we could use that information to help us make assortment decisions, promotion decisions, space decisions in the store, where we promote things, how we promote things. What we couldn't see over time was how those baskets all connected.

Now with Air Miles we can see that. So we know what is happening with Customer A in Yarmouth who is purchasing this, this and this throughout the entire beverage alcohol purchasing pattern for a year. We can combine those with other like purchases. That is how we're managing our business today, from a premiumization point of view and from a mixed point of view. For us it's very important that if we can get you to buy a $17 bottle of wine instead of a $15 bottle of wine - we're not getting you to drink more, but we're getting you to make us more money. That's very important and quite frankly, it has been the only way that we've been able to enhance our profitability on our margins going forward.

I think it also provides for us a cost-effective way at doing data analytics that we wouldn't be able to do ourselves; we try and be as efficient and as effective as we can. In our head office environment, hiring a bunch of people to do data analytics can be very expensive, so we have a team of people at the Air Miles organization that can do that for us under contract, that becomes bundled into the Air Miles cost, if you will.

Now to date, we've been very fortunate in that we've been able to take the Air Miles program and turn it into a bit of a profit centre for us. So the bonus miles that you see on the shelf, we sell those bonus miles to suppliers. It allows suppliers to compete against each other in a way that is not necessarily increasing consumption but is doing the same thing - the mix, the premiumization, the choice of a competitive wine versus another wine at the same price. By them buying those points from us it's actually offsetting the costs of the program. At least up until this year, the program has been a bit of a revenue generator; not a big one, but it has been covering the costs.

MR. CHAIRMAN: Order, thank you. I'll move back over to the PC caucus for 14 minutes. Mr. Houston.

MR. HOUSTON: Before I switch to another topic, I just want to kind of wrap up in my mind on the agency stores and the private wine stores. It sounds like there's no real kind of structured plan to expand that network but you're always open to it. Is that kind of where it rests with those?

MR. MITCHELL: Yes, we're always interested in different models and approaches to help manage the entire process of beverage alcohol in the province. We try not to be close-minded to any model.

MR. HOUSTON: Now in terms of the marketing, I think the Liquor Corporation spends about $2 million a year on marketing. Is that done internally or externally? Who manages the marketing?

MR. MITCHELL: We have a department that manages marketing, actually a team that we call Marketing Merchandising and Customer Insight; they look after all those pieces. As you say, we do about $2 million in marketing. The vast majority of that is done within the buildings so when you see . . .

MR. HOUSTON: That was just a curiosity I had. Since I just learned that for everyone who uses their Air Miles card you know their patterns pretty good, which makes me a little nervous. Do you use that data to come up with a set of promotions to use? Like would you have promotions and fliers that you would send to a certain geographic area, based on some of the data about buying patterns?

MR. MITCHELL: Yes.

MR. HOUSTON: Do you have a set of promotions like you have in mind for the year or how do you determine when the publications will come out and where they'll go?

MR. MITCHELL: We run very standard retailer what we call marketing calendars for the year. We plan nine to 10 months in advance. The customer insights kind of promotion that you are referring to is one part of that so it's a whole calendar and schedule of activities that we are going to do.

We don't do a lot of external advertising. People see the coloured flyers that we put out occasionally. They tend to be driven by seasonal relevance and things that are happening specifically around that time. They're virtually almost always all premium products, new products, things that are going to add value to the basket. Again, the number is very small; I think it's like $400,000 per year that we spend on external media. That number is actually a revenue source because it's all sold as well.

MR. HOUSTON: So in terms of social media, I'm sure like everyone else you guys are probably using more and more social media as time goes on. Do you have a number for how much of the $2 million budget is spent on social media?

MR. MITCHELL: It would be very small; I'll turn to my colleague here. David, do we have that with us?

MR. CHAIRMAN: Mr. DiPersio.

MR. DAVID DIPERSIO: I'd have to say it's a very small percentage of our program. We have a little bit of IT spend to maintain a digital website, but it's probably around $100,000 on the IT side to support a digital platform, but very little of the marketing spend is related to it.

MR. HOUSTON: So overall, the use of the advertising budget is pretty effective in your business?

MR. MITCHELL: Literally that's the million dollar question for us - the effectiveness of advertising. I think that the short answer I'll say is yes, based on the programs that we're doing now. To be quite frank, we've just started to really investigate which ones are working and which ones aren't. Every retailer has to go through that process.

MR. HOUSTON: How do you measure that?

MR. MITCHELL: Well, it depends on what the promotion actually is. It tends to be lift; it could be a follow-on purchase - so the promotion is intended to introduce you to Argentinian wine and did you buy Argentinian wine down the road. There are multiple success metrics that we could have.

MR. HOUSTON: In terms of negotiations with producers - so obviously you have monopoly pricing power - how do you negotiate with producers on pricing? Is there a way you could speak to that a little bit? My curiosity obviously is if somebody is trying to get a product listed and they can't get it listed and it's based on a price - the price is too high or something, there's no place else for them to sell that product. I'm just wondering how you use the monopoly power that you have in terms of negotiating with producers.

MR. MITCHELL: That is probably the most complex question you could have asked today. What I'll try to do is give you a sense of how it works.

MR. HOUSTON: Let me ask it another way then. How about this, because it is a complex question and in the interest of my nine minutes I have left, I don't want to use it all on that. Has industry expressed any concern over the way you negotiate with them?

MR. MITCHELL: Industry always expresses concerns about how monopolies negotiate, always. We virtually operate on an ad valorem model, which for the vast majority of our business means the vendor knows if they want to hit a certain retail price what the cost is they need to quote. That is sometimes a disservice to Nova Scotians because it doesn't necessarily allow us to negotiate the price of the good to acquire it. So if they want to advertise or if they want to list a price at $19.99 and we think it's only worth $17.99, quite frankly the cost we're going to get is going to take us to $19.99 for the vast majority of our business.

For promotions, we're much more aggressive on promotions in terms of negotiating the price that's going to be required to hit a promotional flyer, a promotional price, a promotional in-store. We have certain parts of our business that we actually bid. It tends to be in the economy areas of our category assortments that we know have virtually no brand value.

What we try to do is make sure that we are fair and as transparent as we can possibly be, but when we know we're only going to list two and there is going to be 15 who want to be listed, there has got to be some criteria to get two. That's where we would put significant pressure on the supplier community to have the lowest price.

MR. HOUSTON: I'm thinking of the wine industry here. I know that wine sales are going up and you also mentioned craft beer sales are going up. Do I understand correctly that the NSLC cut its markup that it had on local wine a few years ago and did that help to increase the sales of the wine?

MR. MITCHELL: Absolutely. The first answer is yes, we did cut our markup, and it has absolutely allowed them to sell within our environments. The Nova Scotia wineries are very small with the exception of a couple. Their ability to compete nationally even is very restricted at this point in time.

As open, transparent and as helpful as we are to them, the rest of the world is not so much. So we have been providing them with tremendous support - proud to do so and glad to do so - that would allow them to sell products within our environment that they can make money on. So their markup structures are significantly reduced. We virtually make 25 to 30 per cent gross margin on a bottle of Nova Scotia wine, on an international wine we'd be making a 60 per cent margin.

It's a significant reduction, it allows them to again market within our stores. We virtually give them carte blanche, they can come in and we'll take everything they have, assuming that it's drinkable. But if it's drinkable, we'll take everything they have; every listing they offer us, we will take it.

MR. HOUSTON: So that has really grown the industry then.

MR. MITCHELL: Yes.

MR. HOUSTON: And the demand is there for these products?

MR. MITCHELL: Yes, absolutely. The number one wine in the entire NSLC assortment is a Nova Scotia wine.

MR. HOUSTON: Excellent. So in terms of the local beer, how does a local beer company get their product listed on your shelves? What is the process?

MR. MITCHELL: I'll perhaps split that question in half, if I can. There are two types of beer approaches; the first one, which most people talk about, is our craft beer environment. They enjoy a similar situation as the wine people do - they have a markup structure that is very advantageous for them, it's over half of what it would be for a commercial brewery. The gross margin that the NSLC would be expecting on a craft beer would be about 20 per cent, which again is significantly less than even the wine folks have.

We take the same approach. I mean they can retail it for whatever they want and we will take virtually every listing they have.

MR. HOUSTON: Do those producers have to be able to produce enough so that you can stock all your stores?

MR. MITCHELL: Not all the stores, but there's a basic minimum amount that we need to have that even a single store could potentially support them. We can't be in a position where we bring a product in, five cases and never see it again. There has to be some measure of ongoing success; the public is expecting that. Overall, once these folks get going, they are able to supply enough of our stores so we can give them a presence and move their product through.

The commercial side is much different, it's a much more competitive environment. Commercial breweries are really your Labatts, your Mooseheads, your Molsons and we consider them local. Obviously we have a big plant here in Halifax and their world is a bit more competitive and so at the same time as we try and be as flexible and as supportive as we can, we expect them to compete with one another for their position in the store.

MR. HOUSTON: How does it work - would a craft beer have to be inside a certain price range? I'm thinking of a smaller company like the North Brewing Company in Halifax. They can't compete necessarily on price the same way as the larger companies, so if they have to price their product at a certain - like how do you determine that? I know you are talking in terms of the margin you require, but you're also looking at the price the consumers will pay. How do you negotiate with somebody like that, in terms of shelf space?

MR. MITCHELL: Well frankly we don't negotiate with those folks. I mean we will virtually take almost everything they have and find a home for it in a way that is going to help them be successful. In terms of the retail price they want to sell it for, frankly we just let them pick what they want to do.

Now we'll give them our advice and our counsel. Our category managers are experts in this so they can give them fairly sound advice as to whether or not they are going to be successful with what they are planning and give them suggestions and support on how they need to do it. But they will not have to compete with a Keith's product in order to get access to one of our retail outlets.

MR. HOUSTON: Okay, but they would compete with the other people in their category?

MR. MITCHELL: Technically they would, from a consumer's point of view, but there's not enough of them at this point that they have to compete for space within our stores. As I said, we will take virtually everything.

MR. HOUSTON: Now just in my last couple of minutes, on the regulatory environment, have you had any discussions with the minister on changes that you would like to see to the Liquor Control Act?

MR. MITCHELL: On the regulatory side, the NSLC today is responsible for manufacturers and for retailers. Our aspiration, frankly, would be that we think the manufacturing base might be better served elsewhere than within our environment - one more degree of separation between us being judge, jury and police. We would like to see potentially that change happen and we have communicated that as part of our wish list, if I can say it that way.

In terms of the Liquor Control Act itself in general, it's a very big, long and multi-tangled adventure so I'm not necessarily expecting a complete rewrite or rework of it in any way and we're not suggesting that.

MR. HOUSTON: Just on my final quick question, for the local producers, with all this data and statistics you have presumably on their product sales and stuff - if they wanted to try and list in another jurisdiction, would you share data with them that would maybe help them show how their product sells?

MR. MITCHELL: We would absolutely, but within reason. There are some privacy and contractual relationships we have with what we can share, depending on where that information comes from, but certainly we're more than willing to offer advice and support. In the wineries, for example, we helped facilitating Benjamin Bridge moving across the country. We have done the same thing with Jost and we'll do it with the breweries as well.

MR. CHAIRMAN: We'll move on to the NDP caucus for 14 minutes. Ms. MacDonald.

MS. MACDONALD: I'm going back to the agency stores for a moment and I'm wondering if you can tell us how many of the agency stores are independents and how many are part of, let's say the Sobeys chain, the Needs or any other kind of chains. What is the breakdown in terms of those 60 stores?

MR. MITCHELL: That's a great question, and I don't have an answer for you, but we will get that for you.

MS. MACDONALD: That would be great. I know that there was an announcement about a discount for restaurants in the wholesale product - wine and spirits, right?

MR. MITCHELL: Correct.

MS. MACDONALD: That is underway as of the first of April - is that when that went into effect? Can you give us an update of where that is?

MR. MITCHELL: Certainly. The program actually went in place on January 1, 2014 and I'll give a bit of background. The licensee community has been good partners of ours for a long time. They are obviously a key way of getting to consumers in a certain environment, but they have been struggling significantly for many years. I can tell you, I've been here nine years and I think there was maybe one year in the nine that they've had a positive sales growth in terms of beverage alcohol performance.

They have become less and less a percentage of our overall business so my expectation is that this year they will fall below 9 per cent of total beverage alcohol. That's a significant change from where they are in a number of other provinces and where they have even been here - they've been as high as 16 per cent - 17, 18 per cent.

Certainly there are a lot of reasons for it, but it is what it is - the times have changed and policy, regulation, all really good things. Drinking and driving, and anti-smoking, all these things that are very important have certainly affected them and have affected the selling of our product. We were really hopeful that we could find a way to help these operators who were hurting quite significantly to see if we could help build at least their stability enough that they could perhaps rebuild from where they are.

They are their own entrepreneurs - we cannot help them sell the product within their world. It's a different world; it's not our world. We thought the best way that we could do it was if we could find a way to afford to inject a little bit of funds back into that community through some sort of discount - if I could call it that - to help support them.

Historically they'd been asking for discounts from all governments of stripe and colour, to help them and support them. We were able to work with them and find what it was exactly they were looking for and it was, again, primarily a simple approach - take away all the other fancy stuff that we do for them and give them a lower price of goods so that they could actually then operate.

We have done that, as I said, as of January 14th we give them a 10 per cent discount off the retail price, which is what they would normally pay - the retail price that an NSLC customer would pay before HST. So 10 per cent before HST and we file that back to them, depending on how they buy through our warehouse or through the store or through one of our little centres, either a credit or an off-invoice amount. So we have done that.

The original gross cost was about $2 million to do that. After all the adjustments that we could make internally to all the other things that we were doing for them, we think the net impact is probably going to flow out somewhere around $1 million a year. We've run it as kind of a pilot program - let's see what happens. In our world, unintended consequences are a real and likely opportunity that we will have to face, what actually happens with that. So we're going to run it as a pilot. There will be an assessment done at the two-year mark and we'll see how it played out.

Again, we're very pleased to do it. It's another one of those diversions away from net income going to the shareholder though that people need to be aware of. Our ability to continue to provide net income, even at a stable rate, while we're continuing to provide increased investments in these other channels for us - it makes it very, very challenging but we're pleased to do it and it seems to have been very well received.

MS. MACDONALD: Excellent. It was, as you know, one of the initiatives that I had the privilege of being involved with moving along and I was really glad to see it started but I had forgotten that time frame in which the evaluation would be done on it. Maybe we'll have a chance to get an update when it's more fully along and we can find out what impact that might have had on a sector that I think is really very important to provide support to.

That brings me to the Buy Local and the whole wine industry. My question is around the Canadian scene and what's happening opening up the borders to allow domestic wines from the various provinces to be shipped and moved. I know that Nova Scotia was one of the early adopters in making changes in its legislation, but that was really predicated on other provinces doing similar things. Where does that stand now? How easy is it for our industry to ship into other provinces and vice versa?

MR. MITCHELL: Okay, another great question. Where are we? Well, to be quite blunt, we're not very much farther along than what you were aware of in your previous post. I can tell you that our approach has been to even be a little more flexible. Our recommendation - which is moving its way now, I believe, through legislation - is to allow it to happen without any contingencies placed on it or reciprocal arrangements in other provinces. The notion that you would be able to buy a case of Nova Scotia wine off the Internet and have it shipped to your home by courier is going to happen and conversely, anyone who wants to do the same thing from a winery somewhere else in Canada will be able to do that as well.

Across Canada what's happening is obviously British Columbia, who was the stalwart of that original initiative - is wide open today so you could make it happen if we wanted to. Manitoba is also wide open, so Manitobans can do it if they so choose. The rest of the provinces still have their barriers up and my sense is that Alberta seems to be somewhat open, recognizing that in their environment they feel they are wide open as long as you go through their distribution environment. So they are kind of struggling, I think philosophically, with the notion of direct to home because it's not really part of their model. I'm not sensing any degree of appetite in Ontario or Quebec which, quite frankly, is where it all matters from that point of view but that's kind of where we are today.

In terms of barriers themselves, which I think is kind of the second part of your comment/question, I actually think it's a bit of a red herring - the direct from 100 per cent kind of Canadian juice, if I can call it that, as being the real barrier. I mean the whole program - and I'm not suggesting in any way that the NSLC is against what we're about to do, because I think it is the right thing to do and I actually don't think it's going to be material in the grand scheme of things in terms of wine purchases or in terms of net income. But it's also not really what the barrier is.

That whole process is really about those local wineries not having to share the profitability they make with corporations like ours. They want to keep all the profitability themselves - totally fine and I get that but it's not really a barrier because you could always buy a case of wine from the Okanagan and bring it back with you. You just couldn't ship it by courier.

The real barriers in Canada are on commercial product. We have a wonderful plant in Truro, Peller Industries - they do a huge business with the NSLC and with our Atlantic partners but they cannot ship any of that product into the Province of Quebec or Ontario. They will not allow any of that product. You can't ship it into British Columbia either, which has been a big proponent of direct delivery or opening up of barriers. That, to me, is really where the opportunity lies. If we're really interested in lowering barriers it's on the commercial side, not on the local side.

MS. MACDONALD: I want to ask you a question about u-vints. When the new minister announced the regulations around u-vints, there was no fee or levy put on the product at the point of production, I guess you would say, in the u-vint stores. I know that other provinces, particularly Prince Edward Island, have a small fee.

So my question is, was that consistent with the recommendation from NSLC, which had been really active on this file, or not - that decision? Was that your recommendation?

MR. MITCHELL: Our voice was really more directed to what the impact was going to be on our net income stream as opposed to the structure of how the new relationship would look, so whether there's a levy or not is really immaterial to us. How that levy plays out - whether it's a tax at retail or a tax at production doesn't really matter. Our biggest concern was just making sure that people were aware of what the impact would be down the road of having u-vints operate.

I also have to say that our perspective has always been that u-vints were going to operate, it wasn't a question of if and when, it was what the environment would be in which they would be allowed to operate. For us, we know that they're going to grow significantly. There's not much experience across the country, unfortunately, because there's not a lot of visibility into how that actually is performing.

The only two provinces that have any visibility that I'm aware of are Prince Edward Island and Ontario. In both of those it has developed to somewhere between 15 per cent and 20 per cent of the total wine business which ultimately will come from u-vints. In our world, we do $140 million a year in wine, let's say, so for easy math, say it's 10 per cent, that's $14 million of wine business that will be done there. With our markup structure, that's basically $6 million or $7 million that will not be in the Treasury at some point in time in the future. How long that's going to play out, history will play itself out over time. They're viable little enterprises. They're certainly popping up all over the place and they're employing people and they're doing what we always thought they would do.

MS. MACDONALD: So you'd prefer not to comment on your recommendations around any levy on that. Okay, I accept that.

My final question - I must be close to the end of my time; yes, two minutes - is around the social responsibility piece and any work that's occurring there right now with respect to - I know that part of your mandate is also to be cognizant of the social responsibility side of marketing alcohol. Do you have any campaigns underway at the moment or plans for any?

MR. MITCHELL: Yes, absolutely, the most recent campaign on the SR side - I hope everybody has seen it - is the Cabbioke cab that is running around Halifax and soon to be out to the rest of the province. It's a primary focus of ours about not drinking and driving - planning ahead and making sure you get yourself home safely. We've been doing these sorts of campaigns for many years. This one seems to be a real hit, to be quite frank, and people really seem to be taking to it. They're finding relevance with it. We'll run this no longer as just a Christmas program; this whole notion of our anti-drinking and driving approach is going to be expanded to be a year-long foundation to what we do for drinking and driving.

We also have been working very closely with the universities. As you'll remember, we had our Keep It Social campaign, which we launched in the universities two years ago. They loved it so much and they were an active participant in the design - really focused around anti-binge drinking and the potential impacts it could have particularly within that environment.

In the second year we actually decided to revisit it and they're taking a very active role and much more of a lead role than historically would have been in the past. Historically we would have done that work and then kind of dropped it in their lap and said, what do you think? Now we've kind of turned that around and said, let's work with you - help us create and put a program in place that makes sense for you as places where young people are perhaps drinking for the very first time and we know are sometimes abusing alcohol.

We see those as the big two parts of what we're doing and we're going to continue to focus primarily in those areas right now.

MR. CHAIRMAN: Back to the Liberal caucus to conclude with the questions. Ms. Lohnes-Croft.

MS. LOHNES-CROFT: Just two quick questions on the Air Miles program. You said that the reason is for tracking - do your detailed receipts not give you enough information for tracking? What does the Air Miles program offer that our regular receipts do not offer?

MR. MITCHELL: The regular receipts are a one-time thing, they are almost like what our SAP system provided to us. So the reflection that would come back from a transaction electronically as opposed to the paper receipt is what the transactional system would say.

What Air Miles does is it will take the receipts and add them up over time and say this is what happened in November, this is what happened in February, this is what happened in July, this is what this consumer of premium red wine is liking to look at throughout a longer period of time. We can't connect the receipts, I guess would be an easy way to answer it. The Air Miles card number is the way we connect the receipts.

MS. LOHNES-CROFT: How has the cost been for initiating the Air Miles program? Has it been cost-effective?

MR. MITCHELL: Oh, incredibly, it's actually a profit centre for us so we are actually making somewhere in the neighbourhood of $100,000 to $150,000 a year after all expenses, everything in. That's a bit unusual for retailers who have been running these programs across the country, there tends to be some degree of cost that requires a return on the investment but our supplier communities to date have been very supportive of the program and investing heavily in it and that has allowed us to make a little bit of money.

MS. LOHNES-CROFT: Thank you.

MR. CHAIRMAN: Mr. Maguire.

MR. BRENDAN MAGUIRE: Thank you for coming today. I'm just going to jump right into it. If alcohol is placed in corner stores, would mystery shopping be more difficult? With one staff person usually manning the entire store, would theft become an issue in regard to stealing of alcohol?

MR. MITCHELL: Again a hypothetical for me. I'll say that on the mystery shopping side, it's really a question of how much you want to spend and how much of it you want to do. There's no question, we have 60 agency stores, 105 corporates - you do the math, it's 165. We're mystery shopping them, plus the breweries and the beer store. If all of a sudden you have 1,500 convenience stores selling beer, it's going to cost a lot more money to mystery shop those stores, report them, manage them, feed back the information, train them - no question.

In terms of theft, it's a very interesting question and I'm not sure I can answer it for our own perspective but I will perhaps share some information that I've seen out of Washington State where they recently privatized their entire retailing environment, a really strange model but with a much broader expanse of stores than they ever had with their corporate kind of government-run stores. Their incidence of theft, violent crime, and student issues just went through the roof.

Is it all attributable to this particular situation? I'm not statistically involved enough to know but my sense is that the more you have, the more difficult it is to handle. I will say that from our own experience if you think of the very tragic situation we had here last year where an individual was released from prison - a tragic story on both sides of the equation. I just cannot imagine being able to handle that kind of a situation in 1,500 convenience stores. I just cannot imagine how you would stay on top of it.

MR. MAGUIRE: My other question around corner stores is if we did go to that model, who would be responsible for the training of the staff or guidelines and policies in regard to NSLC?

MR. MITCHELL: Well certainly the program itself, what we expect would be our responsibility - the design of the program, the supervisory elements of it, the ownership of it. Having said that, who is responsible for it would be the owner and how that gets executed within their entrepreneurial environment of their own - definitely we expect these folks to be responsible and take ownership of it. We are there to help, to educate, to train and then ultimately to monitor and for feedback. I would say that ultimately it's their responsibility.

MR. MAGUIRE: So there would be some financial and social impact to providing or allowing corner stores to sell alcohol. What I'm getting from you is that it would be difficult to control the situation with so many corner stores across Nova Scotia.

MR. MITCHELL: We would definitely have to add a much larger team of people to deal and manage and support 1,500 convenience stores, if you wanted to have the same degree of regulatory and responsible drinking oversight that we have today.

MR. MAGUIRE: My last question is, obviously there would be a difference - I would say the people who work at NSLC make a little bit more money than somebody working at a corner store. What kind of economic impact do the NSLC stores have in local economies?

MR. MITCHELL: That's a very interesting question. We've never actually broken it down into a by-community impact. There are a couple of caveats we have to remember. These convenience stores - particularly the agency stores that we have that we operate in - as I say, we require a 19-year-old or over to sell the product, there would be a lot of convenience stores in the province that don't have someone of that age in them. That's one reason why our wage scales are significantly different.

Within our own stores, not only are they 19 or over, they're also heavily trained in the degrees of things that we require - not just social responsibility, but product training and occupational health and safety, and running a store and all the things that we do for customer service and satisfaction. Those individuals are certainly well-vested in the communities and they're contributing. They're doing all the things that residents do in those towns.

So an absolute number, I don't have for you. I can tell you that we have done an economic impact study as part of the view of the industries. The total breadth and scope that we have using the Department of Finance and Treasury Board economic model and the entire benefit just within our world - not including what happens at licensees and within the wineries world or manufacturers world - is about $700 million of an economic impact for us.

MR. MAGUIRE: That's it for me. I appreciate you coming out today, thank you.

MR. CHAIRMAN: Are there any more questions from the Liberal caucus?

I just want to give you the opportunity to provide some concluding remarks if you so choose.

MR. MITCHELL: I just want to thank you again for the opportunity to come and have a chance to explain where the NSLC is and talk about the things that we're doing. I want to let you know that we have 1,450 very hard-working Nova Scotians who are doing their very best to give you the best retail experience out there. I'm very proud of the team that we have. The customer satisfaction and service scores and retail experience scores that we are delivering are through the roof and that's because Nova Scotians are responding to what we are doing. I have a wonderfully dedicated and focused team and I want you to be very proud of them. Thank you.

MR. CHAIRMAN: The meetings next week will actually be held in the Legislative Committees office in the Johnston building because they're in camera; that is December 3rd. We're going to have the Auditor General's Office and the Subcommittee on Agenda and Procedures.

If there is no other business, I'll now adjourn. Thank you.

[The committee adjourned at 10:43 a.m.]