

**Mount Albert
wants a real**



Briefing Book

Prepared for:

**Members of East Gwillimbury
Town Council**

Prepared by:

The Liquor Board Employees Division
of
The Ontario Public Service Employees Union (OPSEU)

January 26, 2009



Mount Albert Wants a Real LCBO!

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Mount Albert Wants a Real LCBO!

1.0 Executive Summary

The Liquor Board Employees Division of OPSEU represents over six thousand managers and employees who work in Ontario's 604 public LCBO stores. Like the majority of people in Ontario, the Liquor Board Employees are opposed to the privatization of the LCBO.

The rapid expansion of agency stores over the past twelve years (more than doubling from 82 to 216 agency stores) is a form of privatization. The Liquor Board Employees are encouraging the LCBO to stop this expansion and repatriate agency stores that have annual sales exceeding \$500,000.

A recent public opinion poll determined that **two out of three Mount Albert residents** would prefer to have a publicly-operated LCBO store in place of the agency kiosk in Sobeys' Foodland.¹ With alcohol sales exceeding \$3 million per year at this kiosk, a full-service LCBO could easily be supported in Mount Albert.

The most suitable location for a full-service, public LCBO store is on the Sobeys' Foodland lot. It would replace the derelict bakery and would be an excellent complement to Foodland.

The rental revenue that Sobeys would receive from the LCBO would compensate it for the lapsed agency store contract. We estimate annual rental payments of \$65,000 in our financial scenarios.

Mount Albert residents would receive these benefits from a full-service LCBO:

1. **Improved Selection** – Most agency stores carry fewer than 500 products. A full-service LCBO would carry over 1,000 products.
2. **Service** – People enjoy shopping at LCBO stores. Seventy-three percent of LCBO shoppers provided satisfaction ratings of 8 or higher (on a 10 point scale).²
3. **Job Creation** – Two to three full time permanent positions will be created with the opening of the new LCBO. There will also be a number of casual positions created.
4. **Investment** – The new LCBO store will require a capital investment of \$500,000 to \$550,000 from the LCBO.
5. **Municipal Tax Revenue** – The Town of East Gwillimbury will benefit from increased property tax revenues from the property.
6. **Economic Multipliers** – Opening a full-service LCBO will create economic multipliers of two to three times. This means that the money the LCBO spends on rent, wages, municipal taxes, utilities, and other products and services will multiply from \$450,000 to over \$1 million in the local economy.
7. **Social Responsibility** – The LCBO's social responsibility mandate is integral to its operation. Last year LCBO staff challenged more than two million customers (up 11% from the previous year) who appeared to be underage, intoxicated, or were suspected of trying to buy alcohol for a minor or an intoxicated person. Of these challenges, more than 134,000 people were refused service.

¹ Strategic Communications is a professional public polling firm with offices in Toronto and Vancouver – www.stratcom.ca

² LCBO website, March 2008 Customer Satisfaction Survey.

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2.0 Background

The LCBO is a very successful business. In its most recent fiscal year, 2007-08, the LCBO had gross sales of \$4.6 billion, and paid a dividend of \$1.35 billion to its shareholders, the people of Ontario. Every year, the LCBO dividend helps the Ontario government pay for health care, education and other important public services.

The Liquor Board Employees Division (LBED) of the Ontario Public Service Employees Union (OPSEU) represents more than 6,000 store managers and employees who work in the publicly-operated LCBO retail stores across Ontario. LCBO stores vary in size from 2,500 to 30,000 square feet, with a wide range of annual sales – from \$300,000 to \$37 million.

The LCBO provides communities across the province with access to a wide range of alcohol products and exceptional customer service through its network of 604 retail stores. As a public agency, the LCBO also plays an important role in ensuring that alcohol is sold safely, legally and responsibly. In 2007-08, LCBO employees challenged more than two million customers (up 11% from the previous year) who appeared to be underage, intoxicated, or were suspected of trying to buy alcohol for a minor or intoxicated person. Of these challenges, more than 134,000 people were refused service. Over eighty percent of these refusals were people who could not prove that they were nineteen or older.³

When the LCBO introduced the agency store program in 1962, the idea was to provide service to communities in northern Ontario that did not have a nearby LCBO store. Rather than building stand alone LCBO stores, the LCBO signed five-year contracts with existing privately-owned grocery stores, general stores and outfitters to sell spirits, wine and beer. The program grew steadily, and by 1995 there were eighty-two contracted agency stores with average store sales of \$230,000 per year.

In the mid-1990s, the agency store program was expanded into **southern Ontario**, with the opening of twenty-five additional private agency stores. In 2001, the pace increased, and by 2003 the number of agency stores had almost doubled to 155. Chart 1 shows the growth of private agency stores from 1995 to 2007.

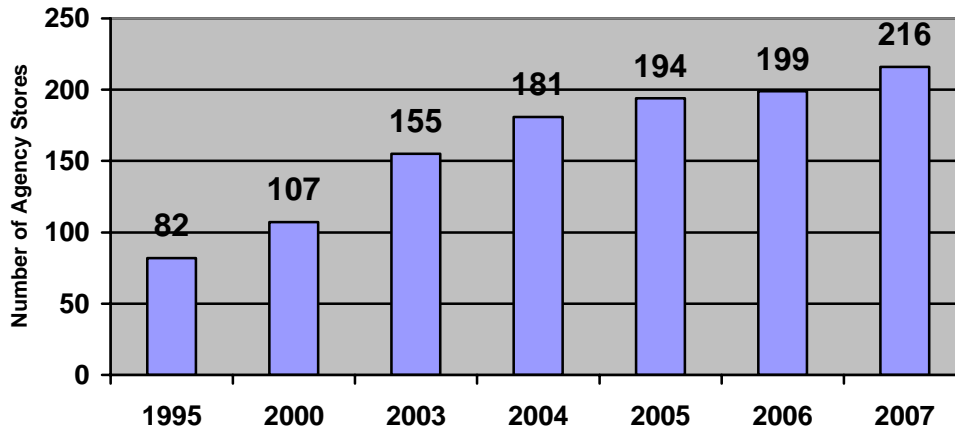
Today, there are 216 agency stores in operation, with average sales of \$720,000 per annum. In other words, the agency store program has been significantly expanded beyond its original intent for small Northern communities.

The Liquor Board Employees do not oppose small agency stores in Northern Ontario markets. They oppose the privatization of alcohol sales through expanding agency stores in large southern Ontario markets that could easily support a publicly-owned LCBO store.

³LCBO News Release, May 21, 2008 and LCBO Annual Report 2006-2007.

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**Chart 1: Private Agency Store Growth
1995 to 2007**



In March 2007, the Liquor Board Employees released a financial analysis of the LCBO's agency store program: *LCBO Agency Store Repatriation - A Financial Analysis* (Rhythm Communications, March 2007 – Please refer to Appendix 2 for a copy of the report). This report was based on financial information provided by LCBO management and identified eighty-nine agency stores in southern Ontario that are good candidates for repatriation by the LCBO.

This does not mean the government of Ontario would expropriate these private businesses. It simply means that the LCBO would allow its current contracts with these retailers to expire, at which point it would open up a full-service LCBO store in that community. **These new LCBO stores would be *combination stores* (selling wine, spirits and beer), just like the ones currently operating in 175 communities across Ontario.**

The eighty-nine agency stores identified for repatriation have annual sales in the range of \$575,000 to \$3.3 million per year, for total current sales of \$107 million per annum. Overall, about 46% of these sales are from wine and spirits and 54% are from beer.

LCBO's net sales to these agency stores is \$44 million per annum (fiscal year 2005-6), including wine, spirits and imported beer, or 41% of the total sales of these stores. All agency stores in Ontario operate on the basis of a five year contract, and the LCBO provides a 10% discount off the retail price. The current level of profits for LCBO sales to these eighty-nine agency stores is approximately \$20 million per annum.

Like all agency stores in southern Ontario, these eighty-nine stores purchase domestic beer directly from the foreign-owned Beer Store. For this analysis, it was assumed that the repatriated agency stores would operate as LCBO combination stores, with domestic beer sales revenue flowing through the LCBO.

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If these eighty-nine agency stores were immediately repatriated, the LCBO would recognize an additional \$16 million in annual profit, for an incremental return on investment (ROI) of 43%.

3.0 Mount Albert Public Opinion Survey

Between August 27 and September 13, 2008, Strategic Communications (a polling firm with offices in Toronto and Vancouver) conducted a public opinion survey with Mount Albert residents. A random sample of 151 residents (aged 19 or over) were interviewed by telephone.

Two out of three Mount Albert residents support opening a publicly owned LCBO store in place of the Sobeys' Foodland agency store in their community.⁴ The reasons why:

1. Better selection and service.
2. Economic benefits to the community – job creation and taxes.

In addition to these direct benefits to their community, there were three other main reasons for replacing the existing Foodland agency store with a publicly-owned LCBO store. The residents were asked the following three questions:

1. The LCBO is owned by the people of Ontario, and it generates over \$1.3 billion dollars every year to help to pay for our public health care and public schools. Do you agree or disagree that this is a good reason to open a publicly owned LCBO store in your community?
2. The LCBO has won over 200 awards for being a top-notch retailer, and the LCBO supports the growth and development of small local wine and craft beer producers by buying and promoting their products. Strengthening the LCBO is good for Ontario's consumers and businesses alike. Do you agree or disagree that this is a good reason to open a publicly owned LCBO store in your community?
3. The Liquor Control Board of Ontario (LCBO) employees are trained to refuse sales to minors or intoxicated individuals. Last year, LCBO staff challenged 1.8 million people who appeared underage or intoxicated. Do you agree or disagree that this is a good reason to open a publicly owned LCBO store in your community?

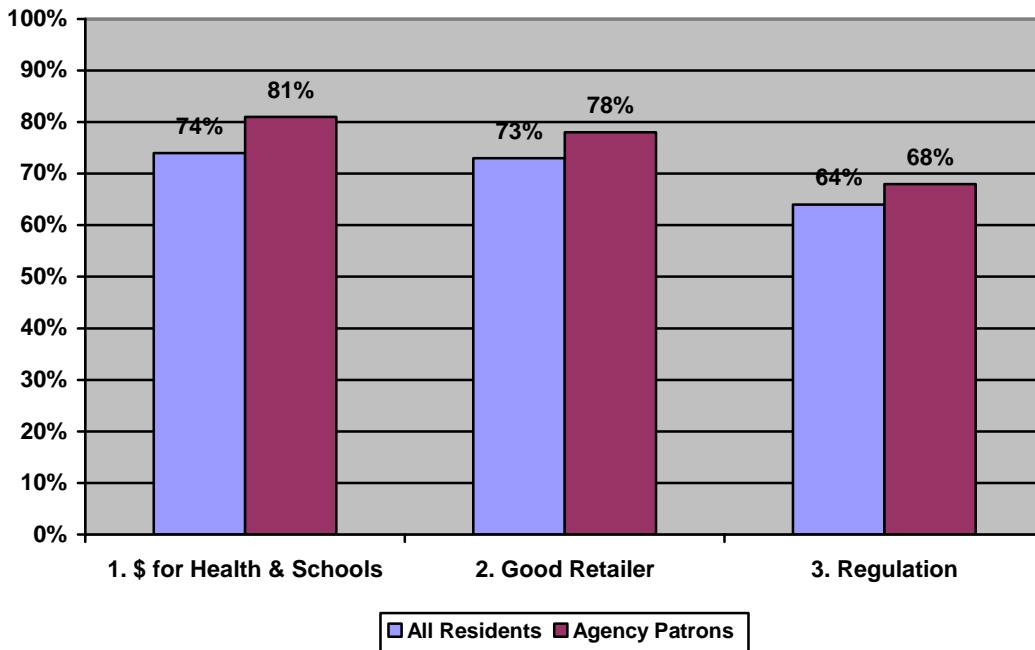
The Mount Albert residents were asked to provide an answer on a five point scale where 1 is strongly disagree, 2 is somewhat disagree, 3 is neither agree nor disagree, 4 is somewhat agree and 5 is strongly agree. Their answers were grouped into these ratings and frequency distributions (the percentage of respondents who provided various answers from strongly agree to strongly disagree).

Chart 2 shows the frequency of Mount Albert residents' reasons for supporting a publicly-owned LCBO store in place of the Sobeys' Foodland agency store (questions 1 to 3 above).

⁴ The overall results are considered accurate to within $\pm 8\%$, 19-times-in-20, of what they would have been if the entire population of those 19+ in Mount Albert had been interviewed. This data was statistically weighted to ensure that the sample's gender and age composition reflects that of the actual population (19+) of Mount Albert, according to the 2006 Census.

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Chart 2: Mount Albert Residents' Support for a Public LCBO Store



Seventy-four percent of all Mount Albert residents and 81% of the Foodland agency store customers either strongly agree or somewhat agree with question 1 above. They support a public LCBO store in Mount Albert because the LCBO provides \$1.3 billion each year to help cover public health care and public education costs in Ontario.

For question 2, 73% of Mount Albert residents and 78% of Foodland agency store customers support having a public LCBO store in their community because the LCBO is a good retailer that supports small local wine and craft beer producers.

Finally, question 3 responses show that 64% of Mount Albert residents (and 68% of the Foodland agency store patrons) support a public LCBO store because LCBO employees are trained to refuse sales to intoxicated or underage customers.

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4.0 Community Benefits

The residents of Mount Albert clearly understand the community benefits from opening a full-service public LCBO store. These benefits include better selection and customer service, job creation, investment in the local economy, increased municipal tax revenue, economic multipliers, and enhanced social responsibility.

Mount Albert agency store customers would like to have a better selection of wine, spirits and beer. Most agency stores carry fewer than 500 products. The Sobeys' Foodland agency store in Mount Albert carries about 700 products. A public, stand alone LCBO store in Mount Albert would carry over 1,000 products.

People enjoy shopping at LCBO stores. Seventy-three percent of LCBO shoppers provide exceptional satisfaction ratings of 8 or higher (on a 10 point scale – March 2008). Liquor Board Employees are well trained and are well known for their exceptional product knowledge and friendly service.

Two to three full time permanent positions will be created with the opening of the new Mount Albert LCBO store. There will also be a number of casual positions created. All of these positions will pay good wages, in the range of \$19 to \$28 per hour.

We are estimating that the new LCBO store in Mount Albert will require a capital investment of \$500,000 to \$550,000 from the LCBO. This estimate is based on LCBO financial information. The actual amount of investment will depend on the negotiations between Sobeys and LCBO for the stand alone LCBO store that will hopefully be built on the Foodland lot in place of the derelict bakery.

The Municipality of East Gwillimbury will benefit from increased property tax revenues from the property.

In addition to the direct economic benefits discussed above, opening a full-service LCBO store will create economic multipliers of two to three times. This means that the money the new LCBO store spends on rent, wages, municipal taxes, utilities, and other products and services will multiply from \$450,000 to over \$1 million in the local economy.

The LCBO's social responsibility mandate is integral to its store operations. Last year LCBO staff challenged more than two million customers (up 11% from the previous year) who appeared to be underage, intoxicated, or were suspected of trying to buy alcohol for a minor or intoxicated person. Of these challenges, more than 134,000 people were refused service. As a publicly owned business, there is no incentive to sell alcohol to minors or intoxicated individuals.

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5.0 The Business Case

In addition to the public support for opening a full-service LCBO in Mount Albert, there is a strong business case (please refer to Appendix 1 for the detailed business case):

1. Sales at the Foodland agency store currently exceed \$3 million per annum and would readily support a stand alone, full-service LCBO store.
2. The best location for a full-service LCBO store is on the same lot as the Sobeys Foodland store on highway 48, replacing the derelict bakery building.
3. The LCBO has the investment capital required to open a full-service LCBO store in Mount Albert.
4. The LCBO can easily meet its minimum return on investment target of 12%.
5. The current contract between Sobeys and the LCBO expires on November 30, 2009.
6. The net income Sobeys would lose from alcohol sales would be replaced by a long-term lease for a stand alone LCBO store on its Foodland lot.

6.0 Timeline

If we work backwards from November 30, 2009, the LCBO will need to begin negotiations with Sobeys for the new store location on the Foodland lot in March or April to ensure construction can be completed over the summer in time for the grand opening on December 1, 2009.

7.0 Town of East Gwillimbury

The Liquor Board Employees are asking the Town of East Gwillimbury Municipal Council to pass a resolution to support opening a publicly-owned LCBO store when the current agency store contract with Sobeys expires.

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Appendix 1: The Business Case

The Foodland store in Mount Albert is owned by Sobeys – Canada’s second largest food retailer, with annual gross revenue of \$13 billion. Ten years ago, when Sobeys purchased Oshawa Foods, the downtown Mount Albert IGA store was included. The new Foodland store on highway 48 was opened eight years ago and replaced the old downtown IGA store.

The LCBO Agency Store contract was awarded to the Mount Albert Foodland store four years ago. Previously, it had been held by a convenience store in downtown Mount Albert. The Agency Store contract with Sobeys expires November 30, 2009.

1.0 Location

Location is a key decision for a successful retail operation. Three potential locations were evaluated for a new public LCBO store in Mount Albert:

1. Foodland Lot – Highway 48
 - Owned by Oshawa Property Holdings Inc. (Sobeys)
 - Ease of entry and exit – streetlights at entrance on Highway 48
 - Ample parking
 - Replace the derelict bakery with a new LCBO store
2. 4.41 acre lot south of Foodland – south on 48
 - Listed selling price is \$699,900 – as of December 2008.
 - On market since August 15, 2008 (tried to sell 15 years ago)
 - Zoned commercial & open-storage industrial (back corner)
 - Fully serviced with town water & sewer
 - Property taxes are \$6,300 per year
3. Downtown
 - Parking is a problem downtown
 - Less traffic compared to Highway 48
 - Nothing suitable currently available



The most suitable location for a new full-service LCBO store is on the Sobeys’ Foodland lot. A public LCBO store would be a good complement to the Foodland grocery store. The photograph on the left shows a derelict bakery that could be raised to make room for a new full-service LCBO store.

The rental revenue that Sobeys would receive from the LCBO would compensate it for the lapsed agency store contract.

In addition, the LCBO would be in a position to invest between \$500,000 and \$550,000 in leasehold improvements, equipment and shelving; thereby decreasing the capital cost requirements for Sobeys in building a new 3,500 square foot store.

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2.0 Financial Forecasts

Table 1 shows various financial scenarios for the opening of a public LCBO store to replace the existing Foodland agency store. These forecasts are based on financial data provided by LCBO management in February 2007.

Table 1: Forecasted Income Statements for a Public LCBO Store – Mount Albert

Net Sales	LCBO Scenarios (2006)		Rhythm Communications (2009)		
	Combo	Modified	Best	Likely	Worst
Spirits & Wine	\$1,602,609	\$1,602,609	\$2,243,653	\$2,003,262	\$1,843,001
Beer	1,651,499	1,651,499	2,312,099	2,064,374	1,899,224
Total Net Sales	\$3,254,109	\$3,254,109	\$4,555,752	\$4,067,636	\$3,742,225
% Increase	0%	0%	40%	25%	15%
Cost of Goods Sold	1,744,615	2,198,777	2,442,461	2,180,769	2,528,594
Gross Margin	\$1,509,494	\$1,055,331	\$2,113,291	\$1,886,867	\$1,213,631
Gross Margin %	46.4%	32.4%	46.4%	46.4%	32.4%
Operating Expenses:					
Salary & Benefits	\$230,000	\$230,000	\$296,124	\$280,667	\$265,698
Occupancy Costs	52,000	52,000	65,000	65,000	65,000
Depreciation expense	45,000	45,000	50,000	50,000	55,000
Other expenses	35,000	35,000	50,113	44,744	41,164
Total Expenses	\$362,000	\$362,000	\$461,237	\$440,411	\$426,862
Expense %	11.1%	11.1%	10.1%	10.8%	11.4%
Net Income	\$1,147,494	\$ 693,331	\$1,652,054	\$1,446,456	\$ 786,769
Income %	35.3%	21.3%	36.3%	35.6%	21.0%
LCBO Profit - Agency	\$705,148	\$705,148	\$705,148	\$705,148	\$705,148
Incremental Profit	\$442,346	-\$11,817	\$946,906	\$741,308	\$81,621
Incremental ROI	98.3%	-2.6%	189.4%	148.3%	14.8%

The two LCBO scenarios were created by the LCBO's finance department. They used the actual 2006 net sales from the Sobeys' Foodland Mount Albert agency store (gross sales were \$3.9 million – including PST and GST). The LCBO did not include any increase in sales as a result of opening a new LCBO store. This is not a reasonable assumption (inflation is currently 2.6%), so we have included three scenarios (Best, Likely, and Worst Cases) with realistic and attainable sales increase percentages.

LCBO management used a gross margin of 46.4% as a percentage of net sales (54% on wine and spirits and 39% on beer) for their forecasts. In the most recent fiscal year, the LCBO gross margin was 48.9%. The "Modified" and "Worst" case scenarios use a gross margin of 32.4%, because the gross margin on beer sales declines from 39% to 11.5%. In other words, the foreign-owned Beer Store benefits from these sales. The ("Best" and "Likely" case scenarios assume

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that the new LCBO store will be a combination store (like 175 other LCBO combination stores), where the LCBO benefits from full beer sales.

The LCBO's expense forecasts are based on their own "store sampling". In other words, they benchmarked the expenses as a percentage of net sales, resulting in total operating expenses of 11.1% (including depreciation on capital investment). The actual expense ratio for LCBO combination stores of a similar size has historically been in the range of 10.2% to 10.4% (from data supplied by the LCBO).

Our expense forecasts are based on actual wage rates and benefits for employees and the hours required to keep the store open for a double shift, plus additional casual labour. The other operating costs (occupancy, depreciation and other costs) are higher than the LCBO's estimates. In the end, our expense forecasts are more generous and therefore more "conservative" than the LCBO's.

The bottom line in every case (except the LCBO's "Modified Combo") is a healthy net income and a significant incremental profit for the LCBO by opening its own store. Even in the "Worst" case, there is an incremental profit and a return on investment (14.8%) that exceeds the LCBO's minimum ROI target of 12%.

Table 2 shows the forecasted capital investment that would be required to open a new LCBO store in Mount Albert. In fiscal 2007-8, the LCBO invested \$37 million in capital improvements to its stores (renovations, relocations, etc.).

Table 2: Forecasted Capital Investment for a Public LCBO Store – Mount Albert

Capital Investment	LCBO Scenarios (2006)		Rhythm Communications (2009)		
	Combo	Modified	Best	Likely	Worst
Leaseholds	\$200,000	\$200,000	\$250,000	\$250,000	\$275,000
Equipment & Shelving	\$250,000	\$250,000	\$250,000	\$250,000	\$275,000
Total Capital	\$450,000	\$450,000	\$500,000	\$500,000	\$550,000
Retail square footage	3,500	3,500	3,500	3,500	3,500
Cost per square foot	\$129	\$129	\$143	\$143	\$157
Occupancy Cost/Ft ²	\$14.86	\$14.86	\$18.57	\$18.57	\$18.57

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Table 3 provides an overview of the forecasted staffing required for a full-service combination LCBO store. The Best, Likely and Worst case scenarios include an 8% wage and benefit increase over the 2006 rates.

Table 3: Forecasted Staffing for a Public LCBO Store – Mount Albert

Staffing - Hours	LCBO Scenarios (2006)		Rhythm Communications (2009)		
	Combo	Modified	Best	Likely	Worst
Manager	2,080	2,080	2,080	2,080	2,080
Full-time (2 CSR)	4,160	4,160	4,160	4,160	4,160
Casual	2,773	2,773	5,198	4,412	3,652
Staffing - Hourly Wage					
Manager	\$26.67	\$26.67	\$28.80	\$28.80	\$28.80
Full-time	\$23.81	\$23.81	\$25.71	\$25.71	\$25.71
Casual	\$18.22	\$18.22	\$19.68	\$19.68	\$19.68
Staffing - Salaries:					
Manager	\$55,474	\$55,474	\$59,911	\$59,911	\$59,911
Full-time (2 CSR)	\$99,050	\$99,050	\$106,974	\$106,974	\$106,974
Casual	\$50,515	\$50,515	\$102,280	\$86,823	\$71,854
Benefits (20% & 14%)	\$24,962	\$24,962	\$26,959	\$26,959	\$26,959
Total Staffing Costs	\$230,000	\$230,000	\$296,124	\$280,667	\$265,698
Staffing Cost % of Sales	7.1%	7.1%	6.5%	6.9%	7.1%

This level of staffing would allow the new full-service LCBO store to be open for 85 hours per week, the same number of hours allowed in the current agency store contract.

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Appendix 2: LCBO Agency Store Repatriation – A Financial Analysis

Written by Russ Christianson, President
Rhythm Communications

Prepared for Ontario Public Service Employees Union – March 2007

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1.0 Executive Summary

Introduction

The Liquor Control Board of Ontario (LCBO) provides communities across the province with access to a wide range of alcohol products and exceptional customer service through its network of 598 publicly-owned retail stores. As a public agency, the LCBO also plays an important role in ensuring that alcohol is sold safely, legally and responsibly.

The LCBO is a very successful business. In its most recent fiscal year, 2005-06, the LCBO had gross sales of \$4.3 billion, and paid a dividend of \$1.2 billion (all of its net income) to its shareholders, the people of Ontario.⁵ Every year, the LCBO dividend helps the Ontario government pay for health care, education and other important public services.

This report provides a financial analysis of the LCBO's private agency store program, and the potential for replacing high-volume agency stores with publicly-owned LCBO outlets.

Agency stores are private retailers who sell LCBO products as an add-on to their core business. These private retailers include grocery stores, convenience stores, general stores, marinas, gas stations and outfitters. The LCBO grants them the right to sell spirits, wine and beer for a five year contract period. Once contracted, the LCBO supplies these private retailers and gives them a 10% discount off the retail price set by the LCBO.

The agency store program was introduced in 1962 as a way to service northern Ontario communities that did not have an LCBO store close by. Over the next three decades, the program reached a stable level of 82 stores, with average annual sales of \$230,000 per store.

In the mid-1990s, the Conservative government shifted gears and began expanding the agency store program into **southern Ontario**. In 2001, the government increased the pace, approving a plan to open 150 new agency stores over several years. A total of 50 new agency stores were opened in 2003. The rapid expansion of the agency store program continued after the election of the Liberal government in October 2003, with 39 new stores opening in 2004 and 2005. Over the 10 years from 1995 to 2005, the number of contracted agency stores more than doubled, and sales tripled. In May 2006, the government announced plans to open another 20 agency stores – all of them in southern Ontario. When fully implemented, this will bring the total number of private agency stores to 219.

The Ontario Public Service Employees Union (OPSEU) represents more than 6,000 employees who work in the LCBO's 598 publicly-operated stores across Ontario. LCBO stores vary in size from 2,500 to 30,000 square feet, with a wide range of annual sales – from \$300,000 to \$37 million. The average annual gross sales level for LCBO stores was \$7.2 million in 2005-06.

OPSEU opposes the accelerating growth in the number agency stores. The union believes that this represents a form of gradual privatization that threatens to erode the LCBO's social

⁵LCBO Annual Report 2005-06

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responsibility mandate and its long-term future as a public agency. In an effort to understand the economics of the agency store program and the potential for bringing these sales back to the LCBO (by opening LCBO stores as appropriate), OPSEU contracted Russ Christianson, President of Rhythm Communications, to perform this financial analysis.

Financial Analysis

Using financial data provided by the LCBO, Russ Christianson and OPSEU have identified **89 agency stores that could be profitably “repatriated.”** As the contracts expire over the coming years, the LCBO could replace these private stores with LCBO stores.

These 89 contracted agency stores currently have:

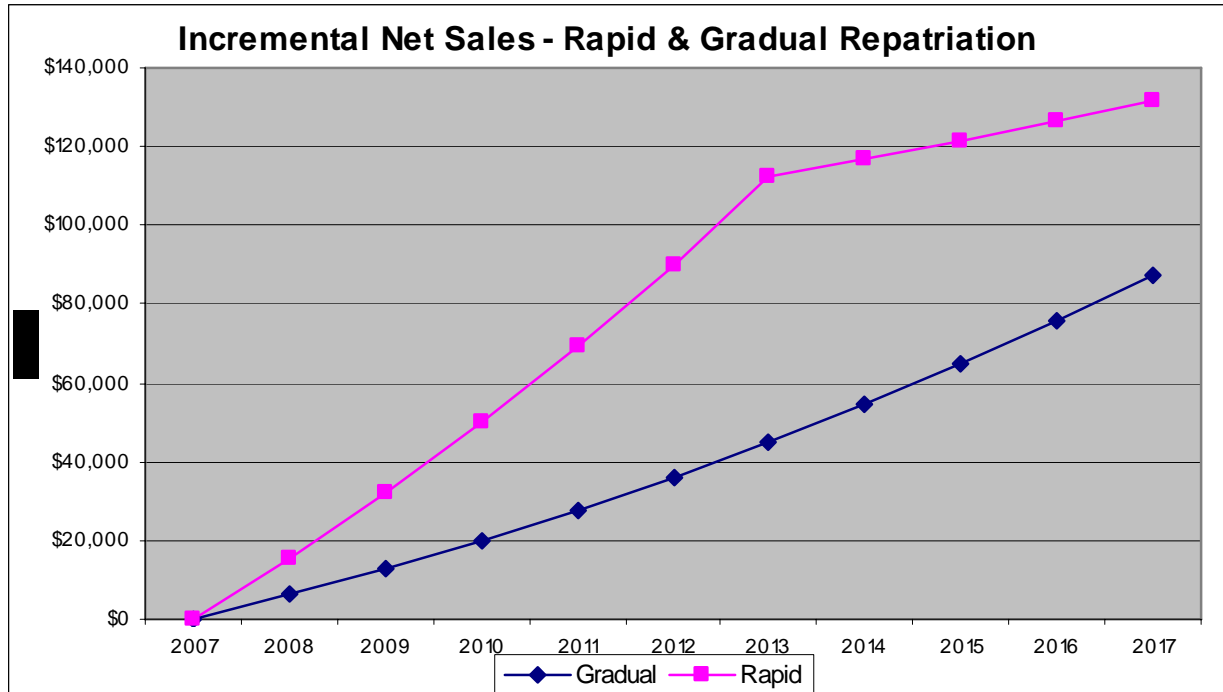
- total alcohol sales of \$107 million per year
- annual per store sales in the range of \$575,000 to \$3.3 million
- average annual sales of \$1.2 million per store.

If the LCBO repatriated the sales from these 89 stores today, it would benefit from an additional \$16.2 million in profit this year, for an incremental return on investment (ROI) of 43.1%.

To further understand the financial implications of repatriating these agency contracts, three financial scenarios were developed. The first scenario, *Status Quo*, is used as the financial benchmark. In this scenario, the agency store program is allowed to grow by five additional stores each year over the next decade. Scenario two, *Gradual Repatriation*, has six agency store contracts being brought home to the LCBO each year, resulting in 60 new LCBO stores over 10 years. The third scenario, *Rapid Repatriation*, is more ambitious, with 15 agency store contracts being repatriated over the next six years, for a total of 90 new LCBO stores.

The following graphs below show the incremental financial benefits that would accrue to the LCBO and to the people of Ontario by repatriating 60 to 90 agency store contracts. The numbers in the graphs are calculated by taking the difference (or increment) between the *Status Quo* scenario and the two repatriation scenarios. All of these scenarios are based on conservative financial assumptions.

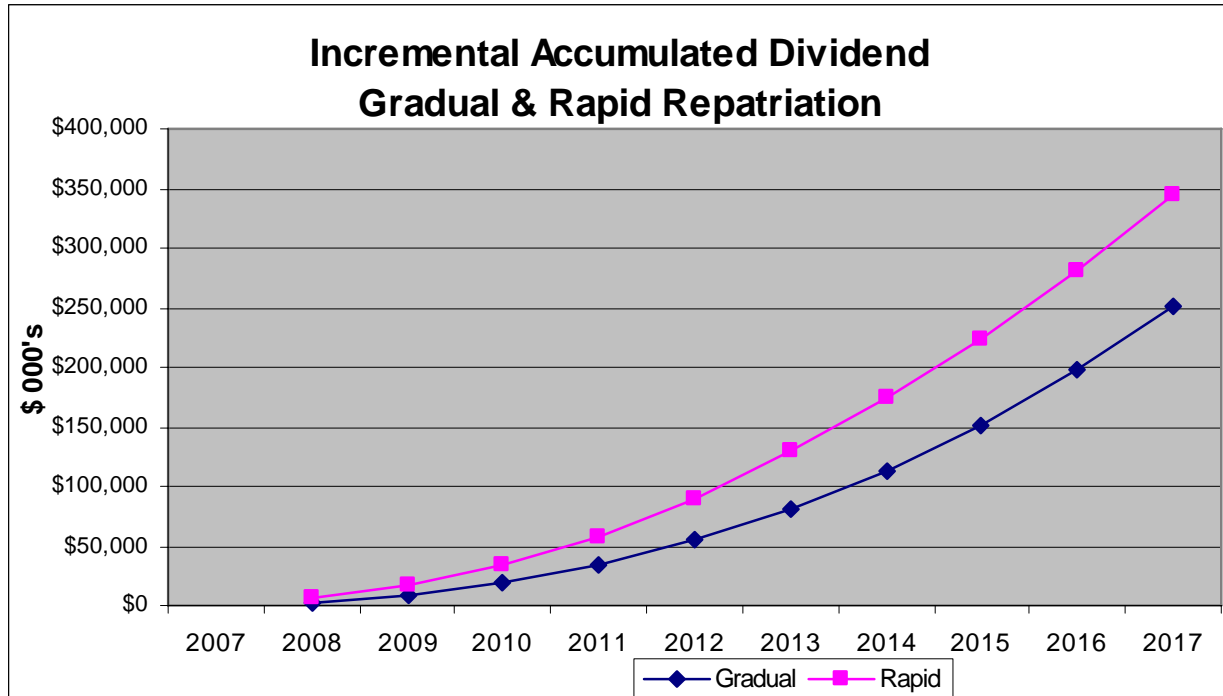
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This graph shows the year-by-year increase in incremental LCBO net sales that could result from repatriating 60 to 90 agency store contracts. Rapid repatriation (90 stores over six years) results in an additional \$131 million in annual LCBO sales by 2017, while gradual repatriation (60 stores over 10 years) adds \$87 million in LCBO sales by the tenth year.

The following chart shows the incremental, accumulated dividend that will result from the repatriation of the agency store contracts in the two scenarios. **By repatriating the sales from these privately-owned stores, the LCBO could provide \$250 to \$340 million more in cash dividends to the provincial government over the next 10 years.**

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Conclusion

The Ontario government has the opportunity to profitably increase the LCBO's sales by reversing its recent decisions to rapidly expand the number contracted private retailers. Instead of increasing contracted agency stores, the province could allow the existing contracts to expire, opening the door for 60 to 90 new LCBO stores. These new LCBO stores would increase the LCBO's net income and the dividend paid to its owners – the people of Ontario – by \$250 to \$340 million over the next 10 years.

Communities across Ontario that gain a new LCBO store will directly benefit from the capital investment (\$325,000 to \$450,000 per store) and jobs created. The LCBO provides a good wage (\$18 to \$26 per hour) and secure employment, and it has an excellent employee training program.

In addition to these direct economic benefits, the repatriation of LCBO stores will also create economic multipliers in these communities of 2 to 3 times. This means that the money the new LCBO stores spend locally on rent, wages, municipal taxes, utilities, and other products and services will multiply from:

- \$111,000 to \$334,000 per year for a store with \$800,000 in sales
- \$142,000 to \$426,000 per year for a store with \$1.2 million in sales
- \$210,000 to \$630,000 per year for a store with \$2 million in sales

And of course, repatriation of these private agency stores will also deliver other benefits to the each community, including better selection and customer service, and enhanced social responsibility.

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2.0 Background

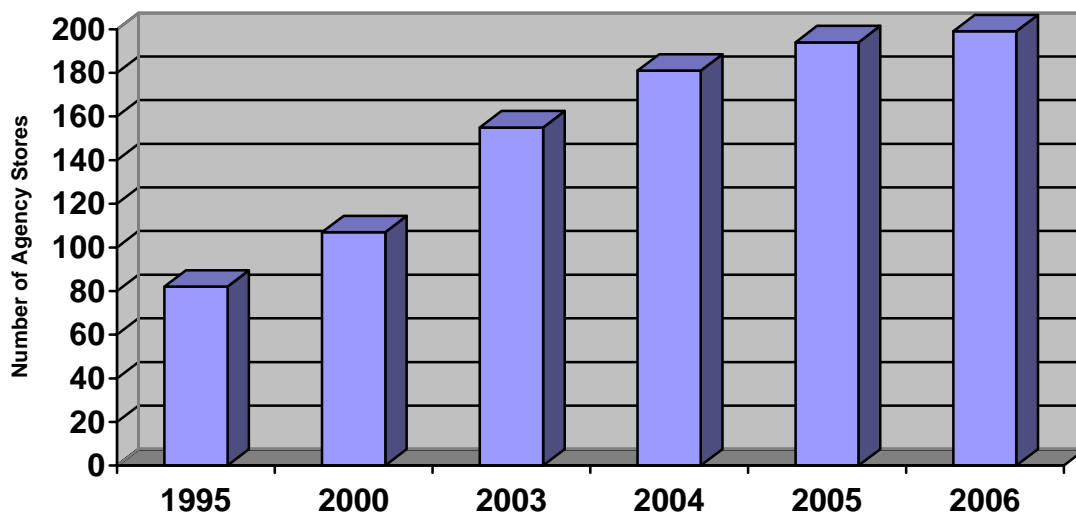
As a starting point, it is important to understand the history of LCBO contracted agency stores. When the LCBO introduced the agency store program in 1962, the idea was to provide service to communities in northern Ontario that did not have a nearby LCBO store. Rather than building stand alone LCBO stores, the LCBO signed five-year contracts with existing privately-owned grocery stores, general stores and outfitters to sell spirits, wine and beer. The program grew steadily, and by 1995 there were eighty-two contracted agency stores with average store sales of \$230,000 per year.

In the mid-1990s, the Conservative government shifted gears and began expanding the agency store program into **southern Ontario**. In 2001, the government increased the pace, approving a plan to open 150 new agency stores over several years. A total of 50 new agency stores were opened in 2003. The rapid expansion of the agency store program continued after the election of the Liberal government in October 2003, with 39 new stores opening in 2004 and 2005. Today, there are 199 agency stores in operation, with average sales of \$720,000 per annum.

In May 2006, the government announced plans to open another 20 agency stores – all of them in southern Ontario. When fully implemented, this will bring the total number of private agency stores to approximately 219.

In other words, the agency store program has been significantly expanded beyond its original intent. Over the last four years, the number of agency stores has doubled, and over the 11 years from 1995 to 2006, agency store revenue has tripled.

Private Agency Store Growth 1995 to 2006



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To better understand the economic implications of this rapid growth in contracted, privately-owned agency stores, the Ontario Public Service Employees Union (OPSEU) contracted Russ Christianson, President, Rhythm Communications to:

1. Perform a financial analysis of the LCBO and its commercial relationship with privately-owned agency stores.
2. Determine the potential for agency store repatriation and the financial implications for the LCBO and the Province of Ontario.

Russ Christianson is a management consultant with 25 years of experience in various sectors, including retail, wholesale distribution, manufacturing, and service industries. He graduated from Queen's Commerce in 1981, and completed a Masters of Industrial Relations at the University of Toronto in 1983. (Please refer to Appendix 1 for Russ Christianson's Resume).

3.0 Methodology

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

- *LCBO Annual Reports – 2005-6 and 2004-5.*
- LCBO and Ontario Government websites.
- *Standing Committee on Government Agencies – Report on Agencies, Boards and Commissions, The Liquor Control Board of Ontario, Legislative Assembly of Ontario (December 2006).*
- *Protecting the Public Interest, The Threat of Privatization and the LCBO's Agency Store Program, Ontario Public Service Employees Union (September 2006).*
- *Beverage and Alcohol System Review (BASR), Report to the Honourable Greg Sobara, Ontario Minister of Finance (July 2006).*
- *Alcohol and Public Health: The Implications of Changes to Ontario's Beverage Alcohol System, Addictions Ontario, Association of Local Public health Agencies, Centre for Addiction and Mental Health, Mothers Against Drunk Driving, Ontario Drug Awareness Partnership, Ontario Public Health Association, Parent Action on Drugs, Toronto Public Health (February 2005).*
- *LCBO Operational Review, Report to the Internal Audit Division of Management Board Secretariat (MBS), Deloitte & Touche LLP (March 2005)*
- *Insights into the Food, Beverage, and Consumer Products Industry. Grocery Manufacturers Association (GMA), Food Products Association (FPA), and Price Waterhouse Coopers (2006)*
- *Serving Ontario Beer Consumers: A Framework for Improved Co-operation & Planning Between the LCBO & BRI (June 2000)*
- *Ontario's Changing Population, Institute of Agri-Food Policy Innovation (October 2006)*
- "Immigration Critical to Canadian Population Growth: Census", CBC news, March 13, 2007

An initial financial analysis was completed by Russ Christianson and was presented at a joint meeting with OPSEU representatives and LCBO executives on February 8, 2007. A follow-up meeting was held with LCBO executives and OPSEU on February 26, 2007, at which LCBO

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representatives provided additional financial data. Over the following weeks, Russ Christianson reviewed the new information provided by the LCBO and integrated it with his original analysis, resulting in the financial model contained in this report.

4.0 Assumptions

The financial model was guided by the following principles:

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

There are a number of underlying assumptions that form the foundation of this financial analysis. The table below provides a summary of the benchmarks that were used to determine the financial results of agency store repatriation on a store-by-store basis.

Table 1: Repatriated Agency Store Financial Benchmarks
(expressed as a percentage of Net Sales)

Total Net Sales	Gross Margin	Salaries & Benefits	Occupancy Costs	Other Costs	Operating Expenses	Depreciation Expense	Net Income
\$1.5 to \$3 million	45.9%	7.1%	1.8%	1.6%	10.5%	1.5 to 3.0%	32.4 to 33.9%
\$1 to \$1.499 million	45.9%	7.8%	2.1%	1.9%	11.8%	2.6 to 3.9%	30.2 to 31.5%
\$750,000 - \$999,000	45.9%	9.5%	2.3%	2.1%	13.9%	3.3 to 4.3%	27.7 to 28.7%
\$500,000 - \$749,000	45.9%	11.5%	2.5%	2.3%	16.3%	4.3 to 6.5%	23.1 to 25.3%

4.1 Net Sales

Net sales are the sales that LCBO contracted agency stores receive from customers – adding back the 10% discount from the LCBO, and deducting the GST and PST. Four categories of stores have been created based on their net sales level. Stores that fall within each of these sales volume categories have similar financial benchmarks (expressed in the table as a percentage of net sales).

The contracted agency stores that have been identified for repatriation in this economic model sell a full range of products – domestic and imported wine, spirits, and beer. The LCBO refers to this type of store as a “combination” store – a store that combines LCBO product lines with a full selection of domestic and imported beer. Currently, 175 of the LCBO’s retail outlets are combination stores.

Agency stores are located within an existing retail store – usually a grocery store or a general store. As these agency stores are repatriated, and stand-alone LCBO stores are opened with enhanced selection and service, it is reasonable to assume that sales will increase. This economic model assumes that sales will increase by 10 percent in the first year of repatriation. Like the other assumptions in this economic model, this is considered to be conservative.

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4.2 Gross Margin

The overall gross margin assumed for this economic model is 45.9%. This is a conservative margin – the LCBO’s gross margin was 48.4% in fiscal 2005, and 48.5% in fiscal 2006⁶. The 45.9% gross margin in this model is based on the contribution margin for each product category. The contribution margin is calculated by taking the sales volume for a product category and multiplying it by the gross margin for each product category. On average, agency stores have 54% of their sales from beer, and 46% from wine and spirits. The gross margin on beer is 39% and the gross margin on wine and spirits is 54% as a percentage of total sales. Therefore, the gross margin for a newly repatriated store is: $54\% \times 39\% + 46\% \times 54\% = 45.9\%$.

As agency stores are repatriated by the LCBO, wine and spirits sales will increase due to better selection and customer service (LCBO’s overall percentage of sales is currently 51% spirits and wine, and 49% beer⁷). Because the margin on spirits and wine is higher than beer, an increase in proportionate sales of spirits and wine will increase the gross margin in each repatriated store.

4.3 Salaries and Benefits

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

4.4 Occupancy Costs

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

4.5 Other Expenses

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

⁶ LCBO Annual Reports 2005 & 2006; LCBO's fiscal year end is March 31.

⁷ LCBO Annual Report 2005-06, page 39.

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4.6 Capital Costs

The table below shows the capital costs required to develop an LCBO store location when an agency store is repatriated. In most cases, the LCBO would lease an existing building and would invest approximately \$130 per square foot in leasehold improvements. To bring in a modular building, we are assuming a higher cost per square foot (20% higher); however, because the depreciation expense is calculated differently, the build option is \$2,500 lower per annum in depreciation expense compared to the leasing option.⁸

Table 2: Capital Costs Required for Agency Store Repatriation

Premises	Capital	\$/Ft ²	Capital	\$/Ft ²	Capital	\$/Ft ²
Leaseholds	\$450,000	\$129	\$390,000	\$130	\$325,000	\$130
Modular	\$550,000	\$157	\$470,000	\$157	\$400,000	\$160
Square Feet	3,500		3,000		2,500	

5.0 Potential Agency Store Repatriation

When the financial benchmarks from section 4.0 are applied to the current list of agency stores, 89 stores are identified for potential repatriation. These 89 stores have annual sales in the range of \$575,000 to \$3.3 million per year, for total current sales of \$107 million per annum, or average sales of \$1.2 million per store per year. Overall, about 46% of these sales are from wine and spirits and 54% are from beer.

Currently, LCBO's net sales to these agency stores is \$44 million per annum (fiscal year 2005-6), including wine, spirits and imported beer, or 41% of the total sales of these stores. All agency stores in Ontario operate on the basis of a five year contract, and the LCBO provides a 10% discount off the retail price. The current level of profits for LCBO sales to these 89 agency stores is approximately \$20 million per annum.

Like all agency stores in southern Ontario, the 89 stores identified in this study purchase domestic beer directly from the Beer Store. For this analysis, it is assumed that the repatriated agency stores will operate as LCBO combination stores, with domestic beer sales revenue flowing through the LCBO.

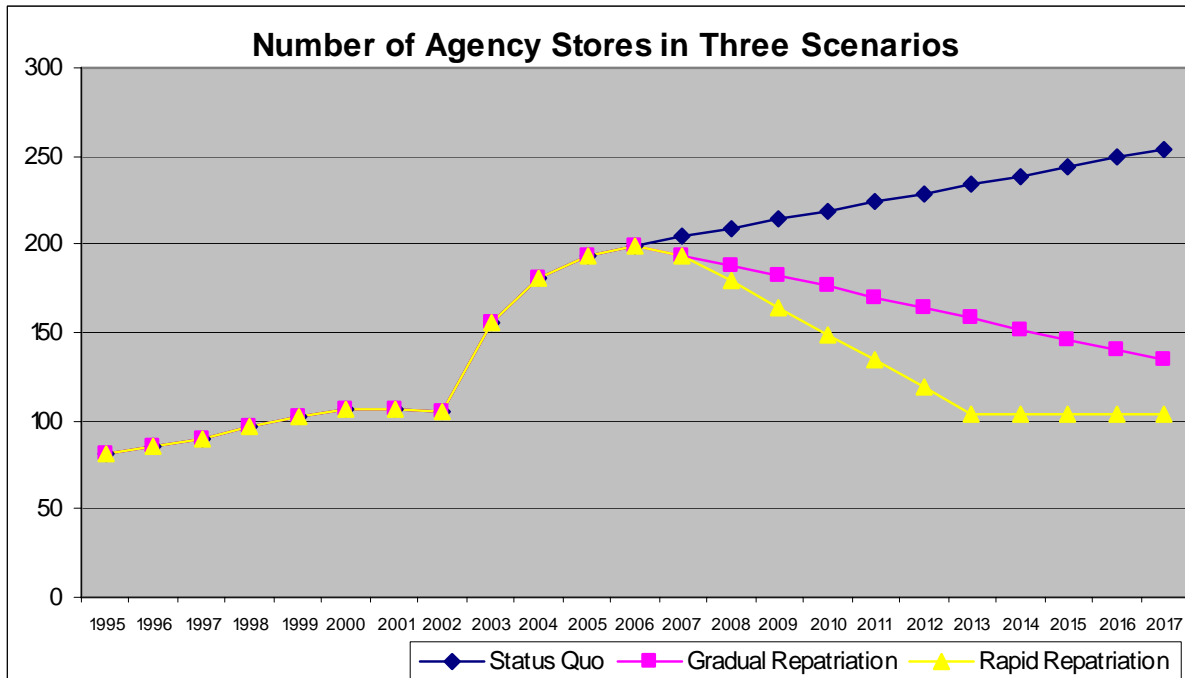
If these agency stores were immediately repatriated by the LCBO, using the conservative assumptions in section 4.0 above, the LCBO would recognize an additional \$16.2 million in profit this fiscal year, for an incremental return on investment (ROI) of 43.1%.

⁸ Depreciation calculations: Lease premises = \$450,000/10 years = \$4,500/annum.
Modular Building = \$250,000/20 years + \$300,000/10 years = \$12,500 + \$30,000 = \$42,500.

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6.0 Financial Scenarios

Three financial scenarios were developed to evaluate the potential impact of repatriating the agency stores over the next 10 years. The first scenario, *Status Quo*, is used as the financial benchmark. In this scenario, the agency store program is allowed to grow by five additional stores each year over the next decade. As shown in the graph below, by the end of 2017, there will be 254 agency stores in scenario one. LCBO will also add one new store per year in this scenario.



Scenario two, *Gradual Repatriation*, has six agency stores being brought home to the LCBO each year, bringing the total number of agency stores down to 134. The third scenario, *Rapid Repatriation*, is more ambitious, with 15 agency stores being repatriated in each of the next six years. This would bring the total number of agency stores back to 104, a number more consistent with the original intention of the agency store program.

Each of the scenarios take into account that the Ontario population is forecasted to grow modestly by 1.5% per year in urban areas, and 1.0% per year in rural areas.⁹ Inflation is also assumed to be modest, with a rate of 1 to 1.5%.

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

⁹ *Ontario's Changing Population*, Institute of Agri-Food Policy Innovation (October 2006).

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Table 3: Financial Benchmarks for Three Scenarios

Financial Benchmark	Status Quo	Gradual Repatriation	Rapid Repatriation
Gross Sales (before repatriation)	4% increase/year	4% increase/year	4% increase/year
Agency Stores	+5/year; 50 more	- 6/year; 60 fewer	-15/year for 6 years; -90
LCBO Stores	1 new store per year; +10	6/year, +60	15/year, +90
Discounts	0.7%	0.7%	0.7%
Gross Margin	48.0%	48.0% to 48.5%	48.0% to 48.5%
Salaries & Benefits	9.1%	9.1%	9.1%
Store Salaries	7.0%	7.0%	7.0%
Total Operating Expenses¹⁰	16.5%	16.5%	16.5%
Other Income	0.5%	0.5%	0.5%

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

In the repatriation scenarios, the gross margin is increased by 0.05% per year, starting in 2008 for rapid repatriation and 2009 for gradual repatriation. This modest gain in margin is a result of improved employee motivation due to the agency store repatriation program. Employees will not only be more productive (thereby helping to control expenses and waste), they will also more readily contribute ideas to improve LCBO operations as a positive response to the concrete expression of the LCBO's commitment to its employees.

¹⁰ This includes depreciation expense.

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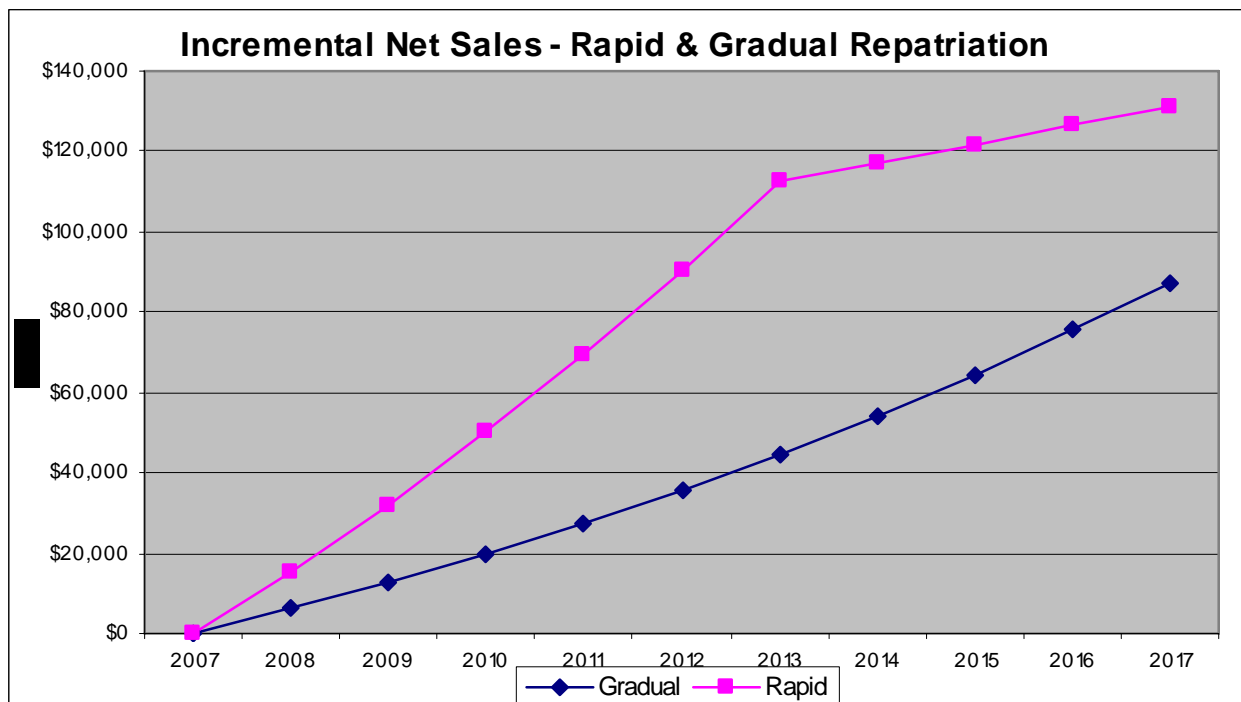
7.0 Incremental Financial Results

Using the *Status Quo* scenario as the benchmark, the incremental improvements in financial performance are shown in the graphs below. For each financial variable, the difference between the status quo and each of the repatriation scenarios is calculated. In other words, the numbers from the status quo scenario are subtracted from the numbers in scenario two and scenario three.

7.1 LCBO Net Sales

In scenarios two and three, the LCBO's net sales have been increased by the current average net sales revenue per agency store (\$1.2 million for the 89 stores identified for repatriation) for each agency store repatriated in 2008. For each subsequent year, this figure is increased by 4% to reflect overall annual sales growth for the LCBO.

The graph below shows the year-by-year increase in incremental LCBO net sales from repatriation. Rapid repatriation results in an additional \$131 million by 2017, while gradual repatriation adds \$87 million in sales by the tenth year. Of course, the rapid repatriation scenario has a much steeper curve as the stores are repatriated more quickly (15 stores per year from 2007 to 2013).

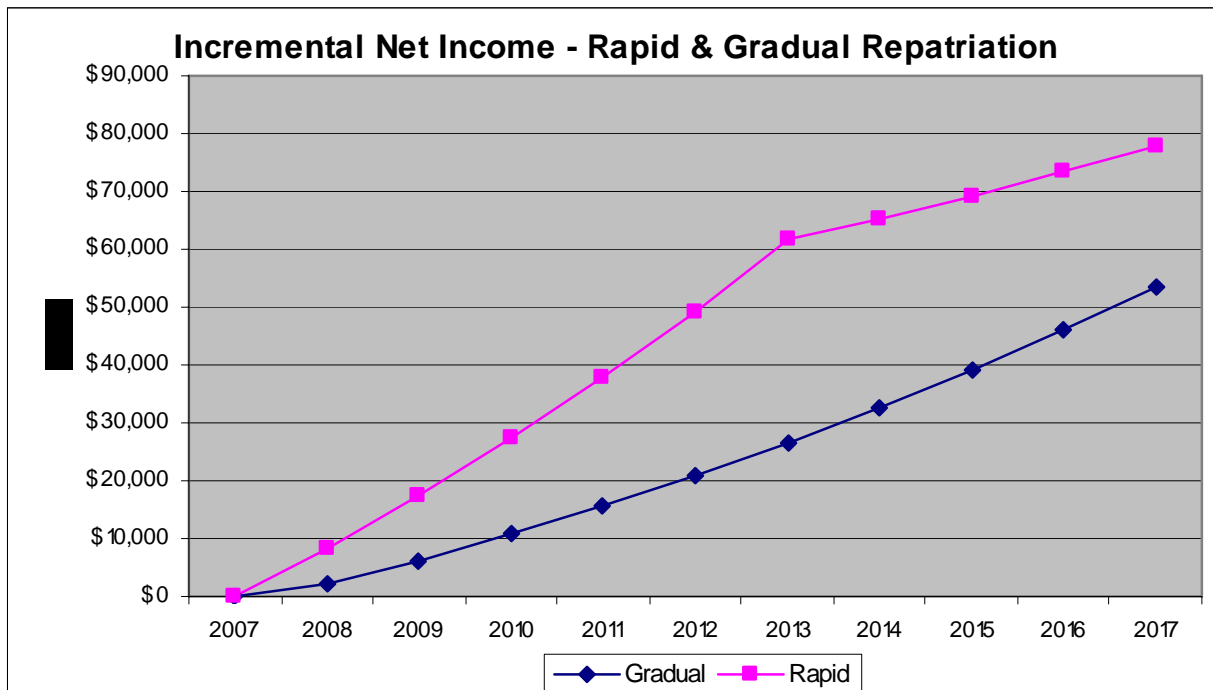


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7.2 LCBO Net Income

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

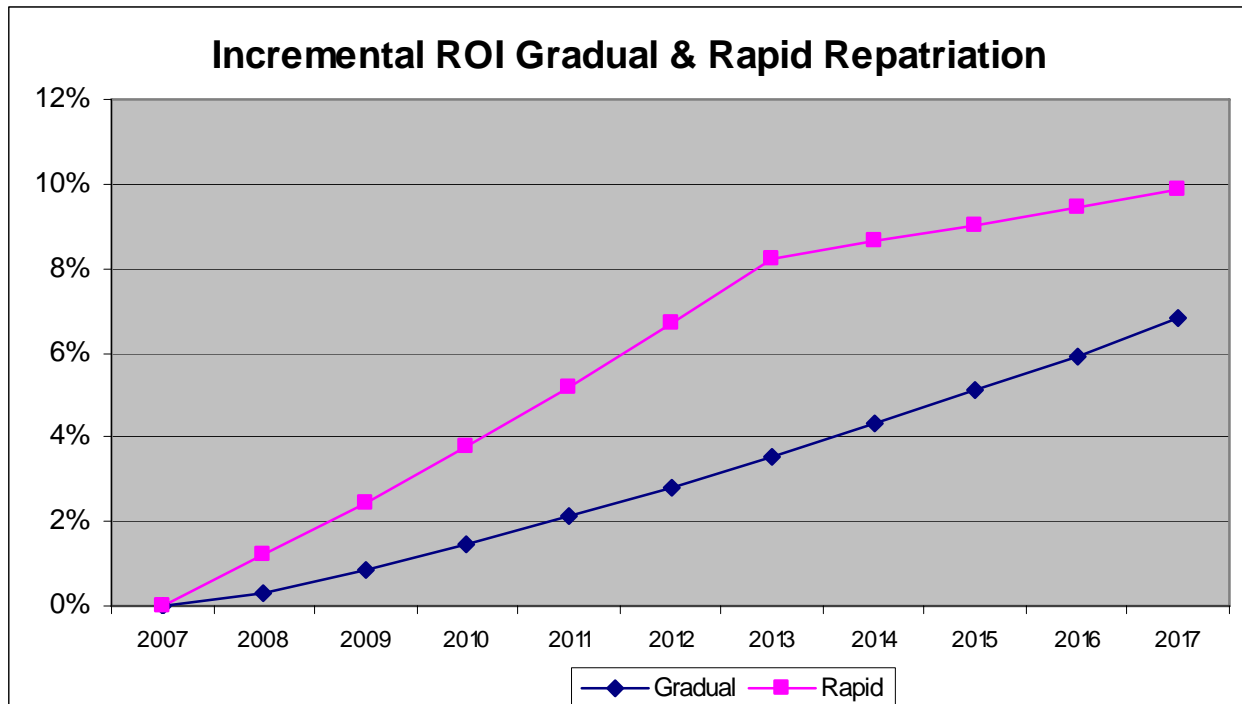
Again, the rapid repatriation scenario naturally has a steeper curve that begins to level off slightly after the sixth year (2013). By the end of the tenth year of agency store repatriation, the LCBO will gain an additional \$54 to \$78 million per annum in net income.



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7.3 LCBO Return on Investment

All three scenarios assume a similar level of new capital investment in the LCBO each year – increasing by \$1 million per year, from \$59 million in 2007 to \$69 million in 2017. As stated in section 4.6, the capital cost of repatriating the stores will be in the range of \$325,000 to \$450,000 per store (\$130 per square foot). In the gradual repatriation scenario, this will require \$2 million to \$3.3 million per year. Rapid repatriation will require \$5 to \$6.5 million per year. Again, the average return on investment for agency store repatriation is 43.1% (a range of 15% to 119% depending on the sales volume of the particular store).



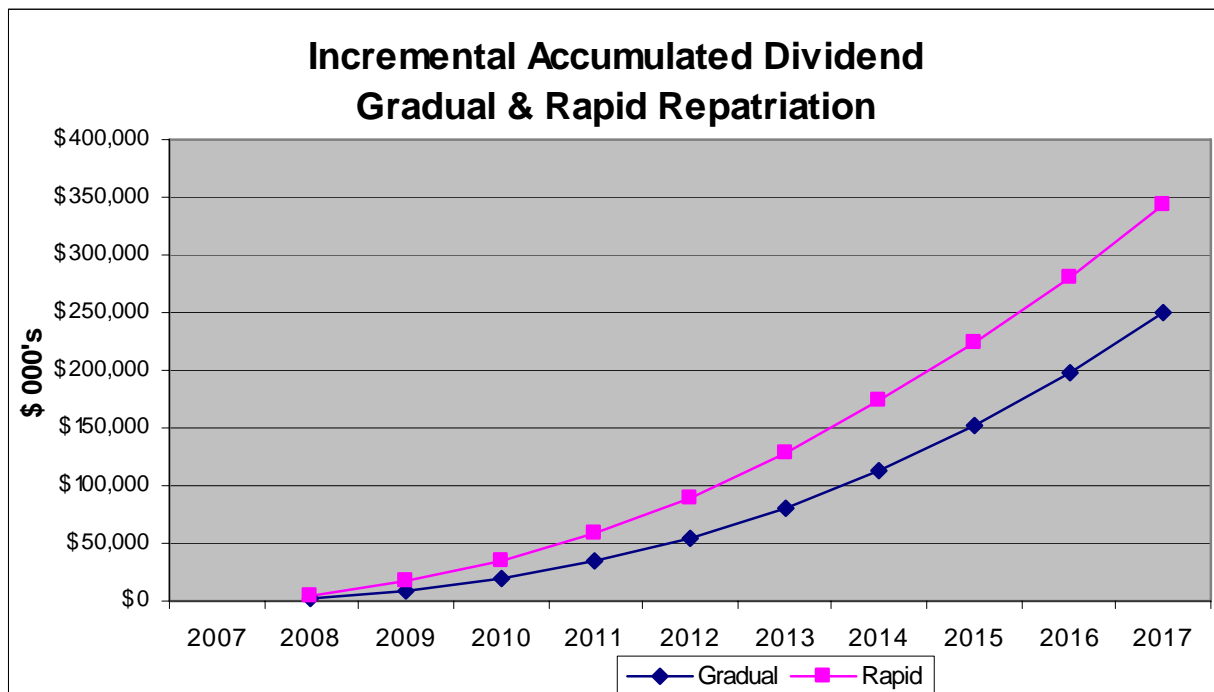
The graph above shows the incremental, annual return on investment for the overall operations of the LCBO, resulting from repatriation. While these numbers may appear small (especially when compared to the store-by-store return on investment average of 43.1%), it is still a significant improvement on the overall return on investment for the LCBO.

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7.4 LCBO Dividend

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

The chart below shows the incremental, accumulated dividend that will result from the repatriation of the agency stores in the two scenarios. By repatriating the sales from these privately-owned stores, the LCBO will provide \$250 to \$340 million more in cash dividends to the provincial government over the next 10 years.



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8.0 Customer and Community Benefits

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

- **Selection** – Most agency stores carry fewer than 500 products. Smaller LCBO stores typically carry between 500 and 1,000 products, while larger LCBO outlets carry 1,500 to 3,000 products or more.
- **Service** – People enjoy shopping at LCBO stores. Seventy-eight percent of LCBO shoppers provide exceptional satisfaction ratings of 8 or higher (on a 10 point scale).
- **Social Responsibility** – The LCBO's social responsibility mandate is integral to its organizational culture. In 2005-06, LCBO employees challenged more than 1.7 million customers who appeared to be underage or intoxicated and refused service to 112,000, most for being unable to produce valid proof of legal age. Public health research around the world always comes to the same conclusion: *Government controlled distribution and retailing of alcohol is the most effective system for ensuring the highest level of social responsibility and reducing the risk of alcohol-related harm.*

Communities across Ontario that gain a new LCBO store from repatriation will directly benefit from the capital investment (\$325,000 to \$450,000) and jobs created. The LCBO provides a good wage (\$18 to \$26 per hour) and secure employment, and it has an excellent employee training program.

In addition to these direct economic benefits, the repatriation of LCBO stores will also create economic multipliers of 2 to 3 times. This means that the money the new LCBO stores spend on rent, wages, municipal taxes, utilities, and other products and services will multiply from:

- \$111,000 to \$334,000 per year for a store with \$800,000 in sales
- \$142,000 to \$426,000 per year for a store with \$1.2 million in sales
- \$210,000 to \$630,000 per year for a store with \$2 million in sales.

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Appendix 3: Consultant Qualifications – Russ Christianson

EXPERIENCE

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

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

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

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

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

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

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

VOLUNTEER ACTIVITIES

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

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

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

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

EDUCATION

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

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

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