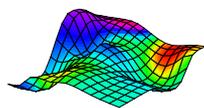


Report to

Australian Wool Innovation

Benefit Cost Analysis of AWI's
Sports & Outdoor Category Investment

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BACKGROUND

BDA Group was commissioned by AWI to complete a benefit cost analysis (BCA) of their product development and marketing investment in sports and outdoor apparel. Investment in this area was made under two Strategic areas across the AWI 2010-13 Strategic Plan.

- Off-Farm – Strategy 3: Performance Apparel and Safety Attributes, Program 1: Consolidate, enhance and transfer knowledge regarding the performance, thermal regulatory, odour and moisture management and fire safety attributes of wool.
- Marketing - Strategy 2: Product Partnership Marketing, Program 1: Trade and Consumer Product Promotion.

Investment in developing the sports and outdoor market has continued under the current Strategic Plan under Strategy 7: Category Management, Program 1: Sports & Outdoor.

The analysis was completed with the primary purpose of providing a robust assessment of the achieved and potential returns to Australian woolgrowers from that investment and forms part of the series of AWI investment evaluation reports. These analyses are publically available from AWI¹ and apart from reporting the return on investment to shareholders support the on-going process of investment planning and reporting across the organisation.

SPORTS & OUTDOOR APPAREL DEVELOPMENT ACROSS AWI

In the 1990s CSIRO and AWI (through its predecessor The Woolmark Company & International Wool Secretariat) had identified an opportunity for wool in the rapidly growing sportswear market. In response Sportswool™ was developed and ultimately launched in 2004. The trademark and logo is registered with AWI and Sportswool™ is now produced and retailed by various businesses globally.

Following the success of Sportswool™ AWI sought to further increase wool usage in the sportswear market. In 2007/08 AWI sought to strengthen partnerships with major manufacturers to help drive new products through to retail consumption. These partnerships included Sugoi, Charles Parsons, Memteks and The North Face². AWI also invested in the development and marketing of products under the Merino Perform™ platform. Merino Perform™ was launched in January 2009³ and included a collection of 10 garments in base layers, golf and soft shell outerwear as well as Sportswool™ products. By 2010 AWI had the support of 13 licensed manufacturers under the Merino Perform™ platform⁴.

¹ <http://www.wool.com/en/about-AWI/how-we-consult/measuring-performance>.

² 2007/08 AWI Annual Report Pages 38 and 50.

³ 2008/09 AWI Annual Report, Page 11 & 16

⁴ 2009/10 AWI Annual Report, Page 16.

To ensure that AWI's investment effort remained focussed in the rapidly developing sportswear market Pre-Fiks Pty Ltd was engaged to assist in the preparation of a Strategic Plan for future product development and marketing, with recommendations for a clear and efficient marketing and innovation strategy to maximise volume increases over the following three years⁵. The investment made by AWI between 2010/11 and 2012/13 was in response to the developed strategy and continues to be pursued under the current Strategic Planning period.

The opportunity to build demand for wool across the Sportswear market was seen as considerable given both its size, estimated at around \$96b globally for 2012, and the relatively small market share enjoyed by wool based garments in this segment⁵. Further, consumer research commissioned by AWI has confirmed that penetrating this market remains difficult and that the development of innovative products is a key success factor⁶.

- Cotton and cotton blends are strong brands while wool and merino wool are weak brands.
- A main barrier to purchase is the non-consideration of wool as wool products are not perceived to deliver comfort and temperature regulation.
- Consumers are less willing to pay a premium for wool and merino wool relative to cotton or cotton blends.
- Sportswear consumers are competitive, curious and open to new or original trends and receptive to fabrics that are seen as innovative.
- While most sportswear garments are purchased for a variety of purposes (walking was the most common use cited), wool garments were slightly more likely to be purchased for a specific purpose.

The developed strategy for AWI's investment in the sportswear market was aimed at growing new demand for wool. It was decided to leverage off existing manufacturing partnerships and develop partnerships with key brands and retailers that involved:

1. Increasing awareness of wool's benefits as a fibre and targeting uses in outdoor / hiking, hunting & fishing and health and lifestyle (such as yoga and gym wear).
2. Testing and developing products with partners, especially new segments for wool in mid and outer layers.
3. Promotion of new products.

⁵ AWI Project TS050.

⁶ Nielsen 2014, Sports Active Clothing Research, Report prepared for AWI, August.

INVESTMENT

Investment made by AWI in building wool's market reach in the sportswear market over 2010/11 to 2015/16 is provided in Table 1. Over the life of the Program AWI will invest a total of \$6.2m, or \$6.3m in current dollars.

TABLE 1: AWI PROGRAM INVESTMENT: 2010/11 TO 2012/13: \$'000

Investment	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	Total
Project	\$184	\$330	\$1,251	\$700	\$599	\$599	\$3,663
Operational	\$129	\$231	\$876	\$490	\$419	\$419	\$2,564
Total	\$313	\$561	\$2,127	\$1,190	\$1,018	\$1,018	\$6,227

Source: AWI Annual Reports and Project Approvals. Note: Operational Costs were based on a multiplier of 70 cents for every dollar invested in projects.

Investment in the current Sports & Outdoor area (a dedicated AWI program from 2013/14) commenced in 2010 following the development of the Strategic Investment Plan. At that time AWI had relationships with a number of manufacturers, with 13 being licensed under the Merino Perform™ platform⁷. Collaboration with manufacturers involved product development, sourcing for brands and creating networking opportunities. From 2010 AWI also sought to build relationships with leading brands to support their marketing of innovative products, developed with manufactures, to consumers⁸.

A summary of the major activities undertaken under the program over the evaluation period is provided below (sourced directly from AWI Annual reports).

2010/11

- Marketing of Merino Perform™ at major international sports / outdoor trade shows.
- Addition of Merino Perform™ Pro to product offer – a product that has advanced vapour and liquid moisture management.
- Completion of the Strategic Investment Plan.

2011/12

- Marketing of Merino Perform™ at major international sports / outdoor trade shows with greater emphasis on mid and outer layer products.

⁷ By 2014 AWI had operational partnerships with the following manufacturers – Designer Textiles International (NZ), Levana / The Merino Company (NZ/AUS), ABMT (AUS), Charles Parsons (AUS) Shanghai Challenge Textiles (Ch), Diyang Mengdi (CH), CDF (Mau), Safil (Italy), Pontetorbo (Italy), Sontex (Denmark), Thygesen & Birk (Denmark), Mira (Korea), Toabo (Japan), Nikke (Japan) and Nanshan (Ch).

⁸ By 2014 AWI developed operational relationships with the following brands – Devold (Norway), Fjallraven (Sweden), Janus (Norway), Sweaty Betty (UK), Ortovox (Germany), Mover (Swiss), Sanfo (Ch), Zealwood (CH), Kroceus (CH), Neve (US), Cabela's (US), K2 (Korea), Asics (Japan), Rapha (UK), Vaude (Germany) and Aclima (Norway).

- Research into development of wool based products as mid and outer layer for use in targeted segments of the sportswear market.

2012/13

- Marketing of Merino Perform™ at major international sports / outdoor trade shows.
- Four main products extended to the market, including wool hiking trousers and jackets, wool fill, soft and hard shell linings for garments and Neulana Sport.
- Expansion of AWI investment to include marketing in partnerships with leading brands in the sportswear market across the Asia / Pacific region and Europe.

2013/14

- Addition of three extra manufacturing partners under the Merino Perform™ platform.
- Marketing of Merino Perform™ at major international sports / outdoor trade shows.
- Further development of trouser and jacket products for hiking and outdoor wear.
- Japanese product development using merino fibre for sportswear products.
- Continued research into impacts of different layering systems on garment performance in sports and outdoor use.
- Engagement of a Mountain Rescue Team as an ambassador for merino wool use in sportswear.
- Continued marketing in partnerships with leading brands in the sportswear market in the Asia / Pacific region and Europe and expansion to the US market.

BENEFITS

As part of AWI's Off-Farm R&D / Marketing Category Management strategy, the Sports & Outdoor program seeks to increase the demand for wool across a number of rapidly growing consumer segments where wool has a modest market share and competition from other fibres is considerable. To date the program has been well regarded by AWI partners and there has been a general increase in wool sales as a result of the AWI partnership⁹.

Designer Textiles *"We have found it very useful connecting with AWI, and in particular their development programme, which assist us to demonstrate innovation to the market place. In the end the industry needs to collaborate to help grow the demand for merino wool and ensure merino fabrics continue to provide an exciting performance story with a strong environmental platform".*

⁹ Feedback received as part of Annual partner Reports to AWI. These reports are now a contract requirement (Seasonal Partner Report) and enables program feedback and sales data to be collected on a confidential basis.

Diyang Mengdi *“Together with woolmark we have grown our business from 30 tons merino fiber to using 180 tons merino fiber per year in recent 7 years, Most of fiber we use is 18.5um and finer. We successfully expand to some brands who have never heard of merino circular knitting”.*

Targets sought under this program by the end of 2015/16 include:

1. Increase of 75,000 units a year, on average, for each manufacturing partner.
2. Increase of an additional 50,000 units a year across non-AWI partners.

By the end of 2013/14 these targets had been achieved¹⁰. Across current manufacturing partners total volumes of Merino Perform™ product produced was estimated at close to 21m units with year on year growth of 10%, or 2.1m units. This is equivalent to an average annual increase in units sold of 131,000 for each AWI partner over 2013/14. Based on an average wool weight of 230 grams per unit the annual growth in wool demand translates to just over 30,000 kgs of wool per AWI partner. From information collected from AWI brand partners it was also estimated that around 25% of units sold were sourced from non-AWI manufacturing partners, or some 160,000 kgs of wool¹¹. In total, an additional 640,000 kg of new demand can be attributed to the AWI investment in the Sports & Outdoor program in 2013/14.

Table 2: Increase Annual Units Sold and New Demand – year on year increase

Market	2010/11	2011/12	2012/13	2013/14
Units Sold (AWI Partners)	0	0.9 m	1.9 m	2.1 m
New Demand	0	259,200 kg	576,000 kg	640,000 kg

2012/13 year increase based on year on year increase for 2013/14 of 10% .kgs and 2011/12 based on 5% growth.

The economic benefit to Australian woolgrowers associated with an increase in new demand was estimated at \$3.9m a year for every 1 mkg generated¹². This estimate was based on:

- 145m kgs of final product with Australian wool contributing 125 m kgs¹³; and
- The gross margin for fine wool, expressed on a kg clean basis, of \$4.49.

Two scenarios were considered in this evaluation. The first provides a baseline measure of economic benefits on increased demand achieved to date and the second is based on an additional 10% growth that could be attributable to the program from investment over the next two years. With benefits expected to be sustained for 15 years (as consumer preference for merino products is maintained

¹⁰ July 2014 Program Achievement Report

¹¹ Increased wool demand data was collected from AWI partners by AWI staff (Lars Ulvesund 2014).

¹² This approach was detailed in a BDA Group report to AWI in February 2012. Estimates will provide a minimum value.

¹³ Other fibres account for the remainder.

across this segment), total benefits (in present value terms¹⁴) would reach \$28.1m under the baseline scenario and \$32.7m with continued investment in the program until 2016.

PAYOFF

In this section the estimated pay off on the AWI investment is reported. Measures are reported in Table 3. It was estimated that the AWI investment has generated net benefits to Australian wool growers of \$24.m in present value terms, and with continued investment to 2016, expected net benefits to Australian woolgrowers are estimated to reach \$27.5m. This represents a return of \$6.3 on every dollar invested by AWI in the Sports & Outdoor Program over the years 2010 to 2016.

TABLE 3: INVESTMENT PERFORMANCE MEASURES

Measure	Baseline	Investment to 2016
Present Value of Benefits (\$m)	\$28.1	\$32.7
Present Value of Costs (\$m)	\$3.6	\$5.2
Net Present Value (\$m)	\$24.4	\$27.5
Benefit Cost Ratio	7.7	6.3

CONCLUSION

AWI's investment in the Sports and Outdoor Program seeks to build demand pressure in a consumer segment that has experienced rapid growth over the past decade and one in which wool, as a fibre, has a relatively low market share. Against a consumer preference for cotton and synthetics, the AWI program has led to the development of innovative wool apparel under the Merino Perform™ platform for specific sportswear purposes such as hiking, fishing and hunting and yoga and gym wear. In partnership with manufacturers and retail brands these products are gaining consumer acceptance, and as a result increased sales have occurred through time, in excess of program targets. This increase in demand has delivered solid returns to Australian woolgrowers and will continue to do so with further investment planned to 2016.

¹⁴ A discount rate of 5% was used.