



BRIAN MCGUIGAN WINES (MGW)

RECOMMENDATION

SHORT TERM: BUY
LONG TERM: OUTPERFORM
PRICE: \$5.00
DATE: 20 FEBRUARY 2002
SECTOR: CONSUMER STAPLE
– BEVERAGES

CAPITAL PROFILE:

Issued Capital: 43.9M
Mkt Capitalisation: \$219 M
Issued capital is before expected issue of 48.4M new shares with SWS merger.
There are also 4M unlisted options on issue.

MAJOR SHAREHOLDERS:

@ 7 September, 2001

McGuigan family 18.9%
James Smiley 5.9%

DIRECTORS:

DS Clarke AO	Ch
BJ McGuigan AM	MD
I Ferrier	non exec
DS White	non exec
NF Greiner AC	non exec
J Smiley	non exec
LA McGuigan	exec

SWS MERGER TIMING:

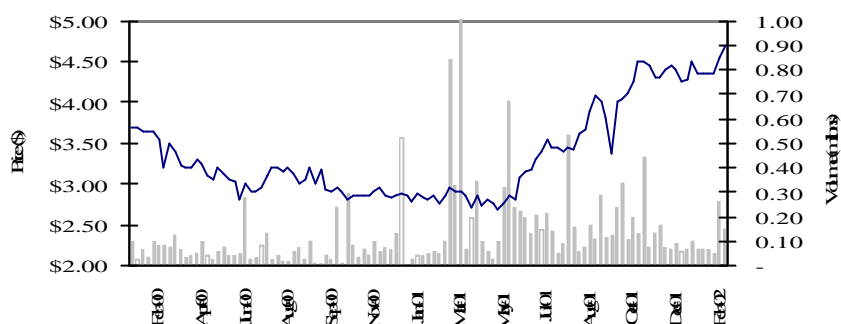
SWS shareholder meeting Mid May
Transaction completion and
ASX trading of merged group Late May

ANALYST: SCOTT MARSHALL

HY RESULT AND MERGER WITH SWS

MGW has reported another strong result, with sales and profits up strongly. This continues the company's long term trend of growth as the company establishes itself as a major Australian wine company.

The announced intention to merge with Simeon Wines (SWS) is the most significant announcement in the company's history, with the combined company becoming the fourth largest listed wine company in Australia.



KEY POINTS

HY Result:

- MGW reported another strong HY profit. Sales up 56% (wines sales +49% to \$40M, Vineyard Management +280% to \$10M). Profit up 30% to \$4.6M. Dividend increased from 5 cps to 6.5 cps.

Merger:

- MGW and SWS have announced an agreed merger based on a Scheme of Arrangement (which requires SWS shareholder and Court approval).
- MGW will issue 48.4M new shares (in the ratio of 10 MGW shares for each 16 SWS shares). The enlarged issued capital will be 96.3M shares. Both Boards have recommended the merger.
- The merged company will own 6 modern wineries, with a capacity of 127 M litres/yr; 3,860 ha vineyards under management - the second largest vineyard asset in Australia; and export to 20 countries.
- The merger, if approved, will create a mid sized company combining the marketing and production capabilities of both companies. We expect the larger company to take advantage of the new opportunities that come from size.

Share Price:

\$5.00

YE 30 Jun	00 (A)	01 (A)	02 (E)	03 (E)
Sales Revenue (\$m)	62.1	76.6	98.1	309.7
Net profit (\$m)	6.6	9.3	11.8	41.6
EPS (cents) diluted	6.9	9.7	12.2	43.2
DPS (cents) diluted	4.2	5.4	7.4	26.2
Franking (%)	100.0	100.0	100.0	100.0
PER (x)	72.9	51.8	40.8	11.6
Cash Div Yld (%)	0.8	1.1	1.5	5.2

Assumes MGW-SWS merger is successful and effective from 1 July 2002

Profit is before Amortisation goodwill

Forecasts are based on available information regarding MGW-SWS merger

HY RESULT

MGW reported another strong HY profit. Sales up 56% (wines sales +49% to \$40M, Vineyard Management +280% to \$10M). Profit up 30% to \$4.6M. Dividend increased from 5 cps to 6.5 cps.

Cash flow fell to negative \$7.6M reflecting inventory and debtors increasing quicker than sales. Operating costs are being contained.

The Icon alliance with Simeon (SWS) is progressing well, resulting in transfer of the Yaldara brand to McGuigan's marketing infrastructure, geographic expansion, more chain store sales.

MGW's vineyard management business continues to grow strongly, and sales of wines to both local markets (sales up 82%) and export markets (up 21%) grew significantly. While the UK was strong, distribution in the US was challenging and a distributor needs to be appointed to overcome the restrictions to growth being experienced by MGW in this market.

PROPOSED MERGER WITH SIMEON WINES (SWS)

SWS is one of Australia's largest producers of wine, producing bulk wine for a number of major wine companies including Orlando Wyndham, Gallo, Yalumba, Freixenet, Tesco, Sainsbury and BRL Hardy (BRL). The proposed merger between MGW and SWS will expand the existing alliance between the two companies and extend the close working relationship that has lasted for 5 years.

The low cost wine-making capabilities of Simeon will be merged with the marketing and distribution capabilities of McGuigans. This is a positive announcement for both companies and positions the merged company for growth. We expect that the company will brand more of the wines that were previously sold by SWS under contract as bulk wine and at low margins to other branding companies.

Terms of merger:

MGW will issue 48.4M new shares (in the ratio of 10 MGW shares for each 16 SWS shares). The enlarged issued capital will be 96.3M shares. Both Boards have recommended the merger. Importantly, the Orlando representative on the SWS Board has

voted in favor of the merger, indicating Orlando may vote in favor at the Simeon shareholder meeting in May.

The merger is subject to the vote at the SWS shareholder meeting and South Australian Court approval.

Timing:

SWS shareholder meeting is scheduled for mid May 2002, with court approval, transaction completion and trading of merged shares scheduled for late May 2002.

The merged company:

The merged company will own:

- Six modern wineries, with a capacity of 127 M litres/yr
- 3,860 ha vineyards under management (including acreage owned by Beston Wine Trust) - the second largest vineyard asset in Australia

and export to 20 countries.

The merged company is also expected to be the third largest ASX listed wine company, and with increased stock market interest should experience a higher PE rating. An increased S&P 200 Index weighting is thus expected.

The merged Board will initially include 4 directors from each of MGW and SWS. Management will initially be: D Clark (from MGW) as Chairman, B McGuigan (MGW) as CEO, and N Mackenzie (SWS) as COO. McGuigan and Mackenzie will maintain their current focus (marketing / branding and winery, respectively)

Benefits:

There are many benefits expected from the merger. These include:

- Scale and hence relevance to major clients. The combined capacity will provide new opportunities for McGuigan – Simeon as the company evolves from a small supplier to a major domestic wine supplier. Depending on the metric used, the company will be the second or third largest wine producer, and the third largest listed wine company.

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- Both companies already have a working relationship. McGuigan and Simeon have worked closely for the past 5 years, and the recently announced alliance between the two companies has brought a closer understanding of each other's strategies and strengths. The merger has been recommended by both Boards and is expected to result in a smooth merger.
- Broader revenue base, long term contracts. The companies currently have a diverse revenue base within the wine sector. Sales are to domestic and international markets. Revenues are generated from vineyard management and wine sales. SWS has many long term wine supply contracts.
- Capital efficiency with sale and lease back of SWS vineyards (to Beston Wine Trust). The vineyard sale and lease back will allow funds to be utilised in higher margin winery and marketing activities (improving ROA), while maintaining control of grape quality via vineyard management contracts.
- Stock market dynamics. The increased market share and perceived improved pricing power resulting from its significant market positioning should result in higher trading liquidity and improved market coverage.
- Cost synergies. The companies have identified \$3.5M in pretax savings, but have also indicated that other savings can be expected as the opportunities are quantified.
- Combine strengths of MGW (branding, marketing) with SWS (wine production).

Strategies.

The two companies have focussed their expertise in different parts of the wine industry. MGW has concentrated on grape growing and wine marketing, while SWS has focused on wine production. They have each excelled in their strategies.

MGW has grown rapidly by establishing itself over the past 10 years as a significant (but smaller) wine company distributing to 20 countries as well as to the local market. The company has established many brands and has been recognised for its wine quality. One MGW wine (Bin 7000) is the most awarded wine from Australia's 2000 vintage chardonnay crop.

SWS is one of the largest wine producers in Australia. Originally a part of the large international Orlando group, it is now an independent contract wine producer with several large customers under

long term contract. SWS believes it is one of the lowest cost wine producers in the world, with several modern, large wineries.

McGuigan – Simeon will work the strengths of each company with the following strategies:

- Rationalise administrative and other operations to cut costs. \$3.5M in costs have been identified, with other savings expected but not at this stage quantified. The unquantified savings would include grape purchasing, packaging, cork, and distribution.
- Locate a US distributor. The merged group would more easily attract a willing distributor, which would fix one of MGW's current issues.
- Increase the production of customer branded wines – adding to the Sainsbury and Tesco wines currently produced under licence for these major UK customers. Situations currently developing in this market globally are providing opportunities for a well placed company, such as McGuigan – Simeon.
- SWS' vineyard assets can be sold to the Beston Wine Trust, extending MGW's current strategy. While the merged company will be under no immediate financial requirement to sell vineyards (gearing is projected to be 50%), any sale and lease back would improve ROA, provide funds for marketing, and provide funds for acquisitions. If McGuigan – Simeon manages the vineyards, then the company would also generate management fees.
- MGW is currently a relatively minor supplier to the Australian market. MGW, with the aid of a larger, low cost wine supplier of quality wines (Simeon), intends to increase its market share within Australia. With the distribution team acquired with the previously announced Yalumba agreement (MGW has acquired the Yalumba brand and sales team from SWS), McGuigan – Simeon has national marketing. This provides new opportunities for supply to the consolidating (growing) national retail chains being established by Woolworths and Coles Myer. MGW is rapidly becoming one of the few major wine suppliers in Australia, providing distinct advantages to the smaller wine producers.
- The increased size will allow the company to launch a wider range of new products, packaging styles, and pre-empt changing consumer tastes for wine based products.

- MGW has recently launched two higher priced wines at the \$16-20 price point. We expect the company to follow the strategy used by BRL Hardy to move the price point of its wines up, improving its profit margins.
- The increased size will attract higher quality management over time, and hence the expectation of improved efficiencies in the longer term.

Note the possibility that the larger merged company is attractive to takeover, say by Lion Nathan (LNN).

SHAREHOLDER STRUCTURE

The shareholders of the merged company will be:

McGuigan	10.6%
AMP	7.1%
Orlando Wyndham	6.4%
Wellington	6.2%
Maple-Brown Abbott	4.8%
James Smiley	4.5%
ING	3.0%
Other Public	57.4%

Brian McGuigan has indicated he will sell down a portion of his holding over time. Wellington is a Boston based funds manager.

COMPARISON AND VALUATION

Merging MGW and SWS will, if completed, create a major Australian wine company. Depending on the metric used, McGuigan - Simeon will be the second or third largest Australian wine company based on production capacity, and the third largest listed wine company.

Estimated Grape Processing Capacity

Company	tonnes / yr
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Southcorp	300,000
BRL Hardy	260,000
McGuigan - Simeon	180,000
Orlando Wyndham	140,000
Mildara Blass	80,000

In terms of wine processing capacity, MGW – SWS will be the third largest wine company in Australia, primarily due to SWS' currently owned high volume wineries.

Vineyards Managed Company	Hectares
Southcorp	8,000
McGuigan - Simeon	3,860
BRL Hardy	2,580
Mildara Blass	2,250
Orlando Wyndham	1,491
Kirribilly Wines	1,175
Riverina	1,050
Cabonne	870

Combining the vineyards owned and managed by Simeon with the vineyards managed for the Beston Wine Trust (and supplying grapes to MGW) by MGW, the combined company will have the second largest vineyard asset in Australia.

Comparative Valuation

Company	Market Cap (\$M)	Sales (\$M)	2003 PE (x)
FGL	9,550	5,000	14.5
SRP	5,265	1,900	20.2
BRL	2,000	985	19.5
MGW-SWS	437	310	11.6
PLW	148	55	16.0
ETW	73	28	21.5
CEW	52	67	7.3

FGL is not a pure wine company, generating about half of its revenues from wine and half from beer. FGL sales shown above are for the group.

On a simple PE valuation based on currently available information (full financial details will be released before the May SWS shareholder meeting), the combined company remains cheap, based on the implied value ascribed via the MGW share price.