

MKF



WINE INDUSTRY

BUSINESS UPDATE

RECORD YEAR FOR PREMIUM WINE


Vic Motto

1994 was a record growth year for a majority of premium wineries, with exceptionally

strong growth in both sales and profits. Compared with 1993, the majority of premium wineries had higher sales, both in dollars and cases, as well as overall price increases and improved profits. The MKF 1995 Wine Business Survey of over 200 California premium wineries represents about two-thirds of all premium wine, with the following results:

BIG GROWTH YEAR

A remarkable 86% of premium wineries had sales increases in 1994. Overall, premium wine sales volume grew by 12% in 1994, returning to the double digit growth rates of the 1980s. Higher average prices prevailed across the board.

All price segments had strong sales growth, led by the ultra-premium segment (over \$14), which grew by 19% in volume in 1994. Super-premium wineries (\$7-14) followed, growing an average of 12% in 1994. Popular-premium wines, which grew by millions of cases in the 1980s, continued to expand, growing by 11% overall on an already large base. These strong showings have led some in the industry to express concern about the available supply of grapes (see chart next page).

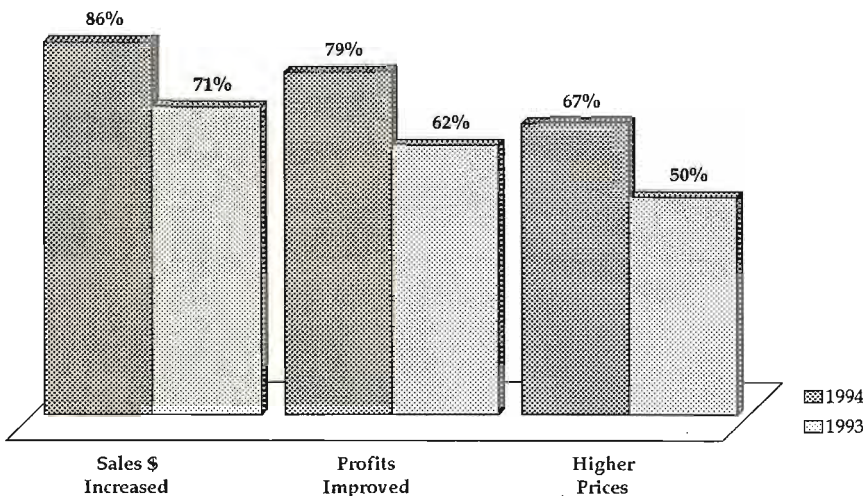
Premium sparkling wine (*Methode Champenoise*), which has been declining in volume for several years, bottomed out in 1993 and began to rebound in 1994. Premium sparkling wine sales turned around and grew by 2% in 1994 at mixed, but slightly higher prices overall.

Rapid increases in sales growth toward the end of the year surprised many wineries. Many experienced product shortages, and some ran out of allocated products.

Premium wine prices strengthened in 1994. In general, there was less

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Premium Winery Trends
% of Respondents



SOURCE: MKF Wine Business Survey

RECORD YEAR, Continued

PREMIUM WINE GROWTH:	\$ Sales	Cases	Prices
Ultra-Premium	23%	19%	4%
Super-Premium	15%	12%	3%
Popular Premium	13%	11%	2%
Sparkling (M.C.)	4%	2%	1%
Overall Growth	14%	12%	2%

programming and an overall decline in the aggressive discounting seen in the recession years.

BUSINESS ISSUES

Despite record growth, there are still many challenging business issues facing wineries, although there is a definite shift from “defensive” to “offensive” issues.

Marketing and sales has been the top business issue expressed by winery CEOs for the past several years. The sales numbers show solid growth, but industry leaders are concerned about broadening the base for wine, and reaching out to new consumers. Some are calling for industry-wide generic marketing to accomplish this. Others seek continuity of growth and overall refinement of the sales process.

The effects of *Distributor* consolidation ranks second, and has moved up in importance in recent years. Managing distributors’ performance and improving the quality of distribution are frequently cited goals. There are clearly more winery representatives in the markets than

ever, and more winery communication with the trade.

Retail consolidation is also mentioned as an issue, as wineries seek broader distribution.

Dramatic sales growth has generated two new issues,

mentioned for the first time in this survey. *Grape Supply / Prices* and *Production Capacity* became of major concern this year. The North Coast grape supply has been short for three years due to phylloxera. Many wineries are also reaching their practical production capacity. A number of wineries experienced product shortages toward the end of 1994. All of these factors have combined to put a strain on the industry’s short-term capacity.

A third new issue mentioned this year is *Consumer Direct Sales*. Many wineries are implementing

new consumer marketing programs in response to a combination of increased consumer demand, product shortages, frustration with distributor effectiveness, and the need to effectively use niche market-

ing. Many wineries want to be able to ship wine more easily and to more states in order to accomplish this.

Government Regulation continues to move up the list, with both federal and local regulations cited as problem areas. Concerns include interstate trade barriers, over-regulation of consumer-direct sales, local regulations and permits, and taxes. In general, government restraint of trade is viewed as a major impediment to growth.

Replanting has slipped in importance as more people are dealing with it, but financing is still a related concern for many. The lack of long-term financing, the large amount of capital needed, and high financing costs are all issues.

The issue of *Prices* has dropped from 3rd to 8th on the list, but is still cited as a concern for wineries of all sizes. Price competition from foreign wine and the ability to increase prices while maintaining growth are concerns.

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WINE BUSINESS ISSUES	Rank		
	1995	1994	1993
Marketing and Sales	1	1	1
Distributors	2	2	7
Grape Supply / Prices	3	New in 1995	
Government Regulation	4	6	9
Profits and Costs	5	3	5
Replanting	6	5	2
Financing	7	8	8
Prices	8	4	3
Consumer-Direct Sales	9	New in 1995	
Production Capacity	10	New in 1995	

THE NEW VINEYARD ECONOMICS



Mike Fisher

The economics of grape growing has changed

rapidly over the last ten years. Changes in vineyard technology have increased the efficiency of the grapevine and improved the quality of wine grapes, at greater tonnage per acre. Many growers are abandoning the traditional spacing and trellis system of the 1960s and 1970s, known as "California sprawl," and are using closer spacing and more sophisticated trellis systems to better match the growing conditions of specific sites.

The many options in vineyard spacing, trellis systems, farming practices, rootstocks and clones can provide higher quality and higher yields, but come at higher costs. The new costs of vineyard development and farming can be nearly double the costs of traditional methods.

VINEYARD COSTS

Motto, Kryla & Fisher has completed a major study to pinpoint the costs of implementing newer vineyard configurations. The **MKF Vineyard Cost Study** covers five common vineyard configurations: two split canopy systems - a Geneva Double Curtain and Lyre system, both at 6'x11' spacing, and two vertical

systems - one at 6'x8' spacing and another at 4'x6'. For comparison purposes, a traditional 7'x11' system is included.

The study is based on a composite of estimated costs to establish and operate a high-quality 30-acre wine grape vineyard in the North Coast of California. The Study costs are typical, but actual costs can vary considerably by vineyard and by grower. The costs per acre to establish a producing vineyard are shown below, followed by the annual operating costs. Annual operating costs do not include any land debt service or expected return on investment related to land.

Basic development costs include land preparation, planting, trellis and drip irrigation. Site-specific costs include drain tile, water supply and frost protection. There may be other site-specific costs, not included here, such as erosion control, terracing, fencing, etc.

Overhead includes property taxes, insurance, office and management. Financing assumes 100% of cash required, including interest. Of course, 100% financing is typically not available, but this places a value on the opportunity cost of the

equity investment.

VINEYARD ECONOMICS

Based on these costs, what are the economics of grape growing? Does it make sense to invest up to \$40,000 per acre in vineyard? The answer, of course, depends on two major variables: *grape prices* and *crop yield*.

Grape prices are determined by the grape market, but also by the grower's ability to market grapes to wineries. Grapes sold as a commodity usually do not command above average prices. Grapes sold with unique attributes due to appellation, vineyard location, micro climate, terrain, clone, and/or vineyard track record can command higher prices. These are factors over which the grower has limited control. However, the grower does have control over vineyard design and farming prac-

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VINEYARD ESTABLISHMENT COSTS PER ACRE:

	<i>GDC</i> <i>11 x 6</i>	<i>Lyre</i> <i>11 x 6</i>	<i>Vertical</i> <i>6 x 4</i>	<i>Vertical</i> <i>8 x 6</i>	<i>Traditional</i> <i>11 x 7</i>
<i>Basic Development</i>	\$10,600	10,700	19,600	12,900	9,000
<i>Site Specific</i>	5,600	5,600	5,200	5,200	5,600
<i>Pre-productive Cultural</i>	3,600	3,900	6,700	4,700	2,900
<i>Overhead</i>	2,500	2,500	2,800	2,500	2,500
<i>Financing</i>	3,800	3,900	5,700	4,200	3,500
<i>Total Cost</i>	\$26,100	26,600	40,000	29,500	23,500

ANNUAL VINEYARD OPERATING COSTS PER ACRE:

<i>Farming</i>	\$ 1,611	1,766	2,786	1,968	1,422
<i>Harvest</i>	840	840	960	720	600
<i>Overhead</i>	997	997	1,183	1,016	981
<i>Operating</i>	3,448	3,603	4,929	3,704	3,003
<i>Depreciation</i>	1,301	1,315	1,907	1,438	1,167
<i>Interest</i>	2,002	2,059	3,484	2,453	2,072
<i>Annual Costs</i>	\$ 6,751	6,977	10,320	7,595	6,242
<i>Estimated Tons</i>	7	7	8	6	5
<i>Cost per Ton</i>	\$ 964	997	1,290	1,266	1,248

RECORD YEAR, *Continued*

WHAT'S AHEAD?

The reasons for this sudden business surge are not readily apparent. Declining per capita wine consumption is an oft-cited statistic, yet premium wine continues to grow. In recent years, premium wine has grown at the expense of generics, but table wine grew by 5% overall in 1994. If per capita consumption is flat, and sales are growing, then obviously the base has expanded somewhat. In fact, the CNN/Gallup poll last year confirmed that more people are drinking wine. So, there are more consumers. In addition, some of the growth in volume last year was restocking the pipeline from the slower recession years.

The growth is real. Grocery store wine volume is growing faster than the wine market overall. This puts wine more in the mainstream, and exposes wine to more consumers. Grocery and specialty stores are merchandising wine better, which stimulates sales. However, little is being done by the industry overall to stimulate or capitalize on this opportunity.

There is no overall industry marketing effort. Individual brands rely heavily on sales and promotion, and use almost none of the sophisticated marketing or advertising techniques of the more successful consumer product industries. Yet, the business keeps growing.

The overall conclusion is that the industry is maturing, more people

are being exposed to wine, and the economy has improved, so the base is expanding slightly. It's time to capitalize on this. The best tools are generic marketing, category marketing, and brand marketing. The opportunity is here and now.



VINEYARD ECONOMICS, *Continued*

tices, as well as marketing, which can often translate into higher grape prices.

Yield becomes even more important at these higher development and farming costs. The questions are, "Can you get higher yields?" and "How much yield will the winery accept?" Yield is a function of a specific vineyard's ability to support a given crop level while maintaining a high level of quality.

While site specific attributes such as soil depth/structure and climate influence optimal yield, farming practices and vineyard design also have a major impact. Based on these factors, yield can range from four to over eight tons per acre.

Quality at higher yields is often in the eyes of the beholder. Many winemakers believe that high quality requires lower yields per acre. Others believe that the answer depends on more and/or different variables. The key is, can you use the new vineyard spacings and technologies to produce fruit with a combination of distinctive attributes and high quality, and also get sufficient yields?

CONCLUSION

Grape growing is a more complex

business today. The premium wine market is expanding, the overall grape supply is contracting temporarily due to phylloxera, and new replanting technologies will produce more and better fruit than ever before. New grape growing regions are emerging, and older ones are upgrading. The market is being split into commodity fruit with a fixed price ceiling, and specialty fruit that must be marketed as such.

Today, it takes more than good farming to succeed as a grower. Growers must be good marketers, good financial managers, and must also understand the changing dynamics of the wine business. The new cost of doing business as a grower demands it.



MKF WINE INDUSTRY

SERVICES

- Wine Business Consulting
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- Merger and Acquisition Consulting
- Business-Oriented Financial Reporting
- Wine Litigation Support and Expert Witness
- Vineyard Development and Replanting Plans



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