



WINE INDUSTRY

BUSINESS UPDATE

EXPORT MARKET GROWS FOR US WINES



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TABLE WINE EXPORTS

The Big Three Exporters: Gallo, Canandaigua, and UDV

U.S. wine export statistics are driven by the low-end of the market. Gallo (including Turning Leaf) dominates the United States packaged wine export market. In 1998 Gallo exported 9,700,000 nine-liter cases of wine. In the aggregate, California wineries exported only 17,422,000 nine-liter cases of wine, so Gallo accounted for more than fifty percent of U.S. wine exports. A Gallo vice president said, "over the past 10 years, most California wineries have looked at exports as a way to get rid of excess supply. But we've made it a priority." And, Gallo's focus shows in the export statistics. Gallo's volume and lower price-point wines dominate (and influence) the export statistics in the new MKF International Report. Survey-

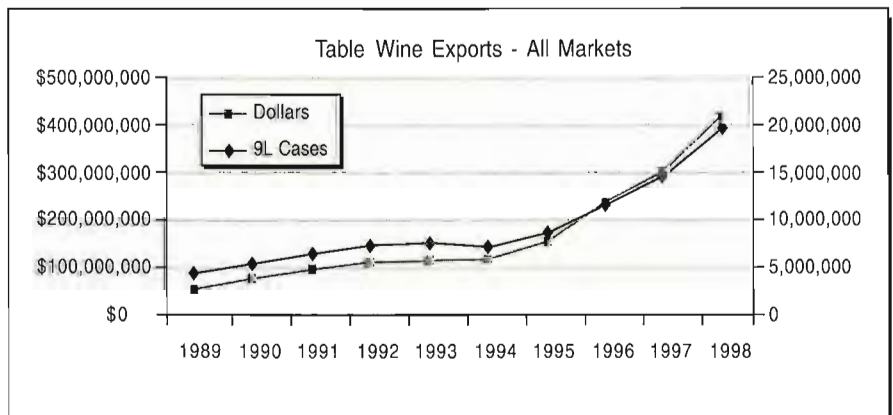
ing the current U.K. market one notices that Gallo (including Garnet Point), Blossom Hill (Heublein), and Paul Mason (Canandaigua) all sell at about £3.49 a bottle in the London marketplace. Generic supermarket brands labeled in the U.S. and shipped overseas also pull-down the average case price of U.S. exports to the U.K.

After Gallo, biggest
The next most important U.S. exporters are Canandaigua (Almaden and Inglenook) 1,600,000 cases, and UDV Wines (Glen Ellen, Beaulieu Vineyards) 1,200,000 cases. All other wineries export less than a million cases of finished wine. None of the Big Three dominant firms concentrate on the super-premium segment. Therefore, the statistics tend to reflect the jug wine and popular-premium price point of the big wineries. As a result, the U.S. has a current average nine-liter case price of approximately twenty-one dollars.

It would be a mistake to examine the export statistics and conclude that the export market is solely a low-end or jug wine market. At Chalone Wine Group, for example, export sales accounted for approximately 4 percent of total revenue, or \$1,758,920, according to their most recent annual report. MKF Research estimates the average FOB for the wines exported by Chalone to be \$120 per nine-liter case. This is considerably different from the aggregate average of \$21 per nine-liter case. The sheer volume of the inexpensive exports of the "Big Three" drag down the average case price.

EXPORT GROWTH
Exports have grown dramatically despite the fact that they have not been the primary focus of U.S. wineries. Exports account for 9 percent of Mondavi's revenue and 4 percent of Beringer's revenue. Currently, the domestic market for wine is extremely profitable and producers are focused on the higher-end of the

Continued Inside



EXPORTS, *Continued*

price spectrum. Consumer's preferences have shifted to premium (varietal) wines. The recent past was a time to focus on higher margins rather than increased volume in the U.S. Wine has been in short supply and on allocation. Therefore, most producers have focused on meeting domestic demand for wine. And, the U.S. wine market is a market for high-end wines. The average value for a nine-liter case of table wine imported from France into the U.S. is \$74. This further reinforces the belief that the U.S. consumer is drinking more expensive wines.

Exports will increase in importance to U.S. wineries in the future. Wineries are learning how to grow the domestic market. This knowledge is freeing-up talent to service the international market. Wineries want to diversify revenue sources by broadening global distribution. The most significant concern of domestic wineries is "what happens to wine sales if the economy slows down?" Some smaller wineries see foreign markets as a methodology to diversify the revenue stream. In other words, to not put all their eggs in one basket.

The Big Three Nations: United Kingdom, Japan and Canada

The United Kingdom is the largest export market for U.S. table wines. The U.K. has always been an important export destination for wine exporting nations. The U.K. is ranked 8th in total wine consumption. But, all the countries with higher total wine consumption are also wine producing nations. The U.K. is the largest wine-consuming nation that is not also a wine-producing nation. Therefore, many nations focus on the U.K. as an export destination.

In the past two years, total volume of table wine shipments from the U.S. to the U.K. has increased 76 percent and the value has increased 85 percent.

Health news, reduced tariffs, and a popular television superhero sommelier (Joe Satake) have moved Japan past the "collector only" phase into a neophyte wine drinking nation. In the last two years Japan surpassed Canada as the second most important destination for U.S. table wine. Despite economic turbulence Japan has become an excellent market for U.S. wines. From 1996 to 1998 the volume of U.S. exports to Japan have increased 187 percent and the value has increased 227 percent. Exports to Japan have a lower average dollar per case value than exports to the U.K. and Canada. Undoubtedly expensive trophy wine is exported to Japan and often given as a gift. But, a proliferation of discount liquor stores selling wine at 500¥ (about \$4) has led to the increase in volume of wine sales in Japan.

Canada (and Europe)

Canada was the most important market for U.S. table wines in the early 1990's. And, despite significant reductions in non-tariff barriers Canada's consumption of U.S. table wines has increased steadily but no where near as explosive as in other export destinations. The volume of shipments has increased by 26 percent and the value has increased 24 percent over the past three years. The average value of shipments to Canada was \$26 per case. Total consumption and per capita consumption of wine has remained stable. And, these U.S. value increases have come at the expense of other nation's wine sales.

The fourth largest export market for U.S. table wines is the Netherlands. However, the magnitude is a deceptive statistic. The Netherlands is a country of about 16 million people with an annual consumption of about 1.94 nine-liter cases per person each year. Germany is considered a much more important wine market but is ranked below the Netherlands in volume terms of U.S. exports. The reason is that the Netherlands is the most common port of entry for wine shipments into Continental Europe. From the Netherlands, wine is distributed throughout the European Union. This makes the Netherlands market appear larger and more significant than it is in reality.

The table wine market is the key U.S. wine export making up about 70 percent, in terms of volume, of the total wine exported. Table wine has grown at 79 percent in dollars and 67 percent in volume between 1996 and 1998. This growth has occurred despite wine shortages in the domestic market. The second largest category is bulk wine followed by sparkling wine. We will analyze each category in turn.

BULK WINE EXPORTS

Bulk wine accounts for approximately 15 percent of all U.S. wine exports. Between 1996 and 1998, the volume of bulk wine exported has increased by 19 percent and total value has increased 24 percent. Various non-tariff barriers in other countries drive much of the bulk wine business.

Canada

Canada continues to be a large importer of U.S. bulk wine. Discrimi-

Continued back page



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WINERY VALUATION CONCEPTS

(A Business Valuation Primer)

In light of the flurry of recent winery acquisitions, you may be pondering "what's my winery worth." Or perhaps, you are considering estate planning options to transition your winery to the next generation. Either way, preparation of a business valuation provides you with the information you need to understand the value of your business.

Reasons for a Business Valuation

There are a variety of reasons to perform a business valuation, ranging from transactional needs (e.g. acquisition) to litigation (e.g. divorce or ownership disputes) to estate tax planning and reporting. In contrast to an appraisal, which establishes a value for certain tangible assets, such as real property, a business valuation includes not only the value of tangible assets (receivables, inventory, facilities and related real estate) but also any intangible value related to the brand, winery permits, distribution networks, grape contracts or general goodwill. Where a winery

owns significant real property, a business valuation would generally rely upon and encompass a separate real estate appraisal.

DEFINITIONS OF VALUE

Depending on the purpose of the business valuation, different standards of value may be applied. The most common standards of value are fair market value, fair value, and investment value. Due to the differences in how these values are defined, it is important for all affected parties to understand what standard of value is being applied in order to avoid misunderstandings.

Fair market value is defined as "the price at which the property (business) would change hands between a willing buyer and a willing seller, when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts." Fair market value is the applicable standard for all tax purposes and in some instances of litigation as established by law.

Fair Value is most commonly applicable to the valuation of dissenting shareholder or partner interests and is defined by state law. It is generally defined as a pro-rata allocation of the value of a business as a whole without differentiating between majority (controlling) and minority (non-controlling) interests.

Investment Value incorporates the concept that businesses can have unique value to particular investors based upon their specific needs and interests. Thus, investment value may be greater than fair market value due to a business' strategic value to a specific individual, e.g. enhanced market share in the super-

premium market or anticipated cost savings from economies of scale. Most mergers and acquisitions are based upon investment value.

VALUATION APPROACHES

A business valuation develops an estimate of value that would provide a fair and reasonable return on investment to an investor or owner, in light of the facts available as of the valuation date. Among other things, this process is based upon an estimate of the risks facing the business and the return on investment what would be required for comparably risky alternative investments.

As with the standards of value, there are a variety of valuation approaches that can be employed. The selection of an appropriate approach needs to consider both internal and external factors impacting the business. The three basic valuation approaches are asset-based, income-based, and market-based. A value can be determined using just one of these methods or a combination thereof.

Asset approaches base the value of a business primarily on its net assets. An asset-based approach is most appropriate when there is a limited earnings history, a liquidation of the business is planned, or the business is a non-operating company (e.g. a holding company). Because an asset-based approach does not easily incorporate the value of intangible assets, it is not as appropriate when a business has significant intangible value.

Income approaches that are commonly used include the capitalization of past earnings and discounted future earnings. Under the capitali-


Continued back page

EXPORTS, *Continued*

natory marketing regulations provide Quebec supermarkets with a loophole to sell wines "bottled" within the province thus avoiding the state-run Liquor Control Board stores. Supermarkets account for over forty percent of the wine sales in Quebec (a substantial North American wine market). But, in other parts of Canada incentives to import bulk wine are disappearing and bulk exports have experienced limited growth over the past three years. Blending requirements requiring a mix of Canadian and foreign wines are being phased out as mandated in the North American Free Trade Agreement. Canada tends to import very inexpensive bulk wines that have an average nine-liter case value of \$6.02.

Japan

Japan is the other significant bulk wine-importing nation. The definition of Japanese "domestic wine" is a wine that is physically bottled in Japan. Bulk wine from other countries, bottled in Japan, has various favorable treatments in the Japanese market. Therefore, incentives to export bulk wine from the U.S. to Japan continue. When non-tariff barriers to trade are removed it is far more profitable for U.S. wineries to export finished wines rather than bulk wine. Japan imports slightly more expensive wine than Canada. The average nine-liter case value is \$14.97. Unfortunately, after Canada and Japan there is no other significant bulk wine market for the U.S. exports.

For this and other information about U.S. imports and exports consult the MKF International Report. 

WORTH, *Continued*

zation of past earnings, the value is estimated as an annual earnings stream received in perpetuity. This method is appropriate when past earnings are representative of future earnings. When a business is experiencing significant growth, decline or other changes, past earnings will not approximate future earnings, and a discounted future earnings method will be more appropriate. Under this method, projected future income is discounted to determine present value.


Market approaches look to data from comparable publicly traded companies and/or recent sales of comparable companies to derive applicable valuation ratios, such as a price/earnings multiple. In order for these methods to be effectively applied, benchmark companies or transactions should be comparable in size, price point, operations, and asset mix, among other things. Accordingly, the analyst must be familiar with valuation subject, the winery to be used for comparative purposes, and any relevant transactional terms and conditions in order to make meaningful comparisons.

DISCOUNTS

In preparing valuations, there are also two discounts that are commonly considered. First, a minority interest discount reflects the lack of control by a minority owner to direct company policy, determine officer compensation, acquire or liquidate assets or execute other significant operating decisions. Conversely, a premium may be added to reflect the benefit attributable to a controlling interest or

possibly to a swing vote position. Second, a marketability discount reflects the lack of liquidity common to privately held companies, such as family-owned wineries, due to the fact that owners have fewer opportunities readily available to sell their interests

Conclusion

Understanding the value of your business (or a seemingly attractive business owned by someone else) is an important tool in helping you make informed decisions, whether you are interested in estate tax planning or considering the sale or purchase of a winery. Armed with this information, you can selectively pursue the opportunities that best suit your needs and optimize the resulting benefits. 

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