

# MKF

MOTTO, KRYLA & FISHER  
Wine Industry  
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# WINE INDUSTRY

## UPDATE

"Wine industry financial, business and tax ideas."

## A Good Year for Premium Wine



*Vic Motto*

It was a good year for premium wine. The MKF wine business survey of over 200 California premium wineries shows that a majority had higher sales and higher profits in 1992. The recession and other challenges to wine have had profound effects,

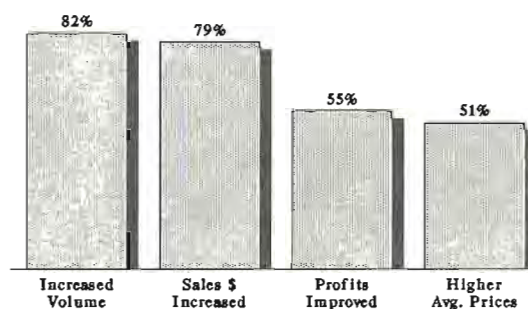
but the premium wine industry fared better than many industries in 1992.

The accompanying chart shows the percentage of wineries that had improvements in volume, sales, profits and prices. Volume gains averaged 15% vs. 1991, while sales dollars grew by 12% and profits improved by 4%. Over 20 hot *Ultra-premium* brands had sales gains of 20% to 40%. Some of these gains came at the expense of a dozen or so well-established brands that dropped 5% to 15%. A large number of wineries in the middle had solid 5% to 10% growth. The *Popular-premium* brands continued to grow at double-digit rates, representing large volume increases.

These trends are very positive and show some real strength in the premium sector of the industry. The details show that the industry is becoming much more competitive as well. The *polarization* of the industry continues, with many mid-size wineries (roughly 5 to 25,000 cases) continuing to struggle and lose ground. Large numbers of smaller brands continue to vie for attention in a shrinking distribution system, both wholesale and retail. Price discounting and value-oriented consumer price trends, combined with escalating marketing costs are squeezing smaller, less well-established brands. Many are clearly sacrificing profit margins, with volume increasing faster than sales dollars. This is due in part to widespread discounting, but the proliferation of lower-priced second labels is also a substantial factor. The second labels are primarily a temporary phenomenon due to recent bumper crops.

The strong overall showing for premium wine during the recession is encouraging. Most of the wineries in our

### PREMIUM WINERY TRENDS 1992 vs. 1991 *% of Respondents*



SOURCE: MKF Wine Business Survey

survey are also bullish for 1993. The survey results in the table show that the vast majority expect sales increases, and over half of them expect improved profitability.

### MKF Wine Business Survey

*% of Respondents*

1992 vs. 1991

	Sales	Prices	Profits
<i>Up</i>	79%	51%	55%
<i>Down</i>	13%	31%	26%
<i>Flat</i>	8%	18%	19%
<i>Total</i>	100%	100%	100%

1993 Outlook

	Sales	Prices	Profits
<i>Up</i>	89%	37%	54%
<i>Down</i>	4%	10%	9%
<i>Flat</i>	7%	53%	20%
<i>Don't know</i>	-	-	17%
<i>Total</i>	100%	100%	100%

### BUSINESS ISSUES:

Despite their strong showing and positive outlook, winery executives see many challenges in 1993. The top ten business issues expressed by wineries responding to the MKF survey are as follows (in order of importance):

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**THE NEW COSTS TO ESTABLISH A VINEYARD**



*Mike Fisher*

With major replanting expected due to phylloxera, we frequently hear the question "What does it cost to establish a vineyard?". Depending on the source, estimates range from \$5,000 to \$50,000 per acre.

There are two major reasons for this wide difference. The first depends on which categories of costs are included. Is it just planting of the vines and trellis system? What about site specific costs such as drain tile or erosion control? Do you include farming, management and overhead during the development stage? Also, are the financing costs included?

Second, even if the categories of costs are the same, there continue to be major cost differences among vineyards. In the last ten years we have seen major advances in vineyard technology, but no "standard" approach has emerged. The costs related to these technological advances depend on which of the different systems are used for trellis, irrigation, spacing, cultural practices, new rootstocks and scion selection. Some of the variables are as follows:

- Site specific costs vary from one location to another and relate to soils, exposure, micro-climate, slope, etc. These costs include differences in basic development such as trellis and spacing as well as subsurface drain systems, frost protection, water supply development, erosion control, etc.
- Economic considerations may restrict options related to vineyard development. If resources are not

available to develop a vineyard in the preferred method, a grower may have to resort to a less elaborate system or alternative methods such as interplanting or in-arch grafting.

- Even though many growers are using the newer technology, others continue to rely on traditional methods used since the 1960's and 1970's, which have lower costs, yields and quality.
- The use of organic or sustainable agricultural influences development costs, whether it be simply choosing to not fumigate before planting or embracing the whole concept of organic farming.
- The Napa County Hillside Ordinance has affected growers in Napa County and may have created a trend in other North Coast counties. Costs to implement the required soil conservation plan vary widely depending on slope and soil type but may be several thousand dollars per acre.

Because of the wide variations in vineyard costs MKF has undertaken a new study to determine the average costs to establish vineyards in five different configurations. These include two split canopy systems - a Geneva Double Curtain and Lyre

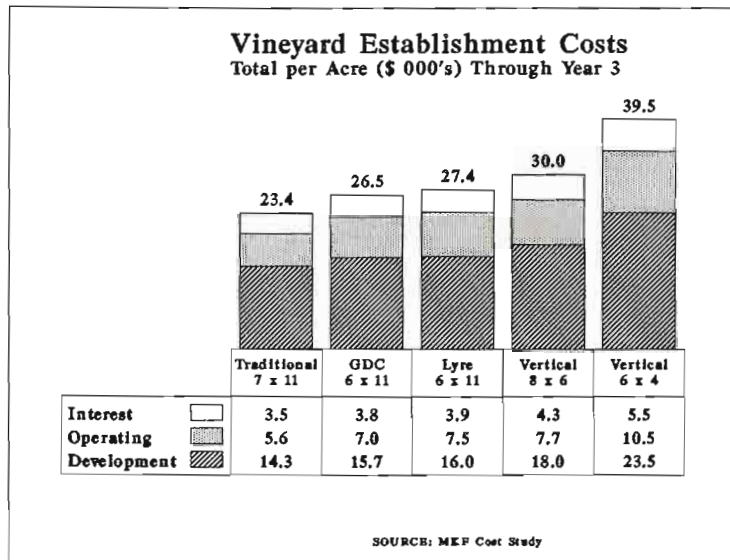
System, both at 6'x11' spacing, and two vertical systems - one at 6'x8' spacing and another at 4'x6'. For comparison purposes, a traditional 7'x11' system is included. As shown in the graph, the establishment costs are categorized into three major components: development, operating and financing.

Development costs are divided into basic and site specific. Basic costs are incurred in a typical replanting with all infrastructure in place. The site specific costs include drain tile, water supply and frost protection.

Operating costs consist of farming, management and administration. Farming costs include pruning, hand vine care, pest management, cultivation, etc., with the largest component being labor. These labor costs can vary widely among growers depending on the nature of the trellis system, farming style, management efficiency, labor rates and site requirements. Administration includes property taxes, insurance, professional fees, etc.

Our study assumes 100% financing, including interest. Of course, 100% financing is not available from conventional lenders, but this approach places a value on the opportunity cost of the equity investment.

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## MAKING YOUR TASTING ROOM WORK FOR YOU



*Jeff Sully*

Tasting rooms provide a unique tool for your overall marketing

program. For many wineries, tasting room sales provide a significant amount of revenue. In a few instances, tasting rooms provide essentially all the revenue. To maximize tasting room profitability, a few concept guidelines, along with simple monitoring techniques can improve tasting room performance.

The most important thing to remember is that tasting rooms are a direct link between you and the *consuming* public. From the customer's viewpoint, your tasting room provides the human element to your wine's personality.

Use your tasting room to define and reflect your marketing message. Re-examine the design criteria behind your label, and carry those concepts to the tasting room. Also, be sensitive to the fact that visitors may have a preconceived notion about what a tasting room should be like. You'll want to provide an experience that begins from the first moment the public sees your facility. You have a captive audience. Making visitors welcome and comfortable lowers sales resistance. This should be an enjoyable time, so your customers will want to come back time and again.

Monitoring techniques allow you to evaluate sales objectives and performance. One we're all familiar with is

looking at total sales over regular intervals. Active tasting room management requires that you look at individual sales components. *It is crucial to identify and analyze those components that make up the whole sales picture.* There are a few simple techniques that will make the job easier.

To truly measure sales performance, look at bottles sold of each variety vs. amount of wine poured for tasting. (Let's assume you pour a 3/4 ounce tasting. That equates to about thirty samples per bottle.) Count the number of bottles used each day, and extrapolate the number of tastes offered. Basing your analysis on a *per tasting customer* provides you with a base for tracking profitability. Knowing how many samples are required to sell a bottle of wine can help you perform many different sales analyses, or set sales goals. For example, your tracking could show that your '89 Cab is not generating enough sales for the amount poured. You would ask your tasting room staff to talk it up. Hopefully, your bottle sales per taste would increase.

If you have an accurate measure of each product's profit contribution margin on a per bottle basis, you can begin to treat your tasting room as a real profit activity center. Contribution margin is the gross profit minus the variable selling costs. This number represents the amount of revenue each bottle of wine contributes to covering fixed overhead and profit. Most of the time, you'll want to look for those wines with the highest contribution margin. These wines should receive major emphasis by your tasting staff.

It is also important to keep a daily record of the number of tastes poured, the bottle sales by variety and vintage, the number of staff on duty, as well as sales dollars. You might also want to keep a section handy for recording notes such as weather or special tours, etc. From this database, you can develop budgets for future planning, as well as track sales growth over time. These simple techniques offer a wealth of information that will allow you to monitor and improve sales programs in your tasting room. ✱

## IRS AUDITS WINERIES



*Karen Kryla*

The IRS has audited over 20% of all wineries in Napa and Sonoma since forming their *Wine Industry Audit Team* four years ago. Currently, the IRS team is auditing about 20 wineries per year in the Napa/Sonoma area. This makes the probability of being audited about 1 in 20 for wineries vs. 1 in 100 for the public at large. IRS winery audits have recently been expanded in other regions, particularly the Central Coast.

**A GOOD YEAR.....**

**1: Marketing-**

Intense competition and difficulties in reaching the consumer are the top concerns for 1993. Brand distinction and product differentiation are often mentioned. One Chardonnay winery laments not being involved in the red wine boom.

**2: Phylloxera-**

The impact of phylloxera, including the grape supply and replanting needs are the second largest issue. What should we replant and how?

**3: Wine Prices-**

Maintaining prices in the face of widespread discounting and the trend toward value-brands are continuing concerns, especially among smaller *super-premium* wineries.

**4: Taxes-**

The big increases in both excise taxes and income taxes planned by the new Administration concern many vintners. Particularly troublesome are new taxes proposed by the Administration to combat the alleged health and social costs attributed to alcohol.

**5: Controlling Costs-**

Many are concerned about rising marketing costs and increases in health and benefit expenses.

**6: Anti-Alcohol Movement-**

Unjustified health and social concerns, restrictions proposed on advertising, punitive taxation, and neo-prohibition are real potential problems in 1993.

**7: Distributor and Trade Consolidation-**

The shrinking distribution system, domination of chains and clubs, distributor and trade bankruptcies are frustrating many. Difficulties in stimulating and managing distributors are some of the resulting problems cited.

**8: Financing and Banks-**

The restricted availability of financing, difficulties in dealing with inflexible bankers, the shortage of long-term capital and the cost of money are major concerns.

**9: Government Regulation-**

The expansion of government in general, along with over-regulation of the wine industry, trade barriers, and increasing govern-

ment interference are popular subjects.

**10: Economy-**

The economy is still somewhat of a concern, particularly in Southern California. Concerns continue about the general prosperity of our country and of the world.

**CONCLUSION:**

In spite of many problems, 1992 did turn out to be a good year, if not a *great* year in view of the general economy. The industry has matured, and has become *very* competitive, but many vintners are optimistic. The California premium wine industry is certainly alive and kicking, with good prospects for the future. Many brands really did well in 1992 and the outlook is favorable for 1993 for good marketers. *Good luck!* \*

**THE NEW COSTS.....**

Once a vineyard becomes fully productive the annual operating costs per ton and per acre are shown below.

These comparisons show that high

technology is expensive. However, these costs are offset by higher quality and yields. As a result, the premium wine industry will be more productive and will produce even higher quality wines as we enter the 21st century. \*

VINEYARD OPERATING COSTS					
	Traditional 7 x 11	GDC 6 x 11	Lyre 6 x 11	Vertical 6 x 8	Vertical 4 x 6
<b>ANNUAL COSTS:</b>					
Farming	\$ 2,200	3,000	3,100	3,100	4,200
Administration	700	700	700	700	700
Depreciation	900	1,100	1,100	1,300	1,700
Interest	1,900	1,900	2,000	2,500	3,200
Annual Costs	\$ 5,700	6,700	6,900	7,600	9,800
<b>COST PER TON:</b>					
Estimated tons	5	7	7	6	8
Cost per ton	\$ 1,140	960	990	1,270	1,230

**MKF WINE INDUSTRY**

**SERVICES**

- Financial statements tailored for wineries and vineyards
- Tax planning and preparation
- Winery and vineyard feasibility studies
- Financial forecasting and long range planning
- Family succession and estate planning
- Bank and financing proposals and negotiations
- Computer accounting systems installation and support
- Review of winery and vineyard operations
- Winery valuations
- Litigation support

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