Wine Industry Financial Symposium

Summary Observations

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The current recession is clearly different than in the past. It is longer and has affected all aspects of the wine industry. Many market segments, especially luxury, were hit hard and there may be long-term structural shifts in wine buying habits.

The wine price curve has definitely been bent downward. Not all consumers are trading down in quality, but they've been trained to look for brand names at bargain pricing.

Many heavy consumers have shifted away from aspirational wine buyers to value buyers – those seeking what economists call transactional utility ("Is this worth it to me?"). Some watchwords: The new normal, the new frugality, cheap is chic, ostentation is out; durability is in.

Some experts believe the wine industry could be "demand constrained" for at least 10 years. That requires pursuing an aggressive strategy of differentiation around appellation, family story, variety, sustainability or whatever sets your operation apart.

In wine marketing today, authenticity is everything. And it's hard to be authentic without a legitimate story and something of a track record. Traditional imagery is back, too – no more critter labels and names. A wine's label and packaging must tell the right story immediately.

Lower priced wines are trending toward commodities – with much less focus on flavor profile and quality and great emphasis on price. Under $10/bottle, consumers are looking for consistency ("Don't surprise me!") and that argues in favor of commoditization. Globalization continues to play a big role as consumers are less concerned about where their wine is sourced.

"Among the hardest decisions you'll have to make to recognize a mistake and cut your losses immediately. The first loss is your cheapest." -- Bill Leigon, Hahn Family Vineyards.

Wine is easy to sell, but hard to deliver. Successful wineries have a well-integrated mix of direct sales and at least some percentage of distribution.

Second labels can be very successful. Duckhorn Wine Co. introduced its lower-priced Decoy brand and went from selling 5,000 cases to 100,000 in 18 months.

The weak economy has forced a big transition in emphasis to retail and away from on-premise sales. High-end restaurant wine sales are gaining back a little ground, but it will be quite a while before they recover to pre-2008 levels. Nielsen researchers predict a

recovery in the restaurant business will be based on Millennials returning to casual-dining establishments.

Banks are lending to wineries, but they have to be really strong deals. For bankers, there doesn't seem to be an adequate risk/reward proposition for them in the wine category right now.

Consolidation will continue for the foreseeable future at every level of the industry – vineyards, wineries, distributors, retailers.

Lots of wineries may be coming up for sale in the West, but the big question is: who will buy them? Not too much activity among the five traditional types of buyers:

- Multi-national spirits companies such as Diageo and Brown Forman.
- Publicly held wine companies such as Constellation and Fosters (NOTE: wineries are cash-intensive, cyclical businesses with low returns – everything a public company hates)
- Private strategic buyers such as Gallo, Delicato and The Wine Group
- Wealthy individuals
- Private equity investors

Family and non-family succession planning is crucial. Active family members have to be passionate about the business, not just see it as an easy paycheck. It's really good if family members have meaningful employment outside the winery (at least 5 years) before coming back to the business. Early on, develop a strong estate planning and wealth transfer framework and keep it current.

One the wholesale side, more consolidation is predicted. Every major market will likely have two big players and a smattering of smaller ones. Distributors continue to reduce their SKU counts. Big distributors are hooking up with big brands and small producers are trending toward direct-to-consumer (DTC) – so where does that leave midsize wineries?

There is a greater blurring of the lines across all three tiers – and everyone wants to "buy direct." In working with distributors, it's much easier for them if your winery is well known for one flagship varietal.

Advice to growers: concentrate on reducing costs at every point (labor, mechanization, equipment, transportation, etc.). You can't hold out for unrealistic prices for grapes. Also, keep an eye on changes in tax rates and availability of water and other resources.

What's hot? Grenache. It has a classic organoliptic profile (I had to look it up) and is highly flexible in red, white or rosé. Also can blend well with pinot noir. Muscat/ Muscato is growing in popularity, too; as are Riesling and sauvignon blanc.

If you have unsold grapes and are thinking about custom crush this year, don't squeeze one grape till you have a solid plan in place for how and where to *sell* the juice/wine.

Everyone should pay close attention to the supply side of the wine market – domestic and global grape production, bulk wine inventory, acreage planted or removed, etc. – and then plan around that.

"The Return of the Boomer" is critical to the wine market today. They have resources and want to enjoy life. They're also a fast-growing category of people using social media. Many Millennials continue to be under- or unemployed.

Prof. Dick Thaler, an expert in behavioral economics and author of the book *Nudge*, had some interesting insights into the role of "choice architects" – anyone who designs the environment in which consumers make decisions. Look closely at how your choices – in restaurant wine lists, tasting room pours, store layout, etc. – are organized. Even the smallest feature of the environment can attract attention and influence behavior. His example: anyone wanting to sell a $250 bottle of wine in an upscale restaurant should put a $400 bottle ahead of it.

Pricing wine correctly is vital and will likely determine a winery's success in a down market. Three basic methods:

- Production + cost
- Wine expert tastings
- Consumer-driven pricing (requires real research and is linked to overall winery marketing strategy)

In pricing wine, timing is vital. Use a basic calendar program to chart the best pricing strategies and tactics over the course of the year.

If you want to build a wine brand, probably need to start out with DTC. And it's much better to have a wine club in place before investing heavily in a tasting room.

For a successful wine club, you'll need a product offering of 7 or more basic wines. The average attrition rate per shipment is 10%, so you need to keep constantly expanding the club. Most wineries with active clubs have out-sourced their shipping. Make your wine club fun – more like a social activity than a business transaction. Some people unconsciously view their wine shipments as "free" because they're invisibly billed to a credit card.

Database marketing is valuable for wineries of all size. Elements of a direct-to-consumer database: Information from POS system, wine club contacts, telesales effort, email database, web inquiries/responses. For midsize wineries, software options include AMS, RMS, Inertia, Wine Direct and others. Small wineries can use Cultivate or QuickBooks.

Train all your staff to manage by the numbers. Establish metrics that are most important to your winery's success, then make sure everyone understands the yardsticks. Offer unique items in your tasting room that "can't be cross-shopped at Costco."

A strong DTC staff will be among your biggest expenses, but also the greatest source of potential revenue. Less than 3% of tasting room staff actually ask visitors for their contact information. If you incentivize staff for wine club signups, it makes sense to pay them a little (maybe $2-$5) for capturing valid email addresses, too. It might be getting easier to capture contact data with new tools like the iPad Bump.

Beyond consumers, use the DTC database to connect with all key audiences including sommeliers, concierges, limo/bus drivers, investors, VIPs, elected/appointed officials and anyone else who can influence your success.

It's important to identify the winery's biggest buyers – and to know if they're brand ambassadors or just buy a lot of wine. Make direct, personal connections with the largest buyers. One suggestion: schedule private living-room tastings where buyers invite their friends and the winery donates 10-20% of sales to the host's charity of choice.

Wineries don't own their brands, nor do consumers. At best, it's a matter of joint-custody. When developing new products, wineries must understand the distinct differences between an on-premise brand and an off-premise brand.

Social media tools aren't very well suited to actually *selling* wine yet, but they can be good for driving customers to purchase at retail. Check out Hahn Family Vineyards free iPhone/iTunes app, www.hahnfamilywines.com. And the tool www.grappos.com helps consumers find exactly where they can buy wines they like.

According to ShipCompliant, 21% of California wineries participate in direct shipping. The numbers are 15% for Oregon (53% of which is pinot noir) and 9% for Washington.

Private-label and exclusive-label wines are growing at a much faster rate than the wine category as a whole.

[NOTE: Many of the speaker presentations are posted online at www.winesymposium.com under Financial Symposium, Program & Details.]