



BW 166 LLC
WINE INDUSTRY ADVISORS

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Financial Sustainability

Setting the strategic direction for a wine company requires an understanding of the financial performance of the company. Profit and Cash Flow are easy concepts to understand on a summary financial statement. They are much more complicated to understand when you consider all of the variables that impact them in a vineyard and winery operation. There are two, almost universal facts, about profits, cash flows and return on assets in the wine industry:

1. Most wine companies do not understand where they truly make their profits and what generates their cash flow and return on assets.
2. The cost and complexity of accurately allocating “all” costs in a vineyard and winery operation will not be worth the benefit. It is necessary to allocate the right costs to have an answer that is 95% right.

In today’s financial environment it is imperative that a wine company “generally” understand where it’s financial success comes from but to do this they have to be pragmatic in how they track it. They need to identify the key drivers to track; the items to allocate with some degree of accuracy; and the items that will not materially alter the financial view of the business. The following are a few areas that need to be considered for the income statement while always avoiding over-complicating the work.

- Grapes: Obviously grapes are the single largest component of wine costs. If a winery buys grapes and there is only one variety going into a single wine this is fairly straightforward in terms of the costs. In most situations this is not the case so things to consider are:
 - If the winery is growing its own grapes are there material differences in the management costs for various blocks? Are the yields fairly similar by block or are there significant variances? Should financing costs be imputed to winery owned vineyards for a better comparison to purchased fruit? Are the grape costs allocated to the actual wines that they go into?
 - For purchased fruit are higher prices paid for certain wines at higher price points? Do these costs get allocated to these specific wines? If only a certain percentage of the higher priced fruit makes the blend for the higher priced wine how do the costs of the balance of these higher priced grapes get allocated?
- Winery Costs: Winery costs are the second largest component of wine costs. One way of breaking down winery costs is between crush and fermentation; aging; and storage. Some considerations are:

- Within the costs for crush and fermentation should a greater percentage of certain assets be allocated to this cost center than just the period of time they are used for crushing or fermenting? Examples of this would be stainless steel tanks and refrigeration. Should a greater percentage of the winemaking staff costs be allocated to this than just the period of crushing and fermentation since this is when a lot of their value is added to the process? Are there certain fermentation tanks that can be used multiple times during the harvest where others are only used once? Should these be allocated appropriately to the specific wines?
- How long are wines aged in stainless versus wood? Are different qualities of wood cooperage used and are these costs accurately allocated to specific wines? During aging how much labor is involved for various processes? Are these adequately allocated to the correct wines?
- Storage, as opposed to aging, is where wines are ready for bottling but are held for a period of time to maintain freshness or defer cash outflows for bottling components. What is the true cost of just holding wines in stainless steel? Are they ultimately bottled before the next harvest season or do they tie up tanks that could otherwise be used for fermentation?
- Bottling: Bottling costs are fairly straightforward. Are packaging components appropriately allocated to each wine including waste and breakage? Are bottling operation costs appropriately allocated to how long various bottling operations take?
- Freight & Warehousing: Are these costs part of cost of goods or are these a separate cost center? Do wines pick up an adequate proportion of costs based on how long they are stored? Are in and out costs tracked separately from monthly storage costs? How are costs allocated for wine libraries or long term storage?
- Excise taxes & Price Promotion: Are these costs allocated by SKU, Brand or not allocated? Do they reduce net sales, or do excise taxes increase cost of goods? Are the impacts of taxes for wines over 14% ABV accurately picked up?
- Selling Expenses: Are the wines sold through multiple channels? Do expenses need to be tracked separately by geography? Do expenses need to be tracked separately for segments such as:
 - Sales to distributors
 - Sales direct to on and off premise
 - Retail room sales
 - Wine Clubs
- Marketing Expenses: Can these be allocated evenly across all products? Should they be allocated by volume or dollars of sales? Is there a difference based on channels or segments?

- General & Administrative Expenses: Can these all be allocated as a current period expense or do some need to be allocated to production? How do bad debts get allocated back to products or segments? Are there specific expenses such as maintenance of the grounds around a winery that need special allocations?

Beyond the income statement it is also helpful to understand the allocation of the balance sheet back to business segments or SKU's. Certain products may have very good gross profit margins but if they require excessive fixed assets or working capital they may actually not be adding to the value of the business.

On the cash flow side how quickly can wines be released? How promptly do customers pay? What are the payment terms from key suppliers?

Making wine is both art and science. However, to be successful over the long term it must be financially sustainable. Knowing what will financially sustain a wine business is more important than ever in today's economic times.