A Timeline and Strategies for Investment in a Winery

R. Brent Ross
Michigan State University

Top 5 Reasons for Starting a Winery

① It should be cheaper to make this stuff than to buy it!
② To make a fortune, small or big
③ To integrate vertically (from grapes to wine)
④ You have just won the state lottery, and want to invest the proceeds!
⑤ To offset taxable income from another business or profession
Sequencing the operation: vineyard first, winery later? (I will first assume that you are determined to grow grapes!)

- Depends upon **ATM**!

  - **A**=Aspirations  What are your goals?
  - **T**=Time  How much time do you have?
  - **M**=Money  How much capital do you have?

- **ATM** has a double meaning: It means that you need a ready source of cash for the first few years you are operating!
How much time do you have? (Best case scenario!)

- Planning, ordering vines, vineyard establishment and development until mature yields are obtained—at least 5 years!
- At least another year is required to produce the first vintage, and perhaps 2 to 3 years to get the marketing plan into full swing.
- You are likely to have at least 4 years of negative net income for the winery.
- So if you start with a vineyard, it takes a minimum of 11 to 13 years to get into a positive net income position if you are marketing only the wine that you produce from your own grapes.
How much money do you have?

Example: 10,000 case small premium winery in the Finger Lakes-NY, 2010

- $29,100 per acre to establish and get the vineyard into full production (land values vary widely!) X 50 acres = $1,455,000
- Includes vineyard establishment, machinery investment, one building, and land at $4,581 per acre (See next slide)
- Requires $1,882,000 to build a 10,000 case winery and cover the negative cash flow for the first 5 years
- Total capital required for first 9 years: $3.39 Million (Best case scenario!)
How much money do you have?

Investment per acre of *V. vinifera* grape required for a 50 acre vineyard, Finger Lakes, NY

<table>
<thead>
<tr>
<th>Item</th>
<th>$ per acre</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>$4,581</td>
</tr>
<tr>
<td>Mach. and equip.</td>
<td>$3,795</td>
</tr>
<tr>
<td>Shop and tool shed</td>
<td>$1,582</td>
</tr>
<tr>
<td>Vineyard est. and dev.</td>
<td>$19,142</td>
</tr>
<tr>
<td>Total investment per acre</td>
<td>$29,100</td>
</tr>
</tbody>
</table>

- 50 acres of vinifera supplies on average enough grapes for a 10,000 case winery

- Total investment for grapes = $1,455,000 (The cost would be cut substantially for native and hybrid varieties)
OBSERVATION

• It depends upon your goals and your location (can you buy in grapes?), but starting the winery sooner, rather than later, is often the best alternative

• Especially true when limited capital is a consideration!

• Cash flow is the driver!
## WINERY

### Wine/grape prices

<table>
<thead>
<tr>
<th>Wine type</th>
<th>Bottle Price</th>
<th>Grape Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dry White 1</td>
<td>$22</td>
<td>$1,818</td>
</tr>
<tr>
<td>Dry White 1 Res.</td>
<td>$27</td>
<td>$1,818</td>
</tr>
<tr>
<td>Dry White 2</td>
<td>$17</td>
<td>$1,091</td>
</tr>
<tr>
<td>Dry Red 1</td>
<td>$24</td>
<td>$1,212</td>
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<tr>
<td>Dry Red 1 Res.</td>
<td>$29</td>
<td>$1,212</td>
</tr>
<tr>
<td>Dry Red 2</td>
<td>$19</td>
<td>$970</td>
</tr>
<tr>
<td>Semi Sweet White</td>
<td>$13</td>
<td>$970</td>
</tr>
<tr>
<td>Semi Sweet Rose</td>
<td>$13</td>
<td>$970</td>
</tr>
<tr>
<td>Semi Sweet Red</td>
<td>$13</td>
<td>$970</td>
</tr>
</tbody>
</table>
WINERY
Year 0 Capital Investment

- Receiving Equip. $105,383
- Refrigeration $10,423
- Cellar Equip. $14,029
- Winery Buildings and Grds. $682,114
- Truck $18,180

Total Yr. 0 $830,129
WINERY
Year 1 Capital Investment

- Fermentation & storage $112,886
- Lab equip. $5,523
- Refrigeration $8,508
- Cooperage $3,827
- Bottling line $23,913
- Office $13,090
- Tasting room $620,301

Total Yr. 1 $788,048
## WINERY

Summary of Capital Investment  
(For buildings and equipment)

<table>
<thead>
<tr>
<th>Year</th>
<th>Investment ($)</th>
</tr>
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<tbody>
<tr>
<td>Year 0</td>
<td>$830,129</td>
</tr>
<tr>
<td>Year 1</td>
<td>$788,048</td>
</tr>
<tr>
<td>Year 2</td>
<td>$35,315</td>
</tr>
<tr>
<td>Year 3</td>
<td>$20,746</td>
</tr>
<tr>
<td>Year 4</td>
<td>$207,307</td>
</tr>
</tbody>
</table>

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**Total for years 0-4**  
$1,881,545
WINERY

Growth Assumptions

<table>
<thead>
<tr>
<th>Annual Vol. (Cases)</th>
<th>Revenue($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1</td>
<td>2,484</td>
</tr>
<tr>
<td>Year 2</td>
<td>3,478</td>
</tr>
<tr>
<td>Year 3</td>
<td>4,521</td>
</tr>
<tr>
<td>Year 4</td>
<td>5,878</td>
</tr>
<tr>
<td>Year 5</td>
<td>7,641</td>
</tr>
<tr>
<td>Year 6</td>
<td>9,169</td>
</tr>
<tr>
<td>Years 7 +</td>
<td>10,086</td>
</tr>
</tbody>
</table>
WINERY
Revenue in Yr. 10

Revenue in year 10 is comprised of:

• Tasting room wine sales $796,182
• Income from wholesale wine sales $555,749
• Income, wine related items $238,855
• Income from all sources $1,590,786

• 4,963 cases sold in tasting room (How much can you sell through the tasting room?)
• 5,123 cases sold wholesale
WINERY Promotion
(Percentage of Wine not sold for Promotional Purposes)

Promotional Use ______% Withheld

• Poured in tasting room 10%

(Cash receipts are reduced by another 10% in the form of case discounts.)
# WINERY

## Financial Plan

<table>
<thead>
<tr>
<th>Year</th>
<th>Amt. of money needed*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 0</td>
<td>$907,237</td>
</tr>
<tr>
<td>Year 1</td>
<td>$947,330</td>
</tr>
<tr>
<td>Year 2</td>
<td>$126,660</td>
</tr>
<tr>
<td>Year 3</td>
<td>$0</td>
</tr>
<tr>
<td>Year 4</td>
<td>$6,254</td>
</tr>
</tbody>
</table>

- Total over five years $1,987,481

*Includes capital investment + operating losses
WINERY
Financial Plan Characteristics

BASIC ASSUMPTIONS:

- All equity financing
- Average cost of capital = 7.0%
- Projected inflation rate = 3.0%
- Effective (real) cost of capital = 4.0%
WINERY
Summary of Financial Analysis

<table>
<thead>
<tr>
<th></th>
<th>10 yrs.</th>
<th>20 yrs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Present Value</td>
<td>$24,240</td>
<td>$2,932,252</td>
</tr>
<tr>
<td>Internal Rate of Return</td>
<td>4.0%</td>
<td>13.0%</td>
</tr>
</tbody>
</table>
Summary points from this analysis

• Starting a winery requires a huge outlay of capital upfront and in the first two years;

• Production is lower than capacity for several years as you develop your market—you cannot sell all the wine that the winery capacity could produce, if equipment were fully utilized, in the early years;

• Therefore, costs per unit are very high (for fixed costs) for perhaps the first five years until you reach the plant’s capacity—implying lower or negative profits. Is this a case for--

OUTSOURCING?
Some Alternative Business Models

• Have an existing winery make the wine and bottle it under your own (exclusive) label. Has to say on the bottle, “bottled in (Town), NY”

• Should cost about half of the retail price per bottle (i.e. native varieties, $5.15 per bottle; hybrids, $6.67)

• If you supply the grapes, it will probably end up costing more! (Extra cost to the winery of running a small batch through the equipment)
Some Alternative Business Models

- Invest in a bottling line, buy bulk wine from other wineries

- Investment costs: Under $10,000 in a basic bottling line will let you bottle as much as 12,000 gal. per year.
  - Caution: “it’s a pain in the __”, according to one winery consultant, to operate such a line, but it does let you indicate on the label that you bottled the wine at your farm. Next question: Do the customers care?

- Operating costs: will be higher than the previous model for several years, at least as you build sales volume
Some Alternative Business Models

• Conduct tastings and sell wines of other wineries as well as your own.

• Rationale: Sell some types of wine that you do not (or cannot) make. Example: Western NY winery making wine from native varieties sells vinifera from a winery in the Finger Lakes to round out its product line.

• Must be licensed as a farm winery.
Some Alternative Business Models

• Make unique products other than wine from grapes*
• Wineries making fruit & berry wine = 58%
• Wineries making dessert wine = 38%
• Wineries making sparkling wine = 29%
• Others making brandy, port, etc. = 8 %
• Total wineries making products with other than wine from grapes = 64%

* Most data from the 2011 Wines & Vines Directory
Some Alternative Business Models: An Example from the Finger Lakes

- Planted vineyards (’97). Started (by a graduate student) with a 10 ac. planting (they now have 40 acres)
- Built tasting room with a café that sold wine from other NY wineries (’98)
- Bought grapes from other growers, use custom processing and bottling for own label (14 MI wineries indicated that they had custom crush facilities)
- Constructed “bare-bones” winery in an old barn
- Complete new winery (’00), make own wine from own grapes
Distribution Strategy

- Wineries in MI with tasting rooms 72%
- Wineries with gift shops 43%
- Wineries with wine clubs 17%
- Wineries in wholesale distribution 61%
- Wineries indicating that ship out-of-state 47%
Impact of Current Economy on Timelines and Strategy

- Ultra-premium, luxury wines meeting consumer resistance.
- Restaurant wine sales are down; hard for the sizable number of high-profile wineries that have built their brands around a strategy of on-premise sales.
- Starting a new brand, unless it's a spin-off from an existing operation, is perilous.
- Smaller wineries, including the thousands of under-20,000-case efforts face uphill battle for distribution and shelf space.
Impact of Current Economy on Timelines and Strategy

• Wine clubs have to prove themselves as consumers sort through their multiple mailings and pick the ones that deliver the most bang for the buck.

• Equipment suppliers see slowdowns in purchases of major capital equipment; cooperages may sell less new oak.

• Brands that have to go head-to-head with imports will be feeling the pressure--including from labels imported by the largest U.S.-based conglomerate producers.
But consumption continues growing....

Source: Wine Institute; Department of Commerce; Gomberg, Fredrickson and Associates, 2011
Number of Wineries in the U.S.

Source: U.S. Tax and Trade Bureau and Wine Institute.

<table>
<thead>
<tr>
<th>State</th>
<th>Growth (2000-2010)</th>
</tr>
</thead>
<tbody>
<tr>
<td>North Carolina</td>
<td>381%</td>
</tr>
<tr>
<td>Washington</td>
<td>329%</td>
</tr>
<tr>
<td>Michigan</td>
<td>224%</td>
</tr>
<tr>
<td>Missouri</td>
<td>213%</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>165%</td>
</tr>
<tr>
<td>Virginia</td>
<td>156%</td>
</tr>
<tr>
<td>California</td>
<td>132%</td>
</tr>
<tr>
<td>Oregon</td>
<td>126%</td>
</tr>
<tr>
<td>New York</td>
<td>112%</td>
</tr>
</tbody>
</table>

* Every state with at least 1 winery
The 50-state wine boom

• This trend should benefit from the economic pinch is the amazing expansion of American wine country to all 50 states.

• Michigan has a number wine trails, boasting many state wineries.

• Iowa has over 80 wineries and the largest-selling label in the Des Moines area is a local brand.

• Paris is too expensive... consumers go for some long weekends in New York's Finger Lakes region instead; or enjoy the scenery and good wines around Traverse City, Michigan.
Impact of Current Economy on Timelines and Strategy

• People in a recession find their pleasures closer to home

• Nearly everybody in the country can have an interesting day in the wine country for the price of a tank of gas.

• Local wineries--at least those with tasting rooms--stand to benefit ...more diversity, more wines and regions and styles becoming accepted as worthy guests at the table of wine, and further expansion of wine culture
Suggestions for grape growers who are considering a winery:

- Use “outsourcing” to get in the wine sales business

- Don’t duplicate what wineries in your area are already doing—these wineries will have a competitive advantage over you for at least several years

- Minimize investment in buildings and equipment. You might use custom pressing, have your own bottling line, sell other wineries’ wines, or have some other winery make wine for your own label

- Round out your own product line by buying in grapes that you don’t currently grow. It is usually cheaper to buy grapes than to grow them!

- Emphasize processing unique products that build on the fruit crops you grow or buy in (i.e. apple, pear, berry wines), fruit brandy, mead)
Some rules for understanding and succeeding in the wine business

① “Cash flow rules.”

② It always takes longer to have a profitable year, and then to recover your investment, than you think it will.

③ You will end up investing more than you think you will (to make up the operating losses in the early years).

④ It’s better to think about who is your ideal customer (and hence, your target market) before decisions are made about Product, Price, Promotion, and Distribution strategies.

⑤ In a location with a mature industry, it is often cheaper to buy grapes (or fruit) than to grow them.
Some rules for understanding and succeeding in the wine business

6. It is usually better to sell wine (and invest in a tasting room and a winery) sooner, rather than later, if you can source grapes (or other fruit).

7. It is difficult for a small winery to succeed with distributors, even in-state.

8. It is costly to get into retail stores and restaurants, especially in an urban area.

9. Thus, most wineries need to start (and maybe remain) heavily reliant on direct sales at the tasting room.

10. Therefore, it is often better to choose a site based on its potential for direct sales and attracting your ideal customers, rather than selecting based on the site’s potential for growing grapes.
Challenges and Management Practices of Wineries in Emerging Wine Regions

R. Brent Ross, Michigan State University
Kathleen Sprouse, Michigan State University
Fabio R. Chaddad, University of Missouri-Columbia
Miguel I. Gomez, Cornell University
Data Collection

**Survey Pre-test**
- Industry experts, extension specialists and winery owners

**Online survey**
- Sent email link twice to wineries via SurveyMonkey in March-April 2012
- **Target:** winery owners

**Field visits**
- Administered surveys in-person in May-June 2012

Total Responses = 113
Distribution of Wineries by Years in Business

% Under 10 Years Old
ALL  72%
MI   70%
MO   70%
NY   76%

Years in business
0-2  3-5  6-10  11-15  16-20  21-30  31-50  >50

COMBINED
MICHIGAN
MISSOURI
NEW YORK
Distribution of Wineries by Cases Produced

% Under 2,500 Cases
- ALL: 65%
- MI: 50%
- MO: 77%
- NY: 67%
- CA (< 4K): 28%
- CA (> 20K): 33%
- CA Median: 8,278

Distribution of Wineries by Cases Produced:
- 0-500: 15%
- 501-1,000: 20%
- 1K-2,500: 25%
- 2,501-5K: 30%
- 5K-10K: 35%
- 10K-25K: 40%
- 25K-50K: 45%
- 50K-100K: 50%
- >100K: 55%
Overview
Wine Owner/Manager Characteristics

% of Time Spent At The Winery

- ALL: 76%
- MI: 87%
- MO: 75%
- NY_PENN: 69%
Overview
Wine Owner/Manager Characteristics

% of Net Worth Invested in the Winery

- ALL: 53%
- MI: 50%
- MO: 58%
- NY_PENN: 49%

Cumulative %

Michigan Grape & Wine Conference
March 4, 2015
## Overview

### Wine Owner/Manager Characteristics

#### Motives for Entry into Wine Industry

<table>
<thead>
<tr>
<th>CHALLENGE</th>
<th>FREQUENCY</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ALL</td>
</tr>
<tr>
<td>Business Opportunity (GW+diversify)</td>
<td>9</td>
</tr>
<tr>
<td>Passion for Food/Wine/People (Wine+Other)</td>
<td>49</td>
</tr>
<tr>
<td>Quality of Life (2) (qual+retire+adv)</td>
<td>38</td>
</tr>
<tr>
<td>Hands in Dirt (2) (dirt+satisf)</td>
<td>32</td>
</tr>
<tr>
<td>Family (Family Business + Fun)</td>
<td>6</td>
</tr>
<tr>
<td>Community (Tourism, EcDev)</td>
<td>20</td>
</tr>
<tr>
<td>Other</td>
<td>3</td>
</tr>
</tbody>
</table>
Challenges Faced in “Undiscovered” Wine Regions: At the **WINERY**

<table>
<thead>
<tr>
<th>CHALLENGE</th>
<th>FREQUENCY</th>
<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ALL</td>
<td>MI</td>
<td>MO</td>
<td>NY_PENN</td>
</tr>
<tr>
<td>Grape Production</td>
<td>32</td>
<td>13</td>
<td>12</td>
<td>7</td>
</tr>
<tr>
<td>Winemaking</td>
<td>27</td>
<td>7</td>
<td>12</td>
<td>8</td>
</tr>
<tr>
<td>Marketing</td>
<td>46</td>
<td>15</td>
<td>16</td>
<td>15</td>
</tr>
<tr>
<td>Finance</td>
<td>25</td>
<td>10</td>
<td>8</td>
<td>7</td>
</tr>
<tr>
<td>Managing the Winery</td>
<td>24</td>
<td>7</td>
<td>13</td>
<td>4</td>
</tr>
<tr>
<td>Labor Related Issues</td>
<td>19</td>
<td>4</td>
<td>8</td>
<td>7</td>
</tr>
<tr>
<td>Environmental Issues</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Regulatory Issues</td>
<td>29</td>
<td>9</td>
<td>9</td>
<td>11</td>
</tr>
<tr>
<td>Quality</td>
<td>11</td>
<td>3</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>Access to Resources</td>
<td>10</td>
<td>1</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>Competition</td>
<td>6</td>
<td>0</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>Other</td>
<td>5</td>
<td>2</td>
<td>0</td>
<td>3</td>
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Challenges Faced in “Undiscovered” Wine Regions: In the INDUSTRY

<table>
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<tr>
<th>CHALLENGE</th>
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<tr>
<td></td>
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</tr>
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</tr>
<tr>
<td>Labor Related Issues</td>
<td>25</td>
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<td>Quality</td>
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<tr>
<td>Access to Resources</td>
<td>8</td>
</tr>
<tr>
<td>Competition</td>
<td>10</td>
</tr>
<tr>
<td>Other</td>
<td>21</td>
</tr>
</tbody>
</table>
# Promotional Activities

## At the winery

<table>
<thead>
<tr>
<th>ACTIVITY</th>
<th>FREQUENCY</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>COMBINED</td>
</tr>
<tr>
<td>Website</td>
<td>111</td>
</tr>
<tr>
<td>Volume discounts</td>
<td>108</td>
</tr>
<tr>
<td>Social media</td>
<td>97</td>
</tr>
<tr>
<td>Customer database</td>
<td>78</td>
</tr>
<tr>
<td>Newsletter</td>
<td>61</td>
</tr>
<tr>
<td>Promotions for returning customers</td>
<td>57</td>
</tr>
<tr>
<td>Club Promotions</td>
<td>46</td>
</tr>
<tr>
<td>Arrangement with tour bus company</td>
<td>38</td>
</tr>
<tr>
<td>Other</td>
<td>15</td>
</tr>
</tbody>
</table>
## Products or services offered
### At the winery

<table>
<thead>
<tr>
<th>ACTIVITY</th>
<th>FREQUENCY</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>COMBINED</td>
</tr>
<tr>
<td>Winery/vineyard tours</td>
<td>75</td>
</tr>
<tr>
<td>Restaurant</td>
<td>28</td>
</tr>
<tr>
<td>Tasting room</td>
<td>112</td>
</tr>
<tr>
<td>Gift shop</td>
<td>84</td>
</tr>
<tr>
<td>Food products</td>
<td>73</td>
</tr>
<tr>
<td>Hosting winery events (weddings, receptions, etc.)</td>
<td>73</td>
</tr>
</tbody>
</table>
Type of Grape Used in Wine Production By State

- **Vinifera**
- **Hybrid**
- **Native**
- **Other**

The graph shows the percentage distribution of different types of grapes used in wine production by state, with separate data for Michigan, Missouri, and New York.
Wine Bottling Style by State

- Varietal
- Blend
- Other

MICHIGAN MISSOURI NEW YORK

COMBINED
Wine Volume by Distribution Channel and State

60% of wineries sell 75% or more of their total wine volume at their winery.
SELLING THROUGH RETAILER

“Supply is important for us, certain local wineries are producing amazing wines but they cannot guarantee us enough supply for us to stock their wine.”

— Mark Esterman, Meijer Grocery’s wine buyer

- Wineries with tasting rooms is important to us, knowing consumers can “experience” their products and brand
- No IRI, scan data or Nielsen data on small wineries or wines in this region is challenging for retailers
- Price is often a major determinant of quality
- We sell what our customers want, not what we think they may want
- Distributors and retailers like wine that is, “the wine is easy to sell”
  - Need to move product
  - Often have limited marketing budget for small wineries’ products
Acknowledgement

• Adapted from original study by Gomez and White. 2013. “Time and Strategies for Investment in a Winery”.

• Winery establishment data for the financial analysis was provided by:

• Dr. Tom Cottrell
  WineDocTM Winery Consulting
  www.winedoc.com
  859-533-8759
Thank you!

Contact information
Prof. R. Brent Ross
Michigan State University
E-mail: rross@msu.edu

AFRI/NIFA Grant Award
Award Number: 0031130
Description: 2011-68006-30815 Chaddad, Fabio