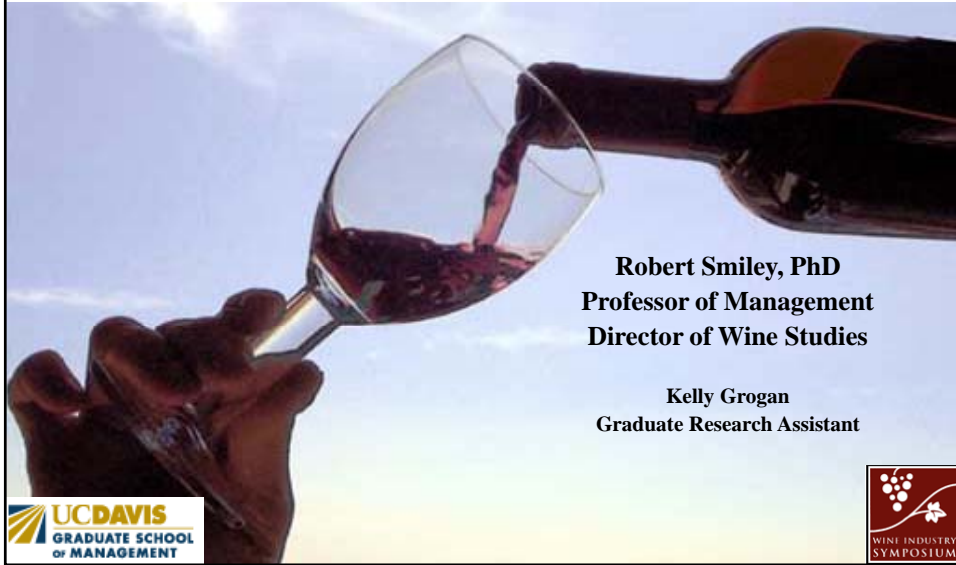


## *A Global Recession and the Economic Effects on the Wine Industry*



**Robert Smiley, PhD**  
**Professor of Management**  
**Director of Wine Studies**

**Kelly Grogan**  
**Graduate Research Assistant**



### 2009 CEO Interview Participants

Ted Baseler	Ste. Michelle Wine & Estates	Chris Indelicato	Delicato Family Vineyards
Warren Bogle	Bogle Winery	Kurt Kautz	Ironstone Vineyards/John Kautz Wines
Stephen Brauer	Fosters Wine Estates Americas	Tom Klein	Rodney Strong Vineyards
Gary Bulger	Hess Collection	John Ledbetter	Vino Farms, Inc.
Jack Cakebread	Cakebread Cellars	Larry Maguire	Far Niente
Joe Ciatti	Ciao Consulting	Erle Martin	Leucadia Cellars Ltd.
Hugh Davies	Schramsberg Vineyards	Charles Merinoff	Charmer Industries, Inc.
Bill Deutsch	W.J. Deutsch & Sons Ltd.	Alex Ryan	Duckhorn Wine Co.
Mel Dick	Southern Wine & Spirits	Bob Torkelson	Trinchero Family Estates
Anjelo Gaja	Gaja Winery	Doug Walker	585 Wine Partners
Joe Gallo	E & J Gallo Winery	Tim Wallace	Benziger Family Winery
Dennis Groth	Groth Vineyards & Winery		



## Interview Questions for the 2009 CEO Survey

1. What has been the impact of the recession on your various products?
2. What changes have you taken to counteract this impact?
3. When do you think the present market disturbance will end and wine sales will return to prerecession levels?
4. When we return to a steady state level of sales, what strategic changes do you expect to have made as a result of this recession?
5. What do you think will be the hottest issues over the next five years?



### Interview Excerpts Question #1

What has the impact of the recession been on your business?

- It has been dramatic and noticeable across the board without exceptions. On the wholesale side, I bet we're down 25+%. Retail sales, direct consumer sales, anything with a tax, we're running higher volumes to maintain flat sales to last year. We're working twice as hard to achieve the same sales, and we're noticing that people that were buying 6 bottles or a case are buying 1 bottle or 2. Wholesale sales, which are down 25%, are 80% of our business.
- Sales are down. It's not universal by product. In the aggregate on a year-to-date basis, we're down almost 30% on revenue, and the hardest part of the business is the high end wine. Our sauvignon blanc is feeling it the least because it's our lowest priced product.



## Interview Excerpts Question #1

What has the impact of the recession been on your business?

- People are buying lesser priced wines, and people are eating at home. They're buying wines that they had bought on wine lists but at retail price, so they're feeling a little better about that. So many people have been buying super premium wines and more expensive wines at the restaurant level, and now that they're eating home, they enjoying drinking the same wines at a much lower price.

RS: Are you adjusting your own inventory levels?

- Definitely, during the good times, we were willing to carry more merchandise, and now we've cut back on our purchasing. We're looking for more turns as compared to what we did in the past.
- Let's say we were carrying 3 or 4 months for certain brands. Now, because of the economy and the need for dollars, we're just working on 60 days on imports and 30 days on domestic products. We have certain brands that are still too heavy, and we're working our way down.



## Interview Excerpts Question #1

What has the impact of the recession been on your business?

- We're definitely seeing people going out less and with wine, they're spending less. There's a big trade-down in the wine business on premise. When you look at spirits, I'm not seeing that trading down. My business is off on spirits because people are going out less, but it seems that they're still drinking premium products on the spirit end unlike with wines where I do see a much larger trade down.
- We've had phone calls from wineries telling us their woes and saying, "We don't even know if we can pay for grapes for 2009." We've had wineries ask us to move the grapes someplace else, and some of them are telling us they're going to pass on the 2009 vintage. It's mostly because of their inventories being controlled by the banks, and the banks tightening the screws.



## Interview Excerpts Question #1

What has the impact of the recession been on your business?

- Last fall, we started to see our receivables stretch. We're with the big guys, and we were surprised to see that. That's something we hadn't experienced before. It continues, and we have to always watch receivables.
- A lot of wholesalers are having to renegotiate their banking facilities. Banks are horrific today in terms of lending money because of the restrictions and the controls. The cost of borrowing is radically different than 2 years ago.



## Interview Excerpts Question #1

What has the impact of the recession been on your business?

- Wholesalers and retailers have reduced their days-on-hand stock, and that has had an impact on different things.
- The number of days supply in inventory is probably down 25% in aggregate. I would say we're making some assumptions, but it's probably 2/3 wholesale inventory reduction and 1/3 retail inventory reduction.



## Interview Excerpts Question #1

What has the impact of the recession been on your business?

- We make most of our sales in the fall, so it's difficult for us to know at this point whether we've been strongly impacted by the recession. Also, most of our wines are on allocation, so we might not even feel it even though demand might shift substantially. But at this point, we do not feel any impact from the recession.
- The business is challenging. Fortunately for us, we have a number of wine brands that are very popularly priced, below \$15, and that seems to be the direction that a lot of consumers are going today, so we're fortunate to have retained and picked up people in that price segment. Unlike a number of companies, we have not had to lay off anyone.



## Interview Excerpts Question #1

What has the impact of the recession been on your business?

- I just found out that two months after the market collapsed, we started having an increase in sales for all our labels. There seems to be a trade-down going on, and our price point seems to be in that range. We've made few changes, but we just keep on growing.
- Our business has actually been pretty good. I wouldn't say outstanding, but pretty darn good. We are growing and are continuing to grow. Our \$9 to \$10 brand is faring pretty well. We don't feel like the economy has hurt it too badly in terms of consumer sales.



## Summary Question #1

What has the impact of the recession been on your business?

- Consumers are trading down, and as a result, producers of high end wine have felt a larger impact of the recession than producers of more moderately priced wines. Many producers of wines at low price points have actually benefited from the recession.
- Distributors, wholesalers, and retails are all decreasing their inventories, making it harder for wineries to sell their wine.
- Banking restrictions are making borrowing more challenging.



## Interview Excerpts Question #2

What changes have you made to counteract this impact?

- I've been in the wine business for 49 years and lived through different business cycles, so it's nothing new to us. We tighten the belt a little bit internally to watch our expenses, and we told our people that they're going to have to work a little harder because it's not peaches and cream out there.
- We took steps to reduce our operating costs. We said no cuts in people, no cuts in salaries, but where else can we find operating savings? We were able to come up with some significant cost cutting on packaging, advertising, and some marketing expenses. We found other costs besides touching grape quality, and we're not having any cuts in people.



## Interview Excerpts Question #2

What changes have you made to counteract this impact?

- We're being conservative in expenses. We're being cautious about a new grape contract. We're bullish about long term, but we know that we're going to have a little more inventory at the end of this year than what we originally hoped. We're delaying entering into new contracts for a year.
- We've held price. There are more price supports going on for restaurants, but we've held our retail price. Last year at this time, we were talking about taking the price of our cabernet up by \$10 a bottle, and we finally decided to keep it flat.



## Interview Excerpts Question #2

What changes have you made to counteract this impact?

- We have, absolutely. We're going to launch another brand, and we're going to launch a more competitive brand that will be largely driven off of over-supply. But it is positioned so that we can grow it on a sustainable basis going forward, so we will be able to source for this product at an appropriate target margin on a go forward basis.
- With regard to our current portfolio, we are reaching through different tactics. We have a dedicated representative contacting our top wine club members just making them aware of some specials and dangling some cellar selections, library-type wines, in front of them and that's proved highly effective.



## Interview Excerpts Question #2

What changes have you made to counteract this impact?

- We're creating deals and pricing concessions as strategically as we can. We're providing whatever support our trade partners need, whether it's more winemaker dinners, more visits, more trade tasting, more account outreach. In the retail room, we're providing enhanced tasting operations, enhanced and extended participation here at the winery. I'm changing some of our retail discount programs. I'm giving price breaks.
- We are putting in place some incentive programs for distributors. And we are not really discounting aggressively which seems to be a different approach than some of the luxury priced products. I think, particularly where companies only have high-end priced wine, they tend to be more desperate, and so they're taking desperate actions.



## Interview Excerpts Question #2

What changes have you made to counteract this impact?

- We're making less wine in the '09 vintage and discounting the current portfolio by a \$1 or \$2 retail to put some grease in the system. The thinking is that's the only way you can get them to talk. They just simply don't want to know unless you've got deal dollars.



## Summary Question #2

What changes have you made to counteract this impact?

- Almost all companies are cutting back on unnecessary expenses and working harder while trying not to cut positions or salaries.
- Some wineries are holding price steady to maintain their brand's image, while others have cut prices to stimulate sales.
- Wineries are targeting loyal club members and bolstering direct to consumer sales.
- Many businesses are working with trading partners to provide or request support.



## Interview Excerpts Question #3

When do you think the present market disturbance will end and wine sales will return to prerecession levels?

- I'm of the mindset that consumer behavior has changed, and I'm not sure if it will ever go back to the way it was before. This is kind of a sea change for us for the long term, and when the economy does begin to perform better, I'm not sure it's going to be like flipping on a light switch and having the consumer go back to their old ways.
- I think it's got a long ways to go. The economy is in dire shape, and people have changed their buying habits quite a bit. People are being very conservative right now.

RS: When the economy picks up again, do you think we will have a permanent change in buying habits?

- Yes, a permanent change in buying habits. People are trying to save money, and they're paying down debts. They're scared about the future.



### Interview Excerpts Question #3

When do you think the present market disturbance will end and wine sales will return to prerecession levels?

- It is here forever, and luxury is being re-defined. Luxury wine, high end luxury north coast wine is being re-defined. Lower perceived value. I believe that people will still trade up. I believe that people still want very high end stuff, but I believe the bar has been dropped down dramatically, so we will take a very, very gradual pull out over a long period of time, ten plus years, to get us back to who knows what.
- I'm not sure if we're ever going to see the mid '90s again. I don't ever see that kind of planting going on again unless there's some catastrophic disease that wipes the industry out.



### Interview Excerpts Question #3

When do you think the present market disturbance will end and wine sales will return to prerecession levels?

- I would say it's going to be pretty deep. Different than the excess supplies we had in the marketplace. This time we really don't have a lot of extra wine out there, so that helps the industry, and it will help us get out of this faster.
- My opinion is that it's going to be quite a while: two, three, maybe four years. I don't think we've hit bottom yet in terms of both the economy and trading down.



### Interview Excerpts Question #3

When do you think the present market disturbance will end and wine sales will return to prerecession levels?

- If you're charging \$150 or \$250 a bottle, if what you're making is so unique and so fantastic, maybe there will be a market for that kind of wine. But just because your address says Napa or Sonoma or Santa Barbara, you aren't going to sell pinot noirs for \$75 a bottle or cabernets for \$150 a bottle unless it's truly outstanding. I don't know if it will go back up.
- I think brands that deliver real value and have a real story that supports that luxury pricing will come back, but I think these consumers are going to be very much looking for a legitimate value proposition in that luxury. You've got to be able to justify the price point other than a façade which maybe you were able to get away with 2 years ago.



### Interview Excerpts Question #3

When do you think the present market disturbance will end and wine sales will return to prerecession levels?

- I hope we start to see a turn as we come close to the holidays and certainly in 2010, but we'll see.
- It's funny you ask that question because we had the WSWA young executives here on Monday night, and I asked that question. Their response was, "It will never come back the way it has been." About half of them said that. But they all agreed that it would come back somewhat in 3 years. I find that a little overly pessimistic. I would say probably 18 months.



### Interview Excerpts Question #3

When do you think the present market disturbance will end and wine sales will return to prerecession levels?

- Starting in October we'll no longer be seeing declines over the previous year because the decline happened last October. And so we think when we start looking at over the year results, we'll see for October that it'll be flat with last year. I think we might see some improvements over the previous year's numbers.



### Interview Excerpts Question #3

When do you think the present market disturbance will end and wine sales will return to prerecession levels?

- I think you're going to see a lot of product hit the marketplace in the fourth quarter.
- I think there are a lot of wineries that are basically pinched for cash-flow. I just know through casual conversations with bankers and people whose opinions I trust and talking to wholesalers, and I know how even some of the iconic brands in this industry are performing now. They've all got supply backing up, and the reality is that one of the brutal aspects of this industry, unfortunately, and especially on the luxury side of the industry, is that you're holding 3 vintages at any given moment, and somebody's going to have to take some action to generate some stimulus to create some velocity.



### Interview Excerpts Question #3

When do you think the present market disturbance will end and wine sales will return to prerecession levels?

- In fact, 3rd quarter last year, in September we had the biggest month we've ever had in our entire history. We were ahead of par, and everything was wonderful. Then fourth quarter, bam, it fell off, and I think our business was off over 30%. Then the first quarter our business was off nearly 30%. Second quarter was 22%. Quarter to quarter. I hope that's a trend.
- As soon as the deal activity pulls away, and I'm guessing it's within the year, we'll be stable. I don't know that we're going to be in any kind of growth mode, but my sense is that we'll return to profitability, and we'll get a fair market value for our product.



### Interview Excerpts Question #3

When do you think the present market disturbance will end and wine sales will return to prerecession levels?

- I happen to be in the group that thinks we're getting closer to the end rather than being in the middle of it. I don't buy into the notion that consumers are going to be different forever. I think they're still going to seek out luxury goods, and I include luxury wine in that. I think the long term prognosis for the wine industry is excellent, and I think the per capita wine consumption, as you know, is growing compared to other areas and other cultures.
- You hear people say things like, "I don't know if we'll ever see what we used to see," and I think that's stupid. Of course we will. Somebody said to me the other day that the consumer is getting used to buying good wine at cheaper prices, and he's never going to go back. Oh yeah, sure, so some of the world's great like Krug champagne has deals on it. Do you think that someday the customer is not going to go back to paying what he used to have to pay for Krug champagne if he can't get it any other way? I think he'll go back to it.



## Summary Question #3

When do you think the present market disturbance will end and wine sales will return to prerecession levels?

- Some people believe that we will never return to prerecession levels. Consumers have found lower priced wines that they enjoy, and they are now more concerned with value.
- Others believe that once the economy recovers, demand for high end wine will return because people like luxuries.
- Many believe only those wineries that deliver true quality and have a story behind them will survive at the high end.
- Estimates of when the market disturbance will end range from a year to several years.



## Interview Excerpts Question #4

When we return to a steady state level of sales, what strategic changes do you expect to have made as a result of this recession?

- We added the additional sales personnel, and I think that we'll retain that, and we always take an aggressive attitude toward sales.
- The most significant parts of it are two-pronged. One will be fewer products available at retail and at restaurants so that the industry's SKU count will be reduced overall. Many fewer brands will actually reach retail shelves whether it's on- or off-premise. There will also be fewer brands due to the distributors who have weeded out many of their weaker performing products. I think essentially we'll see some share growth by the more established labels that are authentic, and that's the second prong. In my opinion, the ones who will survive and even thrive once we're through this whitewater will be those wineries and vineyards that have a story to tell.



#### Interview Excerpts Question #4

When we return to a steady state level of sales, what strategic changes do you expect to have made as a result of this recession?

- We'll end up spending more on the new way to market- facebook and twitter and more online and more trying to generate interest in the brand in ways we haven't tried before. The traditional media is in decline and that includes magazines as well. I think it's going to become a less important place to spend your money, and we are going to have to go online to get those young people. They don't really read these other publications, but there are a lot of people who get their information online.



#### Interview Excerpts Question #4

When we return to a steady state level of sales, what strategic changes do you expect to have made as a result of this recession?

- We've also continued to get closer and closer to the biggest retailers in the country and forge our own closer working relationship, and it's starting to benefit us in a big way. We're trying to make ourselves valuable to them- new ideas, new ways of doing things differently- because the distributor consolidation is really a problem, and we've got to be able to fight through it.
- We'll probably end up making fewer super high end luxury products. Probably broadening the pyramid. Probably making more value priced products and what I call the new luxury value priced products and fewer things north or \$80 or \$90. Just changing the shape of the product mix we have.



## Summary Question #4

When we return to a steady state level of sales, what strategic changes do you expect to have made as a result of this recession?

- Some companies are moving away from higher end wine to be less vulnerable to trading down.
- Some companies are focusing on new ways of marketing and ways to target younger generations who prefer online media to traditional media.
- Others are forging better relationships with retailers to move more product through that channel.
- Similarly, some companies are increasing their sales personnel to increase sales volumes.



## Interview Excerpts Question #5

What do you think will be the hottest issues over the next five years?

- I think the American consumer is going to continue what they've been doing the past 8 years, and that's experimenting on different labels and wines, not just zeroing in on one brand. That's the way it used to be. I think they're going to seek variety.
- I think the wine business will get much stronger. Young people are learning about and enjoying wine. We will be a much bigger wine drinking population, and we'll drink more spirits, also. Innovations of new spirit and wine brands and the new world wineries are all adding to a greater industry. California continues to produce better wines at favorable prices, so I think the future is very bright for our industry.



## Interview Excerpts Question #5

What do you think will be the hottest issues over the next five years?

- First of all, when we get into these harder moments, we're quick to think the sky is falling. I think it's very important to remember that this is just a moment in time. We all are going to have good days, and we're all going to have bad days. The economy is going to have good years and bad years. The wine business is going to have good years and bad years. We're in a difficult stretch now. 10 years from now, or in the future there will definitely be brighter moments.
- I think the premium wine world will be more flat. I think that wine regions are going to become much more aggressive in competition, and so wine competition, not just imports, will continue to remain fierce and give great product quality opportunities to the consumer. The great winemaking regions will become, not meaningless, but significantly less meaningful than they are now.



## Interview Excerpts Question #5

What do you think will be the hottest issues over the next five years?

- I think we're going to end up with some level of increased excise taxes. I think that's automatic; it's just how large they're going to be that's unknown. We're going to continue to buy imports, and imports are going to grow. I think it will be tough. Our costs here, including land, water, and regulations, are going to continue to go up, and I don't know how much consumers are willing to pay for the wine.
- RS: Some people question how well the Central Valley can compete long-term. Do you share that opinion?
- No, I think it's going to be fine. It's all going to be about price point. If they can grow grapes in the \$300 range, that's going to be very competitive with imports. Most of the south valley fruit is about \$300 to \$400. Right now, they can buy cheaper imported wine because of the supply situation, but that's not sustainable.



## Interview Excerpts Question #5

What do you think will be the hottest issues over the next five years?

- Higher taxes. They just instituted a tax in Illinois yesterday. The sales tax is going to double. The state and federal governments have enormous money pressures, and that's going to be a major problem.
- Everything to do with the environment. We're going to be dealing with thornier issues such packaging: recyclable packaging and reused packaging. It's going to be bifurcated where inexpensive wines will be more local and more expensive wines will be more strongly skewed towards imports.
- I see water as an issue as well as sustainability, organic, and how you grow your grapes. Once you're able to sell them and get back to normal, then those come back into play. Supply will also be important. We will have to start planting again. This is definitely going to set us back a couple years more. We're not going to see grapes being planted here.



## Interview Excerpts Question #5

What do you think will be the hottest issues over the next five years?

- I think a lot of that depends upon what my competitors do in the next 6 months. If competitors drop prices too much, 5 years out we'll basically be battling getting the prices back up.
- I'd like to think that 5 years from now, the problem is grape supply. The reality is we're back where we were, and there's not enough Napa Valley cabernet to fill the need, and not enough Russian River pinot noir to fill the need. I think the reality is that the American consumer likes better things, and they like luxuries, and as soon as they can afford it, they will rush back and take what they want and satisfy their own pleasures. I think brands are going to come back strong.
- I don't know if we're going to see the continued accumulation of \$350 plus brands in the Napa Valley. I think we're going to see a lot of those kinds of brands disappear.



## Interview Excerpts Question #5

What do you think will be the hottest issues over the next five years?

- The San Joaquin Air Quality District is a primary target for the feds because of the poor air quality as a result of just the geographic proximity to the L.A. basin, and that's created a place there where we're highly scrutinized in terms of our emissions on the fermentation side. I think this will probably limit our ability at some point down the road. Water use there is another issue. That's everywhere, and I think that those are the things that will probably hold up more planting.
- I think there are plenty of positives. I think wine has become an everyday lifestyle item. I still think people are interested in the health benefits of wine. I really believe that we have great days ahead of us if we're not foolish and hurt ourselves.



## Interview Excerpts Question #5

What do you think will be the hottest issues over the next five years?

- Water. Quantity and Quality. You know what's going on in the southern valley today in the Westlands Water District. Water's going to be huge. It's starting to raise its ugly head up in Sonoma County on when you can or can't pump along the Russian River. That's going to be huge.
- As long as the state is in the financial mess that it's in, excise taxes are going to continue to be an issue.
- The last big thing that I'm seeing is the continuing trend of consolidation of the industry. That definitely affects us. It reduces competition, and that's been going on strongly for the last ten years and quite a bit for the last 5 years.



## Interview Excerpts Question #5

What do you think will be the hottest issues over the next five years?

- I do think that the market is going to size itself. I don't know how much consumer market there is for the amount of brands that were launched and continue to be launched out of high valued regions like the Napa Valley at over \$100 a bottle. I just don't know how much consumer market there is for brands without a really unique selling proposition. So I think there's going to be a vetting there.
- I wouldn't be surprised if Federal Express, UPS, and the like enter the market because it's going to be clear that the 25-30% or 50% markup that the distributor takes is going to be a very bright target for freight companies. I think most people recognize that these distributors are nothing more than glorified freight companies, and there are guys who are bigger and better operating than them who are going to be able to do it as well.



## Summary Question #5

What do you think will be the hottest issues over the next five years?

- Many companies are concerned about increased excise taxes that may result from the state's financial distress.
- Quantity and quality of available water may become problematic in future years.
- Other environmental issues such as packaging and sustainable production will become more important to the consumer once the economy improves. Air quality regulations may also affected producers in the San Joaquin Valley.
- Domestic grapes may be in short supply due to decreased planting caused by the recession and the rising costs of inputs.
- Consolidation of the industry continues to be a concern.

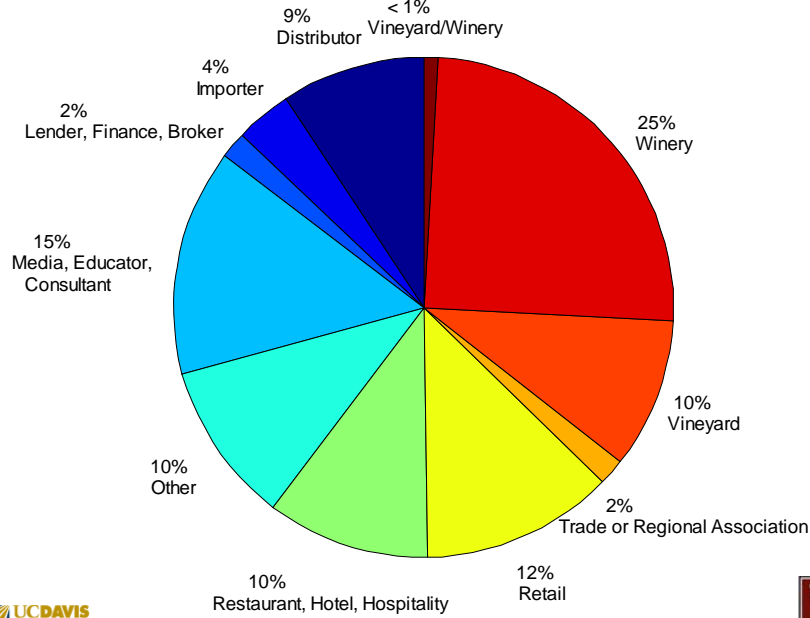


# The Industry Trends Survey

September 15, 2009

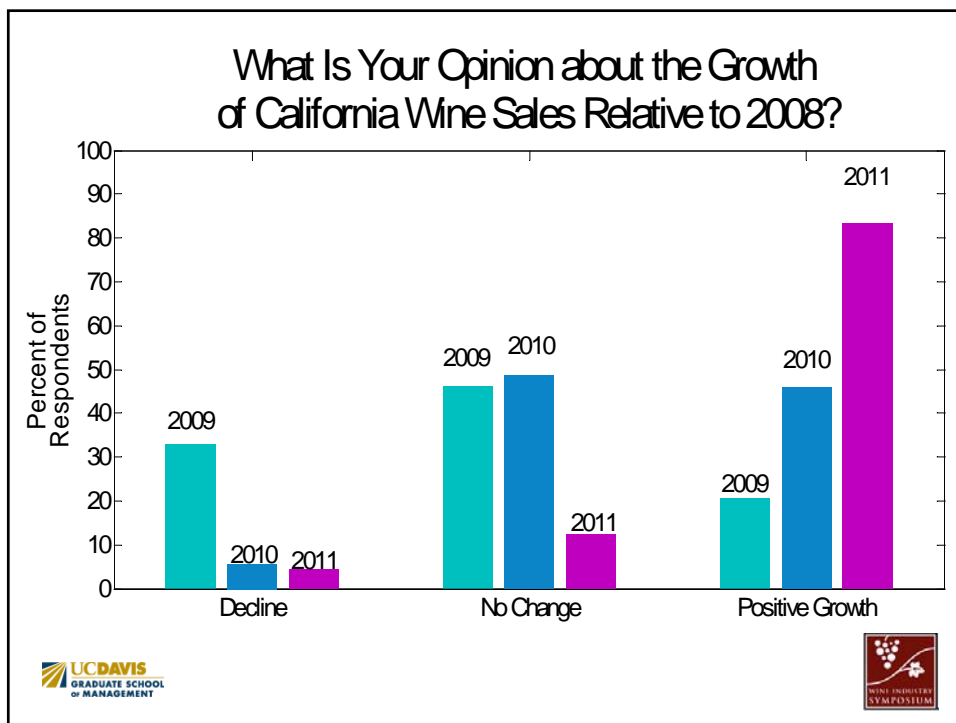
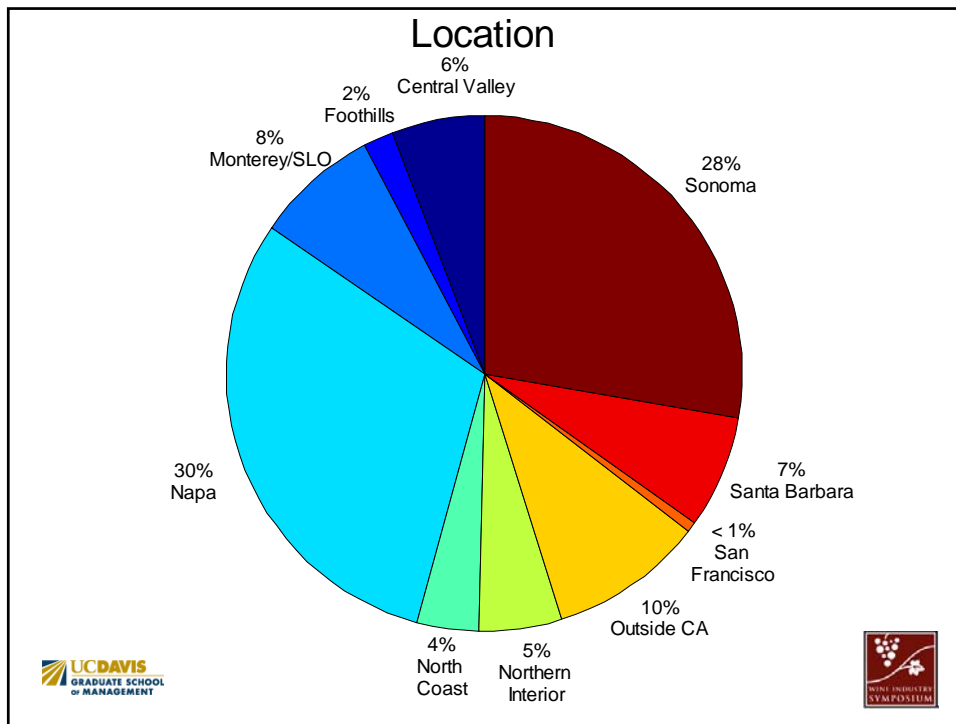


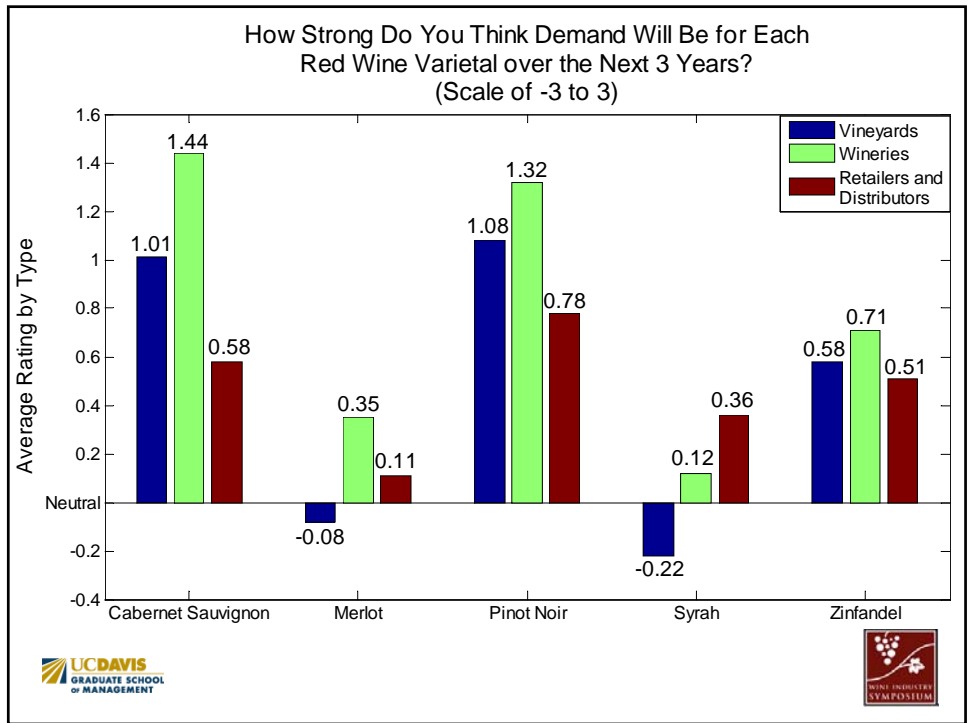
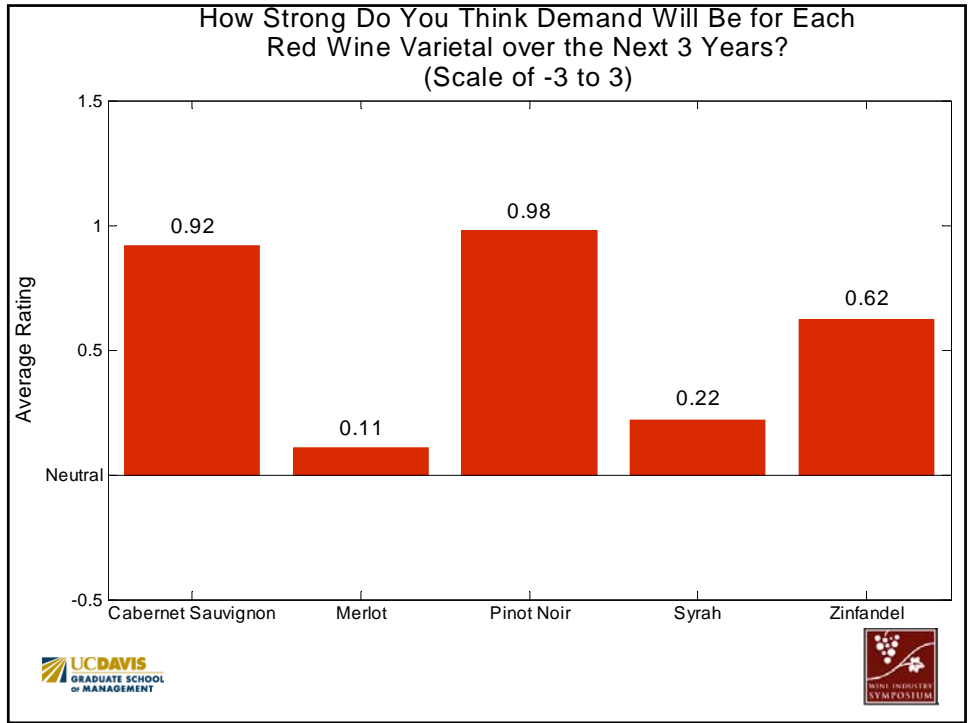
Which Category Best Describes Your Participation in the Wine Industry?

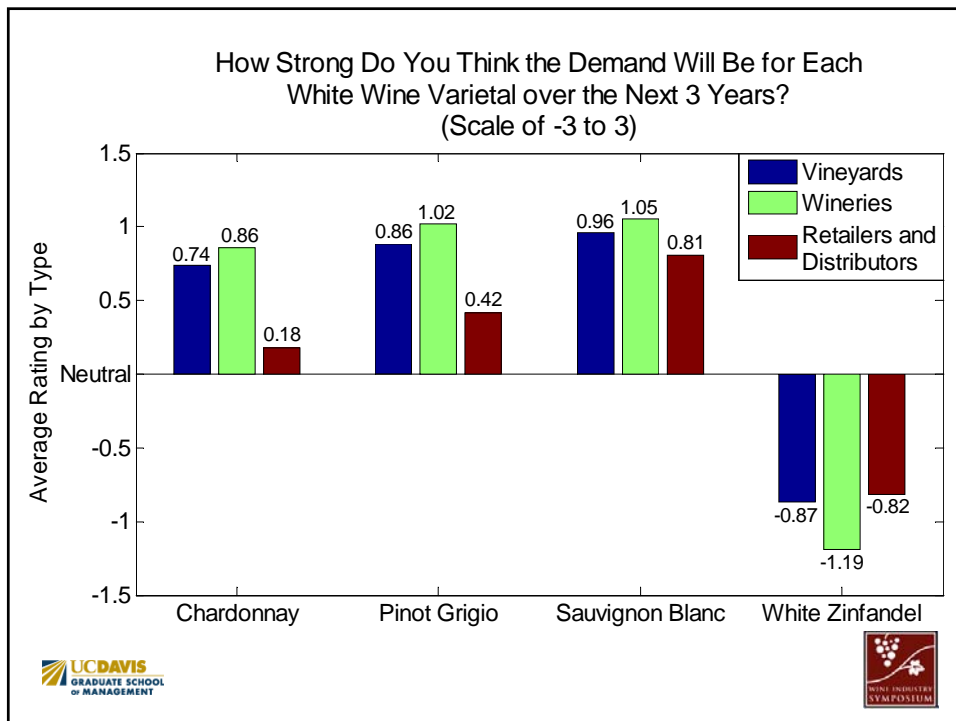
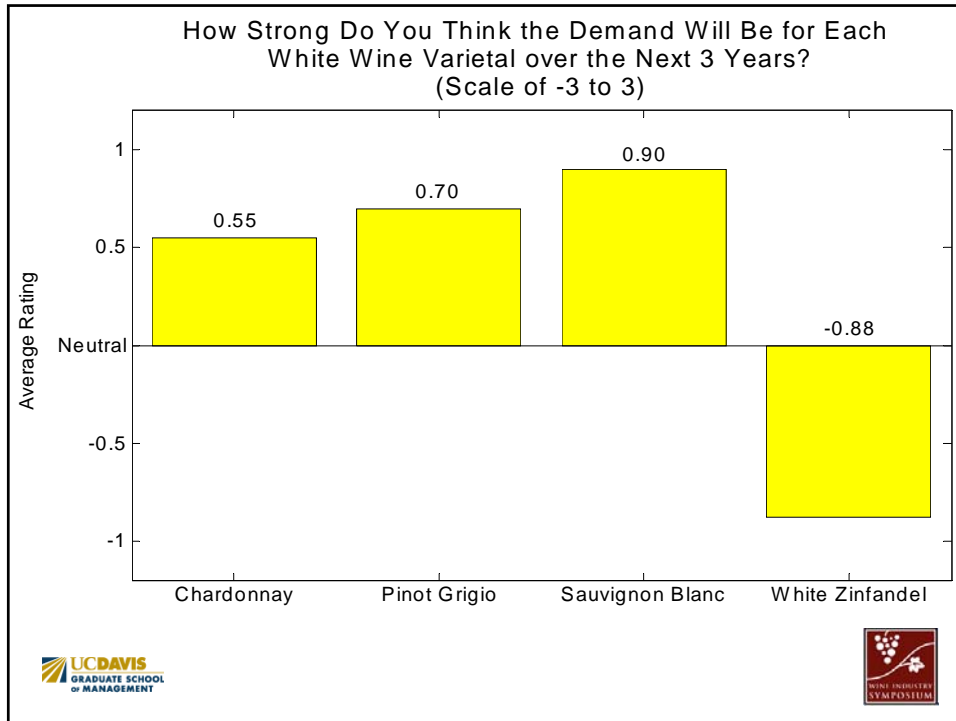


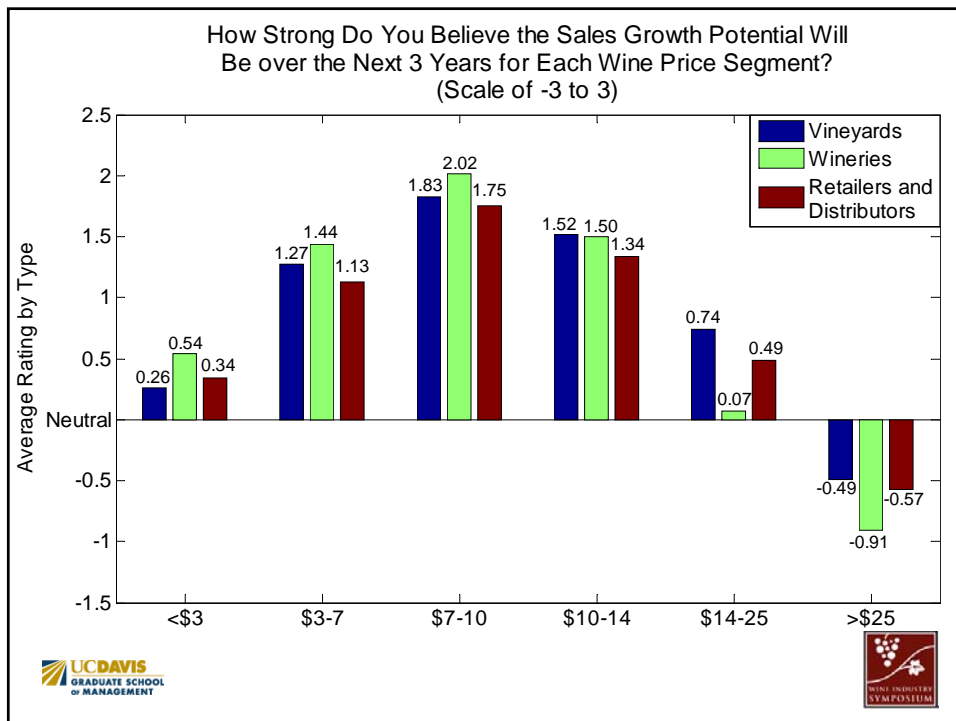
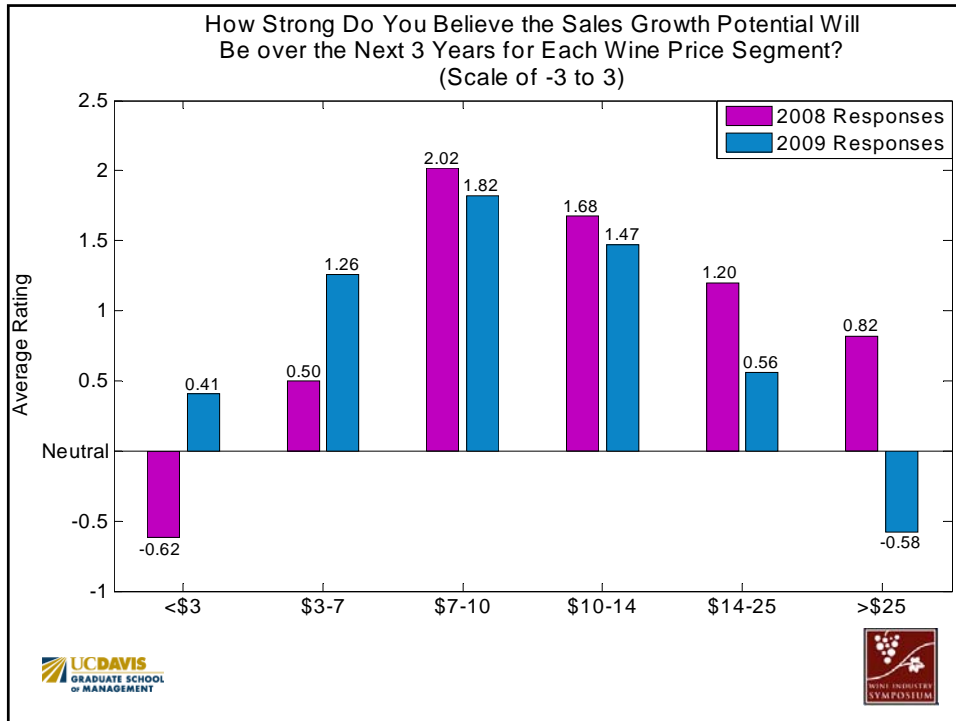
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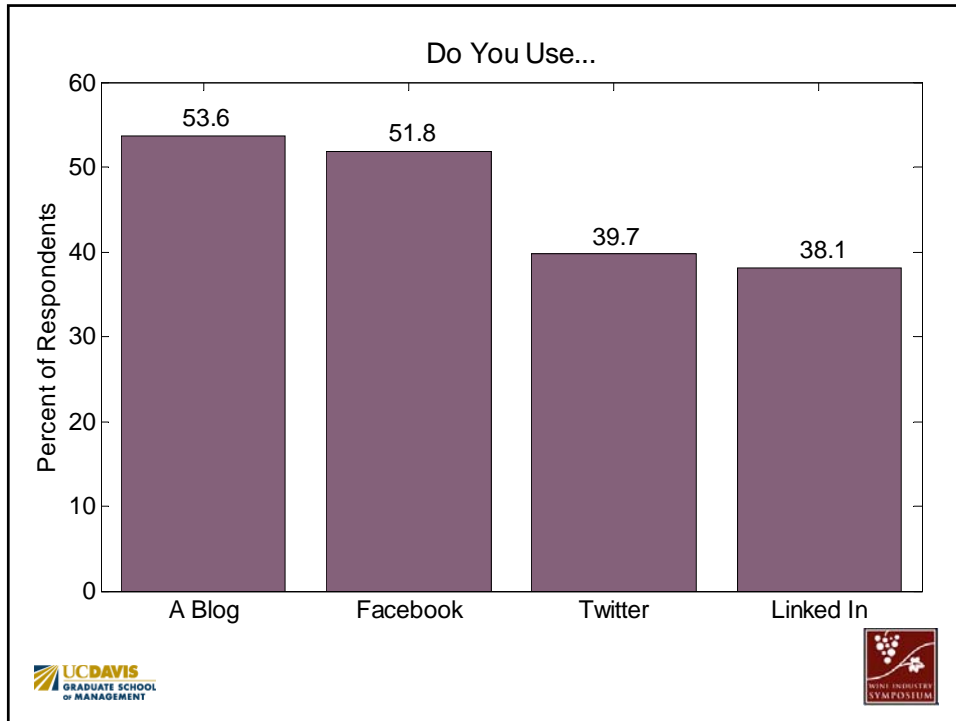


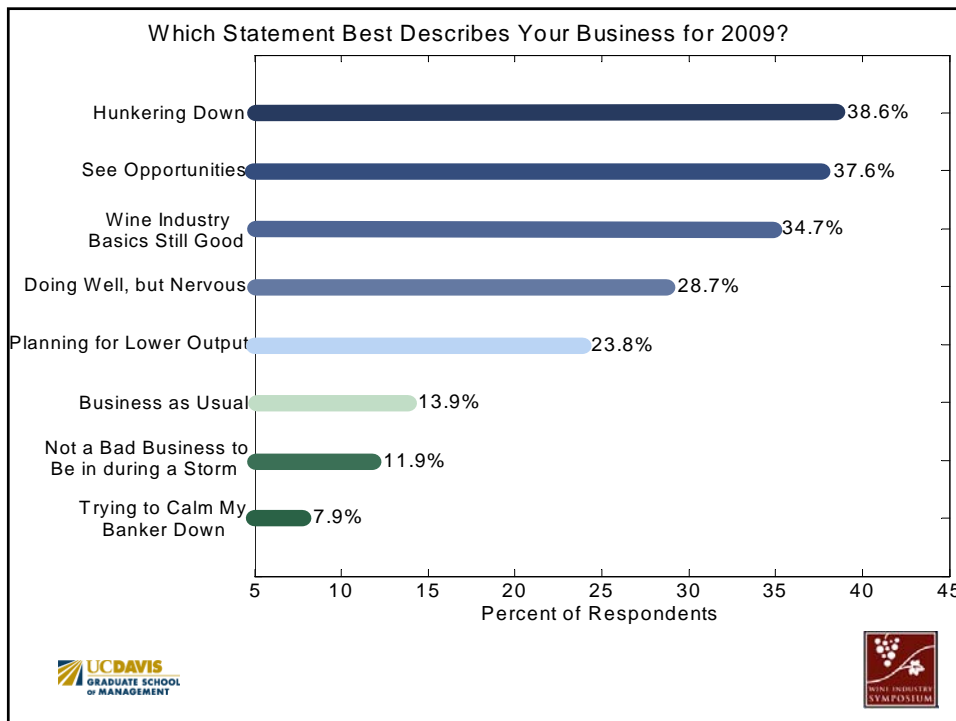
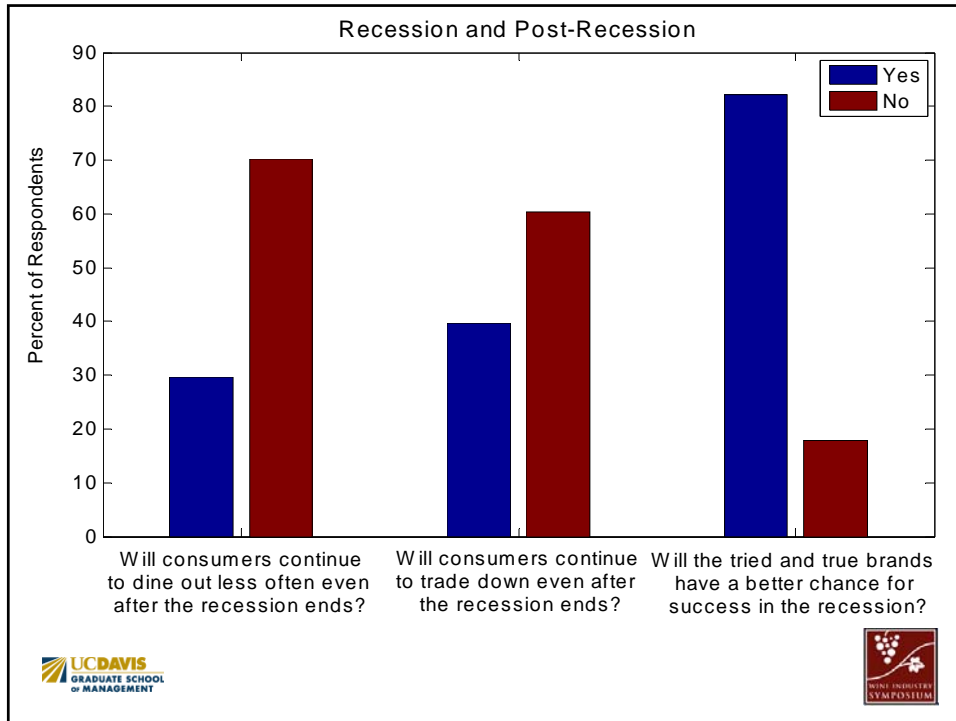






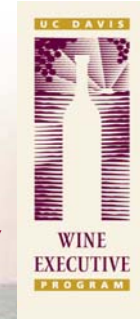






# 2010 ANNUAL WINE EXECUTIVE PROGRAM

PRESENTED BY:  
GRADUATE SCHOOL OF MANAGEMENT  
&  
DEPARTMENT OF VITICULTURE AND ENOLOGY  
MARCH 21-25, 2010  
UC DAVIS  
GALLAGHER HALL AND  
ROBERT MONDAVI INSTITUTE FOR WINE AND FOOD SCIENCE  
DAVIS, CA



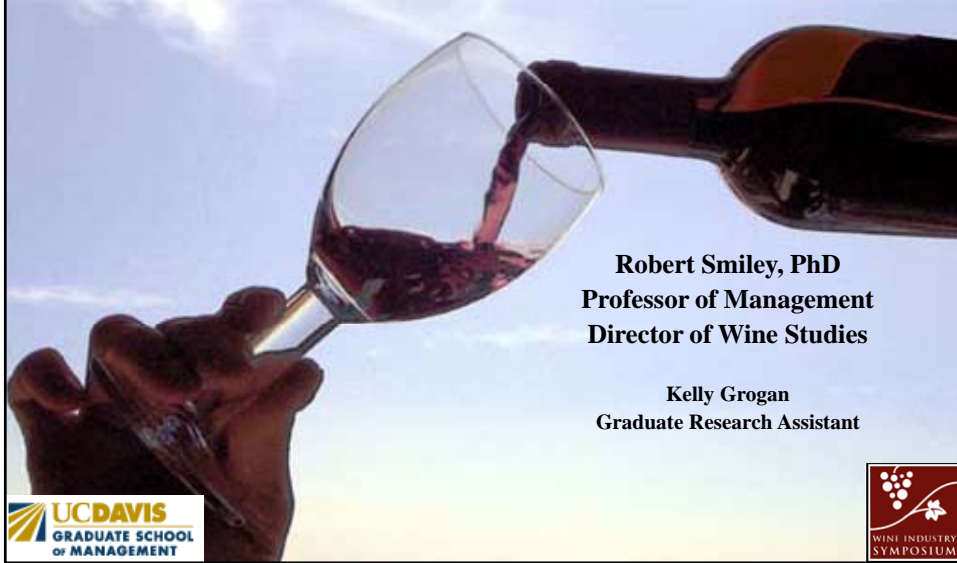
Executive education program focused on the management skills  
necessary to be profitable in the wine industry.

## REGISTRATION & SPONSORSHIP INFORMATION

UC Davis Wine Executive Program  
c/o Graduate School of Management  
One Shields Avenue  
Davis, CA 95616  
Tel: 530-754-6450  
Fax: 530-754-9553

email: [info@wineexecutiveprogram.com](mailto:info@wineexecutiveprogram.com)  
web: [www.wineexecutiveprogram.com](http://www.wineexecutiveprogram.com)

*A Global Recession  
and the Economic Effects on the Wine Industry*



**Robert Smiley, PhD**  
**Professor of Management**  
**Director of Wine Studies**

**Kelly Grogan**  
**Graduate Research Assistant**

