SELLING THE FARM

How Small and Mid-sized Wineries Can
Secure Their Family's Legacy

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Executive Summary

In 2014, Silicon Valley Bank surveyed wineries in Washington, Oregon and California and found that 10.5% were strongly considering selling in the next five years. Of those interested in selling, many were small and mid-sized wineries (SMS) that include a residence. Called, "lifestyle" properties, the value of these types of assets is often in the land and the residence rather than in profits generated from wine sales.

The survey was a follow-up to one conducted in 2008 when a deep recession threatened to clear the landscape of SMS wineries. And although the economic landscape has improved since 2008—land values, for one, have risen significantly—SMS wineries are still struggling with core issues that impact the bottom line: regulation, distribution, and the fight for brand recognition in a crowded marketplace. Heightened competition in particular has forced many SMS winemakers to focus more on marketing and sales and less on making great wine. The quality of the wine hasn't suffered, but the winemakers have.

Owner fatigue and the fact that many SMS winemakers are nearing retirement age likely created the interest in selling spotlighted in

both SVB reports. But winemakers face challenges to a successful sale because:

- Many SMS wineries don't turn a profit on wine sales, limiting local or even regional investor interest. Sellers will need to significantly widen search parameters to find qualified buyers.
- Many SMS wineries are family-owned operations and for various reasons, don't have a succession plan in place that will make retirement feasible, or a family member willing to take over the business.
- Even when family members are willing to takeover, succession may require buying out disinterested family. Since land values, especially in Sonoma and Napa counties, have spiraled upward in recent years, buying family out can be prohibitively expensive.

For many SMS wineries hoping for a successful sale, the answer will be to find a qualified commercial real estate professional that has expertise in winery sales and a global reach to represent the transaction.

Introduction

Of the 646 wineries that responded to a survey conducted in late 2014 by Silicon Valley Bank, 10.5 % on the west coast, including California, Oregon and Washington states said they "were strongly considering a sale or were hopeful a sale would take place" in the next five years. Many of those were small and mid-sized, family-owned wineries.

The study is a follow-up to a 2008 survey that reflected a wine industry ripe for transition thanks to a challenging distribution landscape, and a deep recession responsible for deteriorating wine sales and a dearth of available credit. The 2008 survey reported that up to 50% of wineries in the western US would look to sell in the next ten years, citing as major reasons owner fatigue and lack of a viable succession plan.

Sonoma County recorded the strongest price growth with vineyard values rising by 17.9% in the 12 months to June.

Fast-forward to 2014 and reports of the demise of SMS family-owned wineries were greatly exaggerated. Economists who predicted wineries would close their doors, unable to secure financing to replant, upgrade equipment or refinance existing debt were proven wrong. Farmers are a resilient lot and most held on, unwilling to sell at rock bottom prices.

Since the recovery that started around 2010, the wine business has enjoyed bumper crops, higher bottle prices, healthy sales and ever-increasing land values. In fact, in Sonoma County alone, land values rose on average 17.9% in the 12 months before June 2014.* But even with the healthy wine market restored, owner fatigue still persists and SMS wineries still face challenges to selling.

Sweeping Changes In The Wine Industry

The wine business has changed markedly in the past 30 years. In the 1980s and 90s, when many of today's SMS vineyards were planted, the most important factor to achieving success in the wine business was crafting a great, drinkable wine.

That was then. Today there are more than 7,000 wineries in the US. Over 3,500 are in California with 1,436 considered small as represented by a yearly case production of between 5 and 49,000. Most or all of those wineries are producing great, drinkable wines. But thanks to distribution, competition and regulation challenges, only a small percentage actually turn a profit.

Recreational drinking preferences have changed, too. An aging boomer generation—the cohort that for years has supported the wine industry--will drink less wine going forward and millenials, the next largest generation now coming of age, don't yet have the financial clout of their parents' generation and so can't afford to drink descent wines on a regular basis.

And while the data indicates that strapped for cash millenials love their wine and may eventually surpass boomers in consumption, they also love spirits and micro-brewed beer, a phenomenon that cuts into the profits of the wine industry.

Further, the competition from the beer and spirits markets comes at a time when winemaking is no longer exclusive to Northern California's Sonoma and Napa valleys. Oregon has won a place at the table of great wine regions. Along with the growing regions of the Western United States, today literally every state grows wine grapes (including Alaska!) and anyone who shops at Costco knows that competition from countries like Australia, Argentina and Chile is keen.

But changing demographics and increased competition from all over the country and the world aren't the only problems facing small wineries.

Limited Distribution and Rise of the Winemaker Marketer

Before the dot.com bust in 2001, many small distributors carried lesser-known wines. After the bust, a consolidation occurred in the distribution industry and small distributors were gobbled up by large national corporations that neither wanted nor needed to carry small case production wines. Overnight small wineries were left to fend for themselves.

The law of the jungle in the wine industry is fairly straight forward; limited distribution = no brand value. No brand value = limited distribution. In today's marketplace, unless your winery has a compelling story that creates brand value and guarantees sales, the likelihood of selling your wine anywhere but in your tasting room is slim.

The tasting room is certainly a viable sales channel, especially if production is limited. But for every tasting room that lines the winding roads of any wine region, there are three wineries that don't have tasting rooms and building one is a costly endeavor, especially in a difficult credit environment. Without a compelling story, a small winery is up against enormous competition.

Creating an "authentic" story about the winery and how the wine is made has become the overriding goal of every small winery. Unfortunately, the job of creating a brand presence too often falls to the winemaker who may be ill-equipped to disseminate the winery's story across multiple social media channels. Consequently, small winemakers often spend more time marketing and selling their wines than actually making that wine. What was once a labor of love, has turned into just plain hard labor.

Succession Or Sale?

It sounds like an ideal life; spending days in the fields amid the rows of lush green vines covered in leaves that canopy clusters of plump grapes; evenings sipping the fruits of that labor with family and friends. At least that's what the advertisers, fixated on "hand-crafted" would have us believe. More likely than not, the hands that did the crafting are calloused and the bodies attached, too tired after a long day of working in the vineyards and then posting about it on social media late into the evening to do anything else.

When owners begin to think about retirement, succession is one option that almost all family owned businesses consider. Wineries are no exception. Unfortunately, succession planning is rarely a top priority for many farmers and when owners find themselves ready to retire, no plan is in place.

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Adding to the uncertainty about who will take over the business is the simple fact that farming is tough and not every family member will feel the pull of the land. It's also a long game in which rewards can be years in the future. The struggle isn't lost on children who might decide that while they aren't afraid of hard work, another field where their efforts will be more immediately rewarded might be a better choice.

If there are one or two children or grandchildren willing to take on the business, buying out disinterested family members can be an expensive proposition, especially in counties like Sonoma and Napa where property values are prohibitively high. If the children who want to continue producing wine but don't have the money, they may attempt to secure credit to purchase a business that isn't consistently profitable. With banks still hesitant to lend, who will extend that credit and at what cost?

Deciding To Sell

The above considerations and challenges explain why the 2014 SVB survey still finds many SMS winery owners "strongly considering a sale or hopeful a sale will take place." Unfortunately, when it comes to selling any property, hope should be low on the list of what's necessary for a successful sale. Far more pressing are tangible, quantitative considerations like assets v. liabilities, current market forces, value and age of existing equipment, succession planning. In short, any and all cost considerations that will impact sales price.

There are also what analysts call, "soft considerations." Discretion tops that list. When an owner decides to sell, discretion is the better part of valor for three reasons: time to close, impact on the brand and creditors concerns.

Time To Close

Months and in some cases even a year or more can go by from the time an owner decides to sell and the day the sale is recorded. That slow burn can cause stress in the work force where employees may be legitimately concerned that once the winery is under new ownership their jobs could be in jeopardy. They may begin jumping ship prematurely. The last thing an owner wants when trying to find a buyer is staffing problems.

Impact On The Brand

Customers don't want to know that a winery is up for sale either. In a business where small wineries are all about creating the "story" for their branding, often the story of a family owned winery that has struggled through good times and bad to bring their customers the best wines possible is all part of the charm. Admit that you want to sell because making wine has become a joyless slog or because the kids want no part of the business isn't exactly what marketers mean by "authentic." Wine lovers, looking for a good story and a feel good atmosphere will simply head to the next tasting room.

Creditors Concerns

Considering a sale can take many months to record, a potential buyer but especially a creditor wants to be sure you don't stop working on your business once it goes up for sale. Selling a family-owned business can often raise questions about the financial solvency of the owners. Creditors can become more than just a friendly nuisance if they start having doubts about whether or not the loan will

Case Study – Veritas Winery and Vineyards

In 1981 Bill Hunt** had already made his fortune in the technology industry and wanting to follow a family history of working the land, decided to buy forty acres in Northern California. He planted ten acres in grapes and in the ensuing years, built a winery and tasting room, worked on the brand and established a wine club. Bill didn't need to make a huge profit—this was more than a labor of love it was his way of connecting to his roots. He knew the winery would likely never be his primary source of income. Instead it was a family undertaking into which Bill welcomed his daughter and son-in-law. For a while at least, the family was happy to run the winery, cover expenses and not worry about much else but enjoying good wine.

Unfortunately when Bill and his son passed away in the span of four years, Bill's daughter was left to run the business on her own. Still losing money, Mary didn't think much about succession or what to do next. She was simply soldiering on. Then the recession of 2008 hit and her father's primary business, the one responsible for her income, slowed significantly. Suddenly, a $200,000 loss per year was no longer acceptable.

An Eventual Sale

While Veritas Winery and Vineyards was a stunning property that included an impressive winemaking facility, because of the small case production and, well, because they never had to worry about it, Bill and the family never spent time building a brand. That negative feed back loop of no brand/no distribution/no brand value became a liability when Mary decided to sell. In the days and months that followed her decision to sell, a buyer—the right buyer—proved difficult to find.

The value of her asset was not in the business or the replacement costs or cost of equipment, but in the land. After several years of trying to find a buyer, Mary finally decided to sell her winery at auction through Williams & Williams. Her buyer turned out to be a local business man who had "sat on the fence" for several years and then ended up paying more than the original asking price for Veritas Vineyards.

be paid off, or if the business is being sold due to financial duress.

Who's Going To Buy Your Life's Work?

According to Kevin Foster of Newmark, Cornish & Carey's Wine Services Group, "Vineyards and wineries encompass two separate businesses, each requiring a deep knowledge and a unique skill set to market effectively."

Once a winery owner makes up his or her mind to sell, first and foremost for most transactions to be successful is determining exactly what is being sold. A seller and commercial real estate agent can then work together to find a qualified buyer. As we've noted, many SMS wineries don't have brand value because low production has kept them out of the distribution pipeline. Finding an investor to purchase a winery without an established, recognizable brand can be a daunting challenge.

An obvious place to look is a large, established winery. And while it's true that a large winery might be tempted to add to their portfolio, it's unlikely without a recognizable brand. Wouldn't they be interested in the grapes? Perhaps, but larger wineries are most often interested in established vines and will generally look for wineries that are in the 100-acre range to make it worth their while. A home on the property is of no use to a large winemaker.

Of course there are other possibilities; someone who has made a killing in technology and wants a custom crush operation. But even then, most saavy buyers still want their investment to appreciate over time. Without a brand that means a lot of work for a long-term return that is hardly a guarantee.

Selling A Property At Auction

One possibility is to sell a winery at auction. Large auction houses have extraordinary reach thanks to extensive marketing capabilities. Simply stated, an auction brings the market. The auction process ferrets out serious buyers who are contractually obligated to enter into the same terms and conditions as a buyer would, including losing 10% of the asking price if they back out of a successful bid.

Most importantly to the seller, an auction is a time definite winery sales solution. The average time from listing to close is 75 days.

Conclusion

The brilliant French critic and writer, Jean-Baptiste Alphonse Karr famously said, "the more things change, the more they stay the same." Certainly that's true for a global wine industry that has always been and will continue to be a passionate undertaking requiring equal parts grit and romance, savvy and naiveté. It's no accident that the oft-repeated idiom, "if you want to make a small fortune, take a large one and plant grapes," has proven true for many a beleaguered winemaker. Driven by creativity and often affected by circumstances beyond the winemaker's control, the business of growing grapes and turning them into fine wine can be both cruel and rewarding.

The 2014 SVB report speaks to positive change in the wine industry. There is nothing more productive in business then the change that new owners with new insights can bring. The decision to sell can be a difficult one but once reached, if the sale is handled by an experienced professional commercial brokerage that has a strategic understanding of the local wine market, sellers will enjoy a comfortable retirement, buyers realize a dream come true and perhaps most importantly, the wine industry will continue to thrive.

About The Wine Services Group –Newmark, Cornish & Carey

The Wine Services Group has far reaching resources and a unique, customized approach to servicing the global wine industry. Prior to marketing a property, the Wine Services Group performs targeted and complex analyses customized to the wine industry property, which incorporates brand value, production methods, storage, inventory, distribution and sales. Additionally, a partnership with Newmark Grubb Knight Frank (NGKF) ensures that properties and opportunities are accessible and marketed worldwide through its 7,000 brokers. NGKF's London-based partner Knight Frank also maintains a specialty group that works with wine-related properties in Europe.

The Wine Services Group has formed a joint initiative with Williams & Williams to sell wine-related properties via auction.

**To protect the client's privacy, Bill Hunt is not the owners real name, nor is Veritas Winery the actual name of the winery that was sold.