WINE BUSINESS LEADERSHIP STRATEGIES IN A GLOBAL ECONOMY

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Executives Interviewed

- Bob Torkelson
  - Trinchero / Sutter Home
- Joe Gallo
  - Gallo Winery
- Larry Maguire
  - Far Niente
- Randall Grahm
  - Bonny Doon
- Mark Cuneo
  - Sebastiani
- Tim Wallace
  - Benzinger
- Gary Heck
  - Korbels
- Chris Indelicato
  - Delicato
- Jose Fernandez
  - Constellation
- Joe Ciatti
  - Ciatti
- Patty Bogle
  - Bogle
- Mel Dick
  - Southern Wine & Spirits
- Tom Klein
  - Rodney Strong
- Michaela Rodeno
  - St Supery
- John Ledbedder
  - Vino Farms
- Paul Dolan
  - Mendocino Wine Company
- Tom Selfridge
  - Hess Collection
- Dan Lease & Doug Walker
  - Red Truck
- Alex Ryan
  - Duckhorn Vineyards
- John Kautz
  - Ironstone Vineyards
- Clay Gregory
  - Kendall Jackson
- Peter Mondavi
  - Charles Krug
- Charles Merinoff
  - Charmer Sunbelt
- Scott Weiss
  - Fosters
- Jack Cakebread
  - Cakebread
- Ted Baseler
  - Ste. Michelle Wine and Estates
Questions

1. Has the run-up in demand for Pinot Noir and Pinot Gris run it’s course? Or does it have more legs?

2. Will global brands dominate wine in the future such as a wine version of Budweiser, or will appellation brands continue to be important?
Questions

3. Alternative Packaging: Should producers be leading the consumer more in bringing new closures, packages, and sizes to market? Or should we wait for customer demand?

4. What do you think the future of the all-ingredient labeling will be, and what should it be?

5. What will we be talking about in 5-10 years that we aren't talking about now?
Question 1: Has the run-up in demand for Pinot Noir and Pinot Gris run it’s course? Or does it have more legs?
Pinot Noir / Pinot Gris

• I see Pinot Grigio continuing to grow. The consumer likes the lightness of it. Besides being a pleasant wine, it’s easy to pronounce, it’s easy to remember, and the consumer who goes into an Italian restaurant looking for something other than Chardonnay or Sauvignon Blanc feels very comfortable with it. If you sit in an Italian restaurant and the consumer is not certain what they want and they want white wine, they will probably rattle off Santa Margarita Pinot Grigio - which is all one word. It’s like 50 years ago when suave came out they would order Soave Bolla and they thought it was a type. The consumer didn’t know that Soave was a type and Bolla was a brand.
Pinot Noir / Pinot Gris

- If you look at Pinot Grigio, there is a real ceiling in terms of retail price – the market knows how much you can charge for it. In terms of the higher end ones, the market isn’t going to grow a lot and below seven dollars or so, there is probably still some growth, but I sense we are getting to the point where we are going to be in-balance and probably an oversupply. From what I see, it is getting into balance at the lower price points and at the higher price points we are not going to grow a lot.
Pinot Noir / Pinot Gris

- Pinot Gris’ growth is long term and to me, is not as much of a fad (it’s not driven by a movie) I think it just has a natural appeal from a flavor standpoint. New world Pinot Gris are a little rounder and a little softer than the Italian Pinot Grigio and it’s a nice alternative to Chardonnay – it’s easy to pronounce and it’s going to continue to grow.
Pinot Noir / Pinot Gris

• I’m certain that Pinot Noir has more legs. There is no question about that. If you talk to people who love wine and you ask them what they like to drink, they tell you they love to drink Pinot. You don’t hear the same thing about Pinot Grigio, so I don’t know that it has as many opportunities for success as Pinot Noir has.
The Pinot Noir Phenomenon happened just at the right time for California in that back in the 70’s they planted Pinot Noir everywhere and it just didn’t work in a lot of locations. There are only 5 or 6 locations where it can actually work - Russian river Carneros, Santa Barbara, Mendocino and parts of the central coast. But that’s about it. Now we are starting to plant Pinot Noir in the central valley, there is stuff going in north of Lodi, stuff is going in all over the place because it is such a hot variety. I just don’t believe that those locations are going to produce great tasting fruit and when that stuff starts to come to market that’s when I’ll get more concerned.
For Pinot Noir I think the consumer is divided into two groups: There is the high end Pinot purchaser who really knows a lot about Pinot who is somewhat fanatical about it. And then there is the group that buys the lower priced wines because they have heard about Pinot. What I think is going to happen is that at the higher end, I think you are going to see growth continuing, though there are only so many places you can plant Pinot so there are going to be limitations on the supply.
Question #2: Will global brands dominate wine in the future such as a wine version of Budweiser, or will appellation brands continue to be important?
Global vs. Appellation Brands

• I think it’s going to depend on the price point. If it’s under $10 I don’t think it matters. You can have whatever appellation you want on it. As it goes up in price people get more concerned about where it’s grown, where it’s from what’s the story behind it. If it’s a 25 dollar bottle of wine I think people want to know where it’s from. Certainly from which appellation. And if it’s $75 to 100 dollars per bottle they want to know what appellation, which vineyard and what’s the story.
Global vs. Appellation Brands

• I think it’s a function of price point. I think that below seven dollars a bottle I don’t think it’s that important where the grapes come from for the consumer and so I think that if there is a shortage of chardonnay in California and there is a wine priced at that price point, then the producer will get the wine from Argentina or Australia or wherever. I think that global supply will be the normal course for wines in the lower price points and I don’t think the consumer is going to care.
Global vs. Appellation Brands

- Appellation brands are always going to be strong and to those people who are serious wine drinkers, and collectors, it will always make a difference. The source has everything to do with the quality of the wine – it starts in the vineyard.
Global vs. Appellation Brands - simplify

- I think we will have both and these are kind of like paralell universes. In the new world, appellation essentially is a marketing tool and a marketing trick. I think it has very minimal real meaning. It’s a branding exercise. In the old world, appellation still has a little bit of meaning - and so the two are just not equivalent - they are two different animals. We call them both appellation, but they aren’t really. Appellation in the old world has so much more rigor associated with it as far as farming practice, varieties, spacing, trellising - all that stuff is so proscribed. In the new world everything goes - to the point where appellation I think is essentially meaningless.
Global vs. Appellation Brands

• We continue to see a huge amount of interest by the consumer in appellation and the nuance of where the wine is from. Wine still carries a huge amount of that nuance which is why the branding can be so powerful. If that goes away, we just become a commodity. If you look at a parallel industry of coffee – they have gotten more and more into appellation or origin of the beans to distinguish their coffee and to distinguish different price points. Certainly they spend a significant amount of money on research – so there is something to it.
Question #3: Alternative Packaging: Should producers be leading the consumer more in bringing new closures, packages, and sizes to market? Or should we wait for customer demand?
Alternative Packaging: Should producers lead or follow?

- I think it's really something of a funny situation that sort of like “After you my dear Alfonse” – and everyone is waiting for someone else to kind of take the lead but few people are spearheading real change.
Alternative Packaging: Should producers lead or follow?

• My sense is that as consumption continues to rise – like any other beverage, or any other food product, packaging does attract new consumers and for current consumers, new packaging potentially provides an additional benefit – like it’s easier to store, easier to use, to picnic with etc. Yeah I think so – the producer has to continue to innovate there.
Alternative Packaging: Should producers lead or follow?

• I think it depends on the varietal. We are now putting screwcaps on our Sauvignon Blanc - It is a wine that is going to be consumed within a year of it’s release, and it seems to be a trend that is here to stay. New Zealand is leading the pack and consumers love it - they like the ease of it, the simplicity of it - Particularly women enjoy taking the corkscrew away from the men and allowing themselves to just pop the top.
Alternative Packaging: Should producers lead or follow?

- The widespread industry acceptance of the Stelvin wine closure has radically transformed the image and appearance of screw cap wines. The screw cap has gained traction and popularity in both Australia and New Zealand among high end white and red wines. Despite some resistance from Sommeliers and wine retailers (what are we going to sniff?), it is clear that for white wines the screw cap has earned a permanent place in your wine cellar and on your table.
Alternative Packaging: Should producers lead or follow?

• We are doing some research on Screwcaps. I don’t think they bring anything more to the party than synthetic corks do frankly. Some people think they are easier to open but I have seen myself and waiters struggle with screwcaps.
Alternative Packaging: Should producers lead or follow?

• We believe that the traditional cork suppliers have become much more aggressive, much more responsive, much more attuned to our needs and our complaints. We are really speaking with a louder voice about cork quality issues and are being responded to. I think the quality of corks in increasing.
Alternative Packaging: Should producers lead or follow?

“I think what we need to do is to have options that are consumer driven. There are a lot of consumers out there that want alternate packaging, particularly things like screwcap or the higher quality bag in the box. It enables them to minimize waste, sustain wine quality, and it simplifies serving for them, so I think that when you get a consumer driven trend like screwcap or bag-in-the box, the industry needs to provide that and it becomes a point of differentiation.”
“After you my dear Alphonse…

"I think that what we want to do on this issue is to be in the middle of the pack. We don’t want to be last - and we don’t want to be first."

"Producers should lead - but it won’t be us." 30%

"Consumers demand should lead" 11%

"Producers should lead" 59%
Question #4: What do you think the future of the all-ingredient labeling will be, and what should it be?
All-Ingredient labeling

- I know that there is a lot of concern in the wine industry that it is neo-prohibitionists that are driving this.
- If there are issues of serious allergic reaction or potentially avoided-type full disclosure, that’s one thing – but I don’t think that’s what we are talking about.
- RS: Then what are we talking about?
- I think they want to control alcoholic beverages
All-Ingredient labeling

- Ingredient labeling should be limited to "Contains Sulfites" and "May Contain Allergens." All other ingredients in a bottle of wine change with every bottling. If wineries are expected to change labels constantly, the cost could be prohibitive and could put some wineries out of business.
All-Ingredient labeling

• I’m out all the time drinking with people in the industry and they never get that deep into what is in the bottle. They talk about the taste, the appellation, the history, the name, the family – and that’s what I love to talk about in wine. They aren’t interested in talking about the specifics.
All-Ingredient labeling

• I think it’s a matter of the consumer, and what do they really want to know. If we think there are definitely components in a bottle of wine that the consumer should be aware of, we should tell them. But I would take a poll and see what consumers really want to know. I talk to a lot of consumers about the products that they consume and like myself, they are mostly concerned with carbs and calories.
All-Ingredient labeling

• I think that there is a lot of negotiation that has to go on between the government and the wine industry as to how they are going to handle this because I think it’s already been passed into law and now they just have to figure out the regulations. I think that people were looking at a lot of other products besides wine when they signed that legislation and now wine is just caught up in a broader legislative package.
All-Ingredient labeling

• First of all, I think our country and our consumers are overwhelmed with all this labeling crap. I don’t particularly believe that people read all this stuff. I think a lot of this is because we have some active groups that have been active politically and have spent some money to get some of these things with ingredient labeling. Some of these outfits would want ingredient labeling on everything that you pick up in this country.
All-Ingredient labeling

• What happens when you put wine in a barrel? Should you list what gets leached out of the oak? When you use yeast in a wine, there are things that are leached out of the yeast... Where do you draw the line on that? I think it's more complicated than a lot of consumer products, and frankly I don't think it's necessary. I don't know – I hope not.
All-Ingredient labeling

• We were talking to a buyer at one of the many supermarket chains and talking about the popularity of organic foods in general and I said “What about organic wine?” and he said “Consumers already think wine is organic” so you don’t have to worry about that with wine. There is a purity of image that I think we need to keep that going, and the bottom line is that we add virtually nothing to the wine anyway. I guess I would say it’s not something I would push.
All-Ingredient Labeling

• The industry needs to respond with one voice so that this is not something that descends into the chaos of every producer having a different opinion. We are working closely within the wine institute so that we can speak with one voice so that the information on the label helps the consumer make an informed choice with meaningful information.
All-Ingredient Labeling

• We should present information that is consumer relevant and meaningful, right now we are debating what advocacy groups want on the label we need to step back and ask “What does the consumer need to know?” and put THAT on the label
Question #5  What will we be talking about in 5-10 years that we aren't talking about now?
Future Issues

• Sustainability and the economic viability of being able to grow premium wine grapes in California
Future Issues

• We are going to be talking a lot about this issue of climate change and global warming. “How do we manage our industry from a carbon standpoint and how do we reduce the CO$_2$, because we produce CO$_2$. 
Future Issues

- We are going to be talking a lot about resource management. Environmental issues are going to be a big deal for business in general, and everyone is going to have to deal with it. For example, we use bottles – and bottles are heavy - and bottles are expensive to ship - and it takes a lot of energy to make a glass bottle - so we are going to have to deal with that at some point in time. We ship wine long distances and that’s expensive, we should probably be more focused on local markets.
Future Issues

• The direct sales issue is going to become a bigger deal. The distributors are becoming very powerful as we know, but at the same time, there is a lot of expense in the system and you have to believe that somebody is going to figure out a model where wineries can ship directly to retailers and cut out that extra 25% that it costs us at the distributor.
Future Issues

• Asia is going to be a huge opening for the world – and I think it’s going to take at least 10 years for the world to figure that thing out. There is going to be an increasing customer base that is going to emerge.
Future Issues

• I am concerned with California's ability to compete, with just our high cost of doing business. Generally speaking, we have to be near the top.
Future Issues

• I think the key to really being successful is being behind the demand curve, because every winery that gets ahead of it - the retailer trade knows it, and you have to push it - then you're price discounting and you destroy value very quickly. I tell you, it can turn on you in a very short period of time. The really successful wineries that I’ve seen have given up some growth opportunities so that they can take pricing up and can manage more margin. They are the ones who are the most successful - and I think that is really the key for the success of the wine business.
Future Issues

• One thing the industry is having a hard time with is the supply of glass. What are we going to do about that as an industry?
Future Issues

• I think in 5 years we are going to be wondering why we can’t get more vineyards planted, because we are going to be in short supply.

• The demand continues to grow in this 4-5% range, and in 4-5 years that’s 20-25% more volume and there is just not enough vineyard land and people putting vineyard into production. I think it’s been so brutal, and so tough on growers for the last 5 years that it’s been one of the worst downturns we’ve seen in some time, and the cost of planting a vineyard has gone up about 50% since the year 2000 - just for the steel and the stakes and wire. The costs of planting a vineyard have just exploded.
2007 Industry Trends Survey

Compiled by the Wine Industry Financial Symposium Group® and the U.C. Davis Graduate School of Management

AUGUST 2007
Q1 2007 - Survey Respondents by Type

- Winery: 63%
- Vineyard: 22%
- Consultant: 6%
- Distributor: 4%
- Retailer/Restaurant: 3%
- Lender/Finance: 2%

104 Responses
Winery Respondants by Case Production Volume

- Under 1k: 2%
- 1k to 10k: 20%
- 10k to 50k: 23%
- 50k to 100k: 20%
- 100k to 1M: 28%
- Over 1M: 7%
V12. 2007 Acres Owned by Respondents

- Over 500 acres: 65%
- 200-500 acres: 10%
- 50-199 acres: 15%
- 25-49 acres: 5%
- 1-24 acres: 5%
Industry Outlook
Q2 Response Outlook for Profitability of California Wine Industry for the Next One to Two Years

- Decline
- No Change
- Improvement

Comparison for the years 2006 and 2007.
Q18 Winery vs. Vineyard Profitability Outlook

Were you profitable in 2006? Do you expect to be MORE profitable in 2007?

- Winery
- Vineyard
2. Percentages of respondents who believe the industry is in an "upswing" by respondent type

- Winery
- Grower
- Retailer
- Financial and Consultant
- Distributor
Q20 - Percent of vineyards expecting a crop shortfall in 2007 (by region)
Supply of Pinot Noir by Growing Region

- **Santa Barbara**: Balanced Supply
- **Central Valley**: Balanced Supply
- **Central Coast**: Undersupply
- **Napa / Sonoma**: Balanced Supply
Supply of Pinot Gris by Growing Region

- **Balance**
- **Undersupply**

<table>
<thead>
<tr>
<th>Growing Region</th>
<th>Balance</th>
<th>Undersupply</th>
</tr>
</thead>
<tbody>
<tr>
<td>Santa Barbara</td>
<td>30%</td>
<td>0%</td>
</tr>
<tr>
<td>Central Valley</td>
<td>0%</td>
<td>80%</td>
</tr>
<tr>
<td>Central Coast</td>
<td>50%</td>
<td>50%</td>
</tr>
<tr>
<td>Napa / Sonoma</td>
<td>80%</td>
<td>0%</td>
</tr>
</tbody>
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Supply of Chardonnay by Growing Region

Balance
Undersupply

Santa Barbara
Central Valley
Central Coast
Napa / Sonoma
Market Trends
Q 8- 2007 Five Year Comparison of Growth Potential for Wine Price Segments
Q7 2007 - What Wineries and Growers Think About Sales Growth By Variety

-1.50 -1.00 -0.50 0.00 0.50 1.00 1.50 2.00 2.50

Winery Grower

Very Strong -> Strong -> Weak

Cabernet Merlot Red Zinfandel Pinot Noir Syrah Chardonnay Sauv. Blanc Pinot Grigio White Zinfandel

1. Wine As Everyday Beverage
   - 2006: 4.24
   - 2007: 4.32

2. Economic Growth
   - 2006: 3.7
   - 2007: 4.1

3. Health Benefit of Wine
   - 2006: 2.87
   - 2007: 4.32

4. Removal of Direct Shipping Barriers
   - 2006: 3.5
   - 2007: 4.09

5. Price/Value/Quality
   - 2006: 3.28
   - 2007: 3.68

Scale of 1-5 (2007 converted from Scale of 1-3)
Q4 2007 Top Negative Trends Affecting Growth of Wine Sales

- Global Competition
- Distributor Consolidation
- Retailer Consolidation
- Pricing Pressure
- Governmental Regulation
- Water Immigration Policy

Scale of -3 to +3
Changing Strategies
Q.16W 2007 - What New Products/Packaging Respondent Wineries Will offer in the Next 12 Months

- New Varietal: 43%
- New Packaging: 38%
- Twist Off Caps: 8%
- New Bottle Sizes: 6%
Q17W Has The Ability To Ship Directly Increased Wine Sales?

![Bar Chart]

- **Yes**
- **No**

Winery Size (case production minimums): 5,000, 10,000, 500,000, 100,000, 1,000,000
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104 Responses

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AUGUST 2007
Supplementary Material
The Vine to Fermentation Carbon Cycle

Photosynthesis

- Sunlight
- 100% Atmospheric Carbon Dioxide
- Water

Fermentation

- Carbohydrates (Sugars)
- Plant Tissue
- 42% Atmospheric Carbon Dioxide
- 58% Alcohol

Fossil Fuels

- Cooling / Process Energy

Bottom Line: Fermentation CO2 is **biomass** CO2 and has a net **beneficial** effect on the global carbon budget.