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## LAST 24 MONTHS: NEW REALITY

In December 2007 – when we published our update, [A Perfect Storm Revisited \(II\)](#), the industry’s largest players continued to grow through acquisition and global sourcing. Globalization was helping to mitigate production over-supply. More states were open to inter-state shipping. Regulators, driven by wholesaler trade associations looking to control market access, were at the same time making it more complex to market and ship wine direct and legally. This was inhibiting wineries and logistics providers from easily building profitable new direct shipping business models.

Over the last 24 months, regardless of the new legal complexities, winery direct ship permitting and three-tier delivery models have tapped into consumer markets for premium and super premium wines that were nonexistent even four years ago. The net effect has been to limit growth in this segment to those marketers and wineries who have heavily invested in the new technology and to empower consumers to demand access to premium wines in the most restrictive states.

An unexpected **Great Recession** has had the net effect of accelerating some of our predictions and slowing others down. Although the real ramifications of the **Great Recession** are still unknown, many are expecting a long recovery with long-term impacts on consumer purchasing behavior<sup>1</sup>. Some impacts include:

- The recession, inter-state logistics hurdles and a concentration of wines above \$50/bottle have put small wineries in a perfect storm predicament, many reporting sales down as much as 40%.<sup>2</sup>
- Big players have been reconfiguring and trimming their portfolios to grow profits organically instead of getting larger through acquisition.
- SKU<sup>3</sup> rationalization is hitting even the smallest players.
- Thousands of white table cloth restaurateurs close doors, heavily impacting the luxury sector.
- Luxury consumerism is considered ‘Un-American’ as consumers globally struggle to keep their jobs and feed their families.
- Distributor consolidation has escalated as that segment struggled to survive in this economy, essentially shutting smaller players<sup>4</sup> out of national wholesale channels.

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<sup>1</sup> HBR Video interview with Professor John Quelch: [How to market during a downturn](#).

<sup>2</sup> “Luxury Wine Business Reels from Downturn” - Wall Street Journal, 7/8/09

<sup>3</sup> SKU = Shop Keeping Unit

<sup>4</sup> Most wineries, less than 250,000 cases in volume, are struggling to remain relevant to large distributors.

- Worn down by industry phase and economic cycle, many more wine business owners are looking to exit sooner through sale to 3<sup>rd</sup> parties or to the next generation, February 2008 joint report published by Scion Advisors/Silicon Valley Bank: [Ownership Transitions in the Wine Industry](#)<sup>5</sup>.

Most importantly, the pendulum has shifted and the industry is more competitive and polarized than it was four years ago. Figure 3 illustrates how the large, billion dollar producers are more aligned with the very large distribution companies and the small producers desperately need new or alternative marketing and distribution systems.

The U.S. Wine Market is undergoing its most difficult cycle in 30 years. As large wineries are dominating and controlling a more limited number of wholesalers – smaller wineries are literally being locked out, unable to sell profitably through existing national distribution channels.

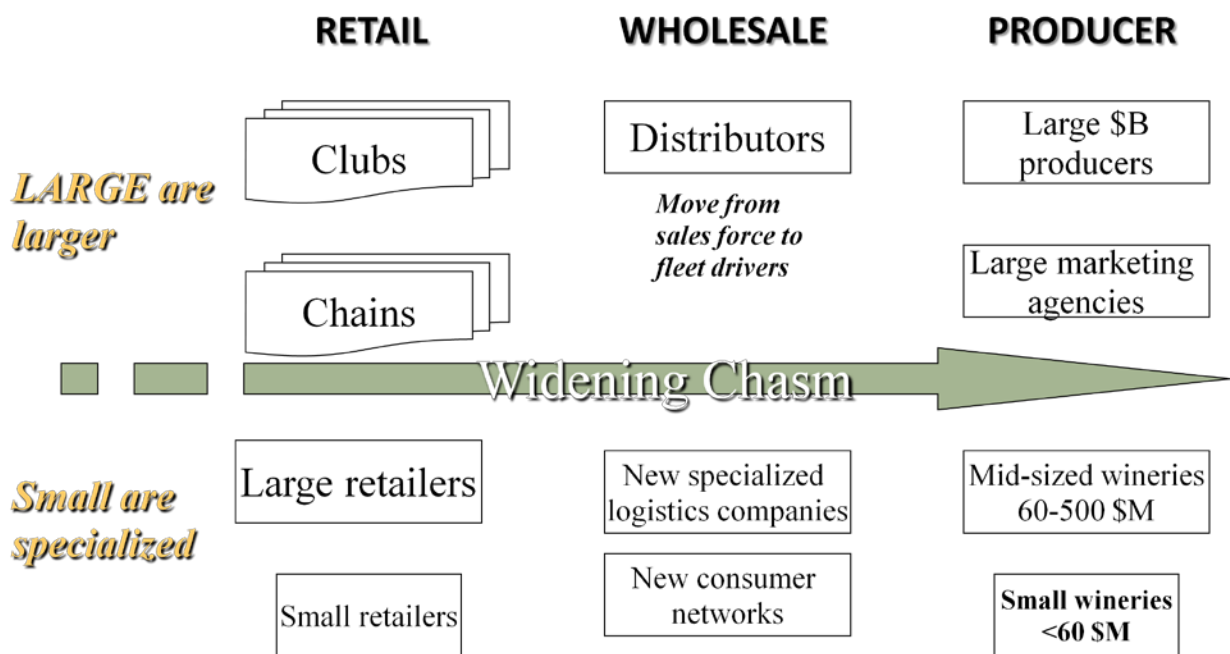


Figure 3 - The Pendulum Shifts: Under 250,000-Case Producers Need a New Distribution System

Furthermore, many wholesalers are heavily cash flow constrained due to the global economic cycle and/or debt incurred during recent consolidation dynamics. Given economic and competitive pressures, this market phase could last for 2-3 years.

<sup>5</sup> [New Report: Ownership Transitions in the Wine Industry](#). Rob McMillan, Silicon Valley Bank Wine Division and Deborah Steintal, Scion Advisors

The long term impact of these forces is dramatic on under 250,000-case wineries, especially those with portfolios in the above \$30msrp/bottle categories. Even A-players, unable to move inventories, are down 30-40%, and are discounting heavily. We are expecting a wave of foreclosures and bankruptcies among wineries most dependent on national channels and unable to cover cash requirements over an extended down cycle.

Figure 4 revisits six key predictions from our 10-year framework for [U.S. wine market liberalization \(Wine Market 2015\)](#).



Figure 4 - 2009 Reality Check: Past 24 Months, Revisiting Six Predictions



## **U.S. wine trade policy and regulations will encourage innovation and participation.**

- 2009 Reality Check: Many initiatives are in play, and we assert that the recession will become the mother of innovation as a critical mass of smaller players struggle to succeed.



## **Integrated distribution models will serve large and small players, aided by new technology - driving efficiencies in production and distribution.**

- 2009 Reality Check: Larger players, more able to invest in technology, are moving into integrated inventory management platforms with key distributors and customers.
- Smaller players are struggling to keep inventories on distributor floors as non-performing SKU's are dropped.
- Filling the void, new distribution business models are investing in technology enabling smaller producers to find new paths to market and ship direct to trade and consumer.
- Integrating with communications, ecommerce and fulfillment systems, experienced compliance solutions such as E-Compli are positioned to support legal shipping direct to trade and consumers.
- Now in development throughout the industry is the "integrated" business model, where one business entity combines winery, import and retail operations (legal in California), and utilizes both direct shipping and three-tier delivery to fulfill national market orders obtained from different marketing sources.

Figure 4 - 2009 Reality Check: Past 24 Months, Revisiting Six Predictions

Little has moved the business of producing, marketing and selling wine forward more efficiently than the economy. Wine producers have not yet been able to quantify the impact to their balance sheet of either the health effects of wine or the green movement but are benefitting from the impact of millennial wine consumption.

For answers to questions, please call Deborah Steinthal: 707.246.6830.