

BENCHMARKING IN THE MIST:

**The Elusiveness (and Urgency) of
Benchmarking in the Wine Industry**

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Introduction

The wine industry business is as complex as its wines are alluring. Winemakers work passionately to discover a wine's identity and unique characteristics, but they are not alone in their quest for discovery.

Like winemakers, winery owners and business managers are on a quest to improve their business, constantly evaluating their strategic plans—especially in this economic environment—analyzing where they've been versus where they want to go, and how they'll get there.

And somewhere out there, deep in the misty Napa or Sonoma Valleys or vineyards of Anywhere, USA, hides an elusive key in the wine industry—the industry benchmark. This is the tool of objectivity. This is where a winery owner looks outward, expands the view, and widens the lens of financial analysis... a tool that will tell a winery how they compare to their competition.

This is where the value of relativism increases beyond, “Are we doing better than before?” and “Can we do better still?”

Never has this elusive comparison tool been more urgently needed than now, in this economically unstable time. Consumer behavior is changing; competition is more challenging. Industry benchmarking should be one of the three legs of the financial management stool upon which businesses should rely. Yet, in the wine industry, instead of a third leg stands a pillar of... what? Is it there? Can it be found, discovered?

Can it be done?

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THREE LEGS OF THE STOOL

When business owners review and report financial information (timely, if managed well), they compare three key data points: historical results, projected results, and industry benchmarks. The comparison of these three data points make up the “three-legged-stool” of sound financial management, no matter which industry they’re in. Take away any one of them, and managing a business becomes a balancing act only an acrobat could accomplish. Yet, this is exactly what businesses in the wine industry have been doing, some with more agility (or luck) than others.

There is no metric that demonstrates “if you include or exclude benchmarking in the wine industry, here are the with-and-without results.” But good wine industry business owners and managers know the critical balance and potential gains this elusive third leg brings to ongoing financial management.

Critical, you say? “How has the wine industry been operating ‘successfully’ without benchmarking, then?”

Our answer is simply this: that the correct word we should question is actually “success.” A company’s results—their profitability or financial success—without point of reference or comparison is not necessarily meaningful. To ignore one of these three-legged stool comparisons is to miss a critical analysis of current results and future growth opportunities. A winery may have the *perception* of success, but how do they know they’re truly successful without looking at the other data points?

For example, a winery owner may note an improvement in gross margin in a certain year over the previous year. Stopping there, he/she will likely conclude the year to be a “success.” However, benchmarking data may indicate that a peer group of wineries enjoyed a much greater increase in margins by managing sourcing and channel strategies a bit differently. Now, the “success” of the year is a bit more questionable.

The key is in the comparison of all three legs; this is why benchmarking is critical—to accurately identify and measure, and set upon the path of, true success.

SOUND FIRST TWO

While our focus here is on benchmarking, it certainly cannot be taken for granted that the other legs of the stool are in place. In order for benchmarking to provide its greatest advantage in the tri-comparison, companies must soundly manage the first two financial data sets—historical and projected results—if they are to leverage all three most effectively.

Trends

This is probably the most common comparative analysis that is performed. Really all that is required to do this is: (a) consistently derived data; and (b) the desire to consistently compare one period's results with those of a previous period. While this seems, and is, quite straight-forward, the underlying assumption is one that must be addressed: that financial results are being consistently generated and analyzed.

Far too often, business owners pay too little attention to financial results, dismissing them as “the numbers” and, rather, devoting time worrying about “the business.” If nothing else, difficult economic times should prove this is a very dangerous and inappropriate distinction. The numbers historically reflect and prospectively indicate the health of the business—the two should not be reduced to be contemplated separately.

As such, success in this area starts with the question, “What are we going to measure?”, and continues with the development of a consistent reporting package. This will provide an answer to the next question, “How do these results compare to what we did last month, last quarter, or last year?”

Projections

While entire papers can be—and have been—devoted to the topic of financial projections, suffice it to say here that they are as critical as they are rare. There are elements of projections that must be considered:

First, an annual income statement projection, while a good start, is ultimately insufficient. Rather, monthly projections must also include the balance sheet, statement of cash flows, and key financial and operational metrics and ratios. In today's economy, the importance of cash-flow has been highlighted. The ability of a winery to generate its own operating cash-flow has always been important, but in an economy with a tightening credit market or decreased desire to pay debt service, “cash” has once again been elevated to its rightful royal position of “king.”

Also, projections should be built upon business drivers—independent factors that affect the balance of the anticipated results. For example, rather than assuming that “Sales” will be \$1M in a given month, one should consider and document what will be sold to whom at what price to ultimately result in Sales of \$1M. This is critical not only for the purpose of building a solid financial plan, but also in analyzing subsequent variances to actual results. In this case, if actual Sales were \$900k, one might determine the reason for the variance was an overly-aggressive launch date of a certain SKU, or

a softening in tasting room sales... which could be an indicator of additional red flags that—given our analysis—would be raised within days of occurrence, as opposed to months later.

A final note on projections is that it is unnecessary—and incorrect—to separate “financial” planning with “strategic” planning. To engage in a detailed financial plan is to put to paper strategic decisions that will be made (channel strategy, brand strategy, etc) and then immediately analyze the financial ramifications of those decisions. Done correctly, this does not result in a once-a-year document that sits at the bottom of a pile somewhere on a desk six weeks later. Rather, this becomes the playbook for the winery—it is a living, fluid document that highlights when results are straying from the plan and gives structure to adjusting the plan as assumptions change.

From an analytical standpoint, developing an expectation of results before they occur is a very powerful tool. Monthly analyses are made significantly more efficient when context is given to results. Being able to immediately see trends, to compare results with expectations, and to drill down to the driver assumptions that led to the variances make reporting actionable. This information gives an owner the ability to manage proactively, make changes, and anticipate rather than react. To go another year without this information is to accept an unnecessary level of risk to the winery.

SIGNIFICANCE OF THE THIRD

If you’ve driven through dense, misty fog, you know by turning on the vehicle’s two fog lights you can navigate the road effectively, albeit at a reduced speed. If historical and projected results are operating like two fog lights, which you *can* control, the third factor in the equation beyond your control is the fog—or industry benchmarking.

Even when you do, while leaning forward with squinting eyes, decide to change course a bit, you do so without the benefit of the knowledge of where the other drivers have gone and how they have progressed. So you, like other business owners in the wine industry, navigate as successfully as you can, all considering.

Compare this mental picture with an open highway on a bright summer day. Seen clearly, either in front or behind, is the competition. You can accelerate, change course, or slow down quickly and strategically, all with the benefit of mirrors and peripheral vision. I’ll even put money on the table you will arrive at your destination sooner.

This sudden illumination is the significance of the third leg—industry benchmarking.

Mist or Myth?

Is the elusiveness of benchmarking in the wine industry truly as inaccessibly lost in the mist as it seems? Or is this purely myth? True on both counts; too many wineries don't get access to any benchmarking data because of its accessibility. The myth, though, is two fold: first, that the data are *entirely* inaccessible; and second, that any winery is so unique that the more global averages do not apply to them. This is simply not the case.

While comparing two wines from different vintages from different vineyards and expecting to find a common trend borders on the ridiculous, comparing specific data points from the wineries that produced those two wines to find a common trend is anything but. In fact, the more wineries with like data points, the better! It is specifically important to obtain information for wineries that look as much like yours as possible. While winery owners like to think their businesses are as unique as the wine they make, they should be glad this is not the case.

VIEW THROUGH THE MIST

Quite a few years back, hidden 3-D pictures became extremely popular for a time. When you looked at the picture, it appeared as a swirled, blurred pattern (or mess!) of some sort which, if you stared at it correctly—if you somehow could look *through* the pattern—a 3-D scene would be revealed... perhaps a ship being tossed about in a storm. The trick was to see *through* the patterned blur to find the real image. And in fact, it was the composition of the pattern—how each color, each shape, each point related to each other—that determined what the 3-D image would be.

A remarkable aspect of this phenomenon was that one had to “learn” how to see the hidden image. Our conditioned vision saw only the colored mess. But, once we finally learned how to look “through” it, any similar picture then became immediately visible.

Likewise, business owners in the wine industry can look through the proverbial mist (which is really just a composition of key business data) to reveal their business’s position and how it compares in the industry. The answer *is* there and, encouragingly, once we learn to look through the mess, a whole dimension will present itself to us.

COMPLETING THE CYCLE

The fact of the matter is that without analyzing financial results relative to industry benchmarks, key successes and risks can be overlooked.

As stated above, a financial result by itself is not meaningful. For example, if a business owner told you that his most recent financial statements showed Net Income of 10% of Sales, you would have no basis by which to judge whether that result was good or bad. If, upon looking at historical results, the owner could show that this figure was up from 8% in the same month last year, you would start to get a sense that this was a positive result. However, if the owner then showed you his forecast, which showed Net Income of 12% for the month, you would look at the result a bit differently. Industry benchmarking gives one more data point upon which financial results and plans can be analyzed. In this case, we might learn the industry average was a Net Income of 15%. In this case, the 10% Net Income result all of the sudden does not seem so good.

A key to successful benchmarking analyses is the development of a peer group—a set of wineries upon which your winery will be analyzed. How shall this be defined? Wineries that produce the same primary varietals? With the same ownership / legal entity structure? In the same geographic

location? With the same sourcing strategy? With the same channel strategy? Within the same range of volume? Or price point?

Clearly, there are a myriad of ways upon which data can be analyzed, aggregated, or split apart. To be sure, there is value in the data. We just need to squint, blur our eyes slightly, and look *through* the mess in order to derive value.

CONCLUSION

THREE AFFIRMATIONS

Yes, wine industry benchmarking is elusive. But it is a critical comparison component in the three-legged-stool of sound financial management because, without it, wine business owners and managers cannot accurately identify or measure true success. And of these legs, none can be taken away. Historical trends, when financial results are generated consistently and analyzed, help a business identify what it is going to measure (which data points are key?) and demonstrates how these results compare with historical results. Future projections are both critical and rare: ultimately, as part of a detailed financial plan, this becomes the active playbook for the winery, empowering the owner to proactively manage their business and to make strategic changes on timely financial data. And is there value in benchmarking?

Yes—both value and urgency in attaining that value. Because without industry benchmarking, business owners must be skeptical in answering the question, “Is my business successful?” To reiterate, a company may have the perception of success, but relative to industry benchmarks, a winery’s success may or may not be as hopeful as presumed; likewise, risks—or significant opportunities—may have been overlooked.

The good news is that, while benchmarking in the wine industry has been so incredibly elusive, “Yes, it is also possible.” And the data are not entirely inaccessible. As these key data become available, business owners need only learn to look through the shrouding mist—the composition of key business data coming together in a strange pattern—to discover their strategic position (true, measureable success), challenges, and opportunities from their surrounding competitors.

FUTURE REVELATIONS

“But you haven’t answered the question entirely. You said benchmarking is possible. How? Where are the data?”

Our answer, for now, is simply this: benchmarking *is* elusive in the wine industry; but again, not entirely inaccessible. Like winemakers are on a quest to discover wine’s unique characteristics, and like business owners are on a quest to improve their businesses, we are working to fill the data void. Benchmarking in the wine industry *is* elusive. The question now is: “Until when?”

WINE INDUSTRY FINANCIAL BENCHMARKING SURVEY

FIRST OF ITS KIND

Moss Adams has been joined by Demeter Group in its quest to conduct the most thorough, benchmarking survey on the financial performance of the West Coast (California, Oregon, and Washington) wine industry. The survey is aimed at providing a complete and authoritative source of data and guidance on the factors that separate the most successful wine businesses from the rest of the industry, and will do so by analyzing data from thousands of wineries and growers who will have the opportunity to complete the survey.

Moss Adams and Demeter Group are founding sponsors of this effort.

THE SURVEY

The focus of the Wine Industry Benchmarking Survey is on the financial performance of wineries and vineyards on the West Coast.

The ultimate goal of the survey is to provide winery owners and managers with the quantitative tools to:

- evaluate business performance on critical financial measures versus a defined peer group. In other words, answer the question, “How are we doing?”
- draw strategic conclusion on the linkages between key operating measures (such as sales volume, pricing, distribution channels, and degree of vertical integration) and financial performance. This will answer the question, “What are the most successful business models?”

FOR THE INDUSTRY, BY THE INDUSTRY

Strategic Advisory Committee

Moss Adams and Demeter Group have formed a Strategic Advisory Committee (the Committee) comprised of experienced financial executives from the industry. The Committee has been selected by Moss Adams and Demeter Group to take part in the initial strategic design of the survey, as well as establish specific goals for the resulting benchmarking report. This will ensure

that the survey gathers information deemed valuable by winery and vineyard financial professionals.

Strategic Advisory Committee

Jim Bielenberg	Vice President of Finance Jackson Enterprises
Doug DeMerrit	Chief Financial Officer Frogs Leap Winery
Eric Grams	Chief Financial Officer Williams Selyem Winery
Cheryl Wieczorek	Vice President, Director of Finance and Human Resources Justin Vineyards & Winery
Michael Williamson	Chief Financial Officer and General Manager Long Shadows Vintners, LLC

Confidentiality

All submitted data are held in strict confidence. The raw data and associated identities of participants are accessible only by authorized Moss Adams LLP survey staff. Only aggregate data is disclosed in the statistical reports and other analyses. Data will only be aggregated in groupings that have a sufficient number of participants to ensure that the information of any individual participant is not disclosed.

Expected Timeline

Item	Expected Completion Date
Distribute survey to the industry	March 15, 2009
Close survey	April 30, 2009
Reports distributed (<i>to participants only</i>)	September 1, 2009

HOW TO PARTICIPATE

It is important to mention that the completed report will only be issued to wineries that participated in the survey. The report *will not* be available to companies who did not participate.

If you wish to participate in this first-ever survey, please contact:

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ABOUT MOSS ADAMS LLP

Moss Adams LLP provides accounting, tax, and consulting services to closely-held, middle-market enterprises in many different industries. Founded in 1913 and headquartered in Seattle, Washington, Moss Adams has 20 offices in California, Washington, Oregon, Arizona, and New Mexico.

Moss Adams has two affiliate companies—Moss Adams Capital LLC and Moss Adams Wealth Advisors LLC—which allow us to offer our clients additional services such as investment banking and asset management. In addition, Moss Adams provides consulting services in a variety of areas, including information technology, litigation support, business planning, mergers and acquisitions, personal wealth management, corporate finance, and valuations.

Moss Adams is the eleventh largest accounting and consulting firm in the United States, and the largest headquartered in the West. Its staff of over 1,900 includes more than 250 partners. Moss Adams is also a founding member of Praxity, a global alliance of accounting firms. This alliance is an association of independent firms in the major markets of North America, South America, Europe, and Asia.

ABOUT THE AUTHOR

Steve Jannicelli, MBA

Steve is a Senior Business Consultant in the Moss Adams Northern California Consulting Group. The practice specializes in business and personal financial planning, including ownership transition and succession planning, for privately-owned and family-controlled businesses. Steve has over 13 years of experience with organizations including Deloitte & Touche, The Gap, PeopleSoft, and Macromedia.

Since joining Moss Adams in 2006, Steve has focused on CFO Services, including cash-flow forecasting, strategic and financial business planning, management scorecard development, profitability enhancement, and industry benchmarking.

Steve received a Bachelor's of Science degree in Economics and Business Administration with concentration in Accounting from St. Mary's College and a Master's degree in Business Administration with concentration in Finance and Marketing from Santa Clara University.

ABOUT DEMETER GROUP

The Santa Rosa office of Moss Adams has formed a strategic business partnership with the Demeter Group to assist in providing investment banking and corporate advisory services for our clients.

Based in San Francisco, California, Demeter Group is an investment bank and corporate development advisory firm for consumer companies, primarily in the food & beverage, wine, and beauty industries. Named after the goddess of agriculture in Greek mythology, Demeter Group advises middle market companies who have brands poised for growth.

The Demeter Group has advised more than 300 companies and private equity firms with total transaction experience in excess of \$5 Billion. Their breadth and depth of industry experience brings unique strategic insights to every client engagement, which translates to tangible and superior financial value.

Demeter Group offers clients a wide range of capabilities that are tailored to your specific needs, including:

- Sale Process
- Acquisition Search
- Corporate Planning and Option Evaluation
- Valuation
- Due Diligence
- Private Placement of Equity Capital