Pinot Noir

The Supply and Demand Conundrum

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Today’s Purpose

- Describe the current playing field in which you operate in growing, making and selling Pinot Noir
- Give you an understanding of the elements of supply and demand as they relate to Oregon and the broader US market
- Hopefully this will broaden your frame of reference and help you make better decisions in growing, making and selling your wine
What We Will Cover Today

- Supply and Demand analysis of PN. Top down and bottom up approach.
- Historical perspective of production and sales
- What the past has set in motion for the future
Setting the Stage

- 2007 Total Wine Production All Wines-
  - US – 260M cases
  - California – 235M cases
  - Oregon – 2.4M cases, just shy of 1% of the total production
- Pinot Noir represents about 2.5% of domestic wine sales
- Oregon PN represents .3% of total domestic wine sales
- Pinot Noir-Oregon VS California in 2007-
  - Planted 10K acres vs 29K acres
  - Bearing 8K acres vs 24K acres
  - Production 1.25M cases vs 5.55M cases
- Overall total domestic wine consumption is up
- Wine consumption per person is up
- Oregon estates account for about 50% of grape production in Oregon
- All this talk about recession
The Supply Side

- We can only sell what we make

- 4 primary factors affect wine supply:
  - Yield per acre in the vineyard
  - Acres in production/rate of new plantings
  - Inventory turns/release dates
  - Winery fermentation capacity/duration of harvest
Grape Yield per Acre - The Swings in Yield
Grape Yield Per Acre

- Years: 1998 to 2007
- Tons per Acre: 0.00 to 3.00
Vineyard Yields

- The 5 year trailing average yield up until 2006 was between 1.9 and 2.05 tons per acre.
- Yields were 2.36 and 2.52 tons per acre in 2006 and 2007, respectively.
- In 2004 the yield under 2 tons per acre resulted in a loss in production of 203,000 cases.
- In 2006, the yield over 2 tons per acre contributed 167,000 cases to the total production.
- In 2007, the yield over 2 tons per acre contributed 260,000 cases to the total production.
New Vineyard Plantings
Pinot Noir Vineyard Plantings to Case Sales

- New vineyard plantings
- Case Sales

Graph showing the relationship between new vineyard plantings and case sales from 1998 to 2007.
New Plantings

- Trailing 3 year average growth in vineyard plantings in 2001-3 was between 17%-18%
- The average growth rate in planting dropped in 2005-7 to between 7%-10%
Wine Production
Production VS Sales-PN

Year

Cases


Sales
Production
Wine Production levels

- Generally wine production levels are greater than sales levels. This is to account for future growth.
  - This held true except for the 2004 and 2005 vintages.
  - The small crop yield in 2004 caused a 22% decline in wine production from 2003.
  - The 2005 yield was better than 2004 but short of a normal
  - Production in 2006 and 2007 jumped 45% and 16%.
- Trailing 5 year average growth rate in production was 23%. 
Observations about Supply Side

- Low yields in the vineyard in 04 and 05 created shortages that reduced sales growth rates artificially below actual demand in 2006 and 2007.
- Vineyard plantings are not keeping up with the sale growth rates, nor are they keeping up with historical planting levels.
- New plantings tend to be more dense which will contribute to higher yields in the future.
Observations (continued)

- The larger than normal yields in 2006 and 2007 have restored inventory levels and created an opportunity to test the actual demand of PN.

- Grape production in the warmer regions of the state is increasing and their yields are generally higher than in the cooler regions, this should contribute to more supply.

- Limited fermentation capacity- “no room in the inn” in 2003. 1000 tons were without a home. More capacity was created after 2003, but could be a problem in the future with a compressed harvest.
The Demand Side

- Many factors affect demand
  - State of the economy
  - Popularity of the variety
  - Overall wine consumption
  - Perceived value/quality/buzz
  - Cultural values that are popular such as family owned, hand crafted wines
  - Uniqueness/product differentiation
  - Competition
Demand is best described as the “pull” for the wine. If you have to “push” your wine you probably have exceeded its demand.

The easiest measure of demand is sales growth.

However, sales growth is really “perceived demand”.

In the presence of inadequate supply, actual demand may be higher.
Sales Growth Rate

- Annual sales growth rate
- 5 year trailing average growth rate
Demand Side-a-facts

- The demand for PN has been very high since 2000
- Oregon PN especially seems to be in the front of the pact
- Trailing average 5 year sales growth rates for 2005-2007 have been 25%, 18%, and 18%, respectively, which until recently, have exceeded production growth rates for the same periods
- Sales growth declined in 2002 after 9/11 and in 2004 because of limited supply.
- Sales growth declined again to about 5% in 2006 and 2007 as a result of limited supply
- When demand > supply, inventory levels decrease and sales will level off.
The Declining Inventory Levels

- Historically, sales are made primarily from vintages at least 2 years old
  - For example, sales in 2008 should be primarily made from the 2006 vintage
- This began to change in 2005
- Release dates started earlier and wines from the previous year were being sold
- On average about a third of the 2006 vintage was sold in 2007.
P/Y vintage available for sale VS currents sales-PN

Year
Cases
0 100,000 200,000 300,000 400,000 500,000 600,000 700,000 800,000 900,000 1,000,000

Sales
P/Y vintage available for sale
Ratio-Prior Vintage Inventory to sales
Months in Inventory

Number of Months


Total
Summary Observations

- Since 2005, strong demand for Pinot Noir combined with low grape yields has caused wines to be released significantly earlier than in the past. This has eroded inventory levels from an average of 36 months to less than 25 months.

- The decline in sales growth rate to about 5% in the last 2 years is more a result of lack of supply rather than softening demand. When inventory levels improve, sales growth should return to previous levels.

- New plantings since 2004 have not kept up with the pace of sales growth. This will impact sales growth in 2008 and beyond.

- Recent changes in how wine is made is making it possible to release wine several months earlier.
What does the future hold?

- The primary dependent variables for future wine production and sales are:
  - Bearing acreage
  - Yield per acre
  - New plantings
  - Juice yield
  - Release dates
One Possible Scenario

What potential sales growth in the next 5 years may be likely if:

- Yield per acre = 2 tons
- Wine yield = 62 cases per ton
- New planting = 1000 acres per year
- Inventory turn in months = 26
Production VS Sales Projection-PN

Year

Cases

Sales

Production
P/Y Inventory to Sales

Cases vs. Year


Graph showing the relationship between Cases and Year, with two lines representing Sales and Prior year vintage inventory.
Projected Sales Growth Rate

Sales growth rate

Trailing 3 year sales growth rate
One Possible Scenario - Observations and Comments

- If the assumptions are correct:
  - It will take until mid 2009 for the jump in production in the 2007 vintage to work its way through the pipeline
  - The 2007 vintage will provide an opportunity to grow sales at 17% during 2008
  - Sales growth will drop back to 4% in 2009 with nominal gains thereafter
The Problems with Projections and Parting Words

- You’re guaranteed to be wrong when forecasting the future
- However, you can take this with you in the short term:
- On the down side-
  - The shortages of the past few years are water under the bridge. For new brands, don’t be caught over confident. It has not always been easy to sell PN.
  - With adequate supplies available this year and next, competition could get tough, especially those with young brands
  - Price pressure is sure to reveal itself, especially if the economy continues to slide
For strong brands that sold out in substantially less than 12 months from release, understand that you have not tested the limits of your brand strength for a while. BE CAREFUL.

The industry has not experienced excess inventory for quite a few years. For those new to the business, being 1 case too long on inventory is too much. When “pull” becomes “push” the focus of the business changes to solving problems, rather than taking advantage of opportunity.

Pay attention to depletion reports. Respond quickly to lagging sales.
Mid to long term, sales growth is limited to new plantings. To sustain the sales growth rates of the past few years, the number of new plantings per year would have to more than double current levels.

- Without the investment for new plantings, larger than normal grape yields, PN goes out of favor, or some other economic disaster, the industry will most likely experience strong demand with respect to a limited supply. Sales growth rates will likely be limited to the single digits.
On the up side-

- The market for additional fruit should be good until supply catches up with demand. Plant as much as you can without being “irrationally exuberant”.

- Enjoy, at least in the near term, the seemingly insatiable demand for PN.

- Don’t forget to create more production capacity as time goes on….it will be needed to take advantage of high yielding crop years especially in compressed harvests.
Closing quote from Alan Greenspan:

“I guess I should warn you, if I turn out to be clear, you’ve probably misunderstood what I said.”
Reference Sources

- Web Site California Wine Institute