Towards Start up winery profit

“When do I start making Money?”
• Biologist by education – animal science
• Career:
  – 8 years in animal science field
  – 15 years as commercial loan officer for many agricultural operations including wineries
  – 2 years as Business Consultant – serving winery and dairy farm clients
  – Since 2011 – director of the Winery Benchmark
Outline

• Winery Accounting – basic fundamentals
• The 5 to 10 year phase – how to analyze
• Budgeting from the bottom up
• Q&A
• GAAP/Tax requirements – not always the best for management decisions
• Cost accounting – be careful....it’s the key to accuracy, but hard to do right.
• Small wineries – don’t make it complicated
Profit/Loss Statement

Income
Less COGS
=Gross Profit
Less Sales Expenses
Less Overhead
=Net Profit
Less Draws (Owner Salaries)
=Available Profit (for Debt or Investment)
Income
Less COGS
= Gross Profit
Less Overhead (include sales expenses & draw here)
= Net Profit
COGS

“Costs of Goods sold”, or “Variable” expenses

- includes direct labor
- cost to produce wine (glass, cork, grapes, etc)
Overhead

“Fixed Costs, or

“Sales, General & Administrative costs”

Includes:

• All other labor
• Utilities
• Taxes
• Insurance
• Interest
Typical Winery Start Up

• 5 years of vineyard development

• Other costs during this phase may include:
  – Licensing
  – Permits
  – Production area
  – Wine equipment
  – Tasting Room
The 5 to 10 year phase

• Marketing, Marketing, Marketing
  – First solid income of the business
  – Did you make a profit?
  – But what about cash flow?

• Build Inventory
  – Common mistake is to under estimate this equity drain
  – Necessary for sales growth
  – How should you finance this?
Inventory

- Lesser of Cost or Market (Value) – in this presentation assume inventory is at cost

- Example ......cost per case
  - $10 Labor
  - $13 Bottle, cork, labels
  - $40 grapes
  - $4 supplies
  Result: $67 per case
Example

- John’s winery sells $60,000 of wine at an average of $100/case (600 cases sold)
- The cost to produce wine at this winery is $67/case
- John bottled 1,000 cases of wine in the same year
- Did John’s winery make a profit?
- Did John’s winery cash flow?
Example of mistake

John incorrectly conducts his cost study. He estimates cost of production at $40/case. He thinks he will see this:

$60,000 Income  600 cases  $100/cs
-24,000 COGS  600 cases  $40/cs
$36,000 Gross Profit
### COGS Calculation:

<table>
<thead>
<tr>
<th></th>
<th>“Cost”</th>
<th># cases</th>
<th>Cost/Case</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Beginning Inventory</strong></td>
<td>$20,000</td>
<td>500</td>
<td>$40</td>
</tr>
<tr>
<td>+ Costs</td>
<td>$67,000</td>
<td>1000</td>
<td>$67</td>
</tr>
<tr>
<td>- Ending Inventory</td>
<td>$36,000</td>
<td>900</td>
<td>$40</td>
</tr>
<tr>
<td><strong>= COGS</strong></td>
<td>$51,000</td>
<td>600</td>
<td>$85</td>
</tr>
</tbody>
</table>
Result of Mistake

John is surprised when his accountant shows him the Profit/Loss Statement including:

- $60,000 Income
- 600 cases
- $100/cs

- $51,000 COGS
- 600 cases
- $85/cs

$9,000 Gross Profit
John corrects his production cost study, and determines costs correctly at $67/case. He expects to see this P/L Statement:

$60,000 Income 600 cases $100/cs
-40,200 COGS 600 cases $67/cs
$19,800 Gross Profit
## COGS calculation:

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<th>“Cost”</th>
<th># cases</th>
<th>Cost/Case</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Inv</td>
<td>$33,500</td>
<td>500</td>
<td>$67</td>
</tr>
<tr>
<td>+ Costs</td>
<td>$67,000</td>
<td>1000</td>
<td>$67</td>
</tr>
<tr>
<td>- Ending Inv</td>
<td>$60,300</td>
<td>900</td>
<td>$67</td>
</tr>
<tr>
<td>= COGS</td>
<td>$40,200</td>
<td>600</td>
<td>$67</td>
</tr>
</tbody>
</table>
Results of Third Try

$60,000 Income  600 cases  $100/cs
-40,200 COGS  600 cases  $67/cs
$19,800 Gross Profit

The original estimated P/L statement was correct and the COGS calculation showed that costs are being properly allocated.
$60,000 Income
- $40,200 COGS
$19,800 Gross Profit
- $18,000 Overhead
= $1,800 Net Profit

John’s winery made its first profit!!
Actual Cash Flow

$60,000 Income 600 cases $100/cs
-67,000 Prod Costs 1000 cases $67/cs

= -7,000 Cash Flow after production
  -18,000 Overhead

= -25,000 Cash Flow before loan payments
  -12,000 Principal payments

= -37,000 Cash deficit
To generate cash flow as a start up winery, you must either:

1. Be extremely profitable, or

2. Level off inventory growth
Managing Inventory

- Monitor inventory and make more of what sells quickly
- Make more white wines – faster turns
- Plan your “inventory build” as part of your capital costs
- Avoid operating lines for the purpose of inventory build (i.e. it’s not a cycle, it’s a permanent level of inventory)
### Estimate Inventory Growth

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cases sold</td>
<td>1000</td>
<td>2000</td>
<td>2500</td>
</tr>
<tr>
<td>Est. Cost to produce</td>
<td>$70/case</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory req’d</td>
<td>1.3 x cases sold</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash required to “build inventory”</td>
<td>$91,000</td>
<td>$45,500</td>
<td>$0</td>
</tr>
<tr>
<td>Sales (say $125/cs)</td>
<td>$125,000</td>
<td>$250,000</td>
<td>$312,500</td>
</tr>
<tr>
<td>Cash Prod. Costs</td>
<td>$161,000</td>
<td>$185,500</td>
<td>$175,000</td>
</tr>
</tbody>
</table>
Budgeting from the Bottom Up

- How much profit do you need to break-even?
- How do you figure out what an appropriate sales target is?
- How feasible is your plan?
• Overhead
• Note: Owner draw – we have included this in overhead in examples so far
• Principal & Interest debt payments
• These 2 items (overhead and debt payments) are where you start
Revised Profit/Loss

Income
Less COGS
Gross Profit
Less Overhead  (includes owner draw)
Net Profit
Add interest Expense back
=Total Available Funds  (EBITDA)
Subtract all debt payments (Principal & Interest)
Bottom – Principal & Int

• Let’s say you have payments of
  – Wine equipment $675/mo
  – Mortgage $1,200/mo

• Annual Principal and Interest payments are:
  – $22,500
<table>
<thead>
<tr>
<th>Loan Payments</th>
<th>$22,500</th>
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</thead>
</table>

## Build it
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<tr>
<td></td>
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<td></td>
</tr>
<tr>
<td>Overhead</td>
<td>$18,000</td>
<td>Don’t include interest here</td>
</tr>
<tr>
<td>Loan Payments</td>
<td>$22,500</td>
<td></td>
</tr>
<tr>
<td>Description</td>
<td>Amount</td>
<td>Notes</td>
</tr>
<tr>
<td>----------------------</td>
<td>----------</td>
<td>--------------------------------------------</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>$40,500</td>
<td>Use your Gross Profit per case ($33) to determine cases to be sold (results in 1230 cases)</td>
</tr>
<tr>
<td>Overhead</td>
<td>$18,000</td>
<td>Don’t include interest here</td>
</tr>
<tr>
<td>Loan Payments</td>
<td>$22,500</td>
<td></td>
</tr>
<tr>
<td>Item</td>
<td>Amount</td>
<td>Notes</td>
</tr>
<tr>
<td>--------------------</td>
<td>--------</td>
<td>--------------------------------------------</td>
</tr>
<tr>
<td>COGS</td>
<td>$82,500</td>
<td>Use your cost of production per case ($67) x cases sold (1230)</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>$40,500</td>
<td>Use your Gross Profit per case ($33) to determine cases to be sold</td>
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## Break-Even

<table>
<thead>
<tr>
<th></th>
<th></th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income</strong></td>
<td>$123,000</td>
<td>Cases sold as determined below x average price</td>
</tr>
<tr>
<td><strong>COGS</strong></td>
<td>$82,500</td>
<td>Use your cost of production per case ($67) x cases sold (1230)</td>
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Revised Profit/Loss

- Income: $123,000
- Less COGS: 82,500
- Gross Profit: 40,500
- Less Overhead (let's say $2,000 interest): 20,000
- Net Profit: 20,500
- Add interest Expense back: 2,000
- Total Available Funds (EBITDA): 22,500
- Subtract all debt payments: 22,500
- Excess/Deficit: 0
**Optional**

- If Retail/Wholesale “mix” will change, then run this optional calculation

**Total Required Sales** = Retail Sales % x (Gross Profit Req’d / Retail Gross Profit %) + Wholesale Sales % x (Gross Profit Req’d / Wholesale Gross Profit %)
Result of this exercise

• Sales target of at least $123,000 has been established
• With average price of $100/case, that’s 1,230 cases sold
• If wholesale sales increase to reach this target, the cases sold will need to increase dramatically
• Make a feasible plan to make a profit.
Key Concepts

• Don’t forget the cost of “building” inventory
• Have a plan to finance this (cash or mortgage best)
• Have a record keeping system & accounting plan that will tell your story accurately
• Vineyard economics: low yield = high cost grapes & high cost wine....lowers GP%
• Build the right size winery!
Questions?

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https://www.farmcrediteast.com/winerybenchmarks