Grapes 101

Success: Beyond Tons and Gallons

Grapes 101 is a series of brief articles highlighting the fundamentals of cool climate grape and wine production.

By Kevin Martin
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Perhaps your interests were based in viticulture, with a strong desire to grow vines. Perhaps, instead, your interest was chemistry or enology. There is something rewarding and tangible about taking grapes and turning them into wine. These are challenges that winery and vineyard owners romanticize. For most, running a business is the downside, a necessary evil, if you will. Balancing liquidity, solvency, profitability and efficiency to create long-term profitability. Some financial ratios can help you assess each of these categories of financial health.

Current Ratio. The current ratio is a measure of liquidity. To determine the current ratio take current assets and divide by current liabilities. Current assets include cash, inventory and receivables. Current liabilities include short-term debt and payables. Most growers carry little inventory or short-term debt. A receivable would include the amount a processor owed the grower for a particular month but has not yet been received Thus, this particular ratio is made relatively straightforward and it is something most growers consider. Basically the balance in the checking account, or other liquid accounts, need to be greater than bills for that period. While the current ratio should, at all costs, remain above 1, a lower value does not necessarily mean impending bankruptcy. While it does mean that the fiscal health of the operation is poor and corrective action should be taken. Corrective action includes delaying investment opportunities and increasing cash reserves in the event that liabilities become due early or are called upon for various reasons. While such events are unlikely, it gives the grower flexibility in the event of other unforeseen financial circumstances.

Debt/Assets Ratio. The debt to asset ratio is a measure of solvency. The debt to asset ratio of a vineyard needs to be lower than other industries. This ratio is calculated by taking total debt and dividing by the value of assets. Due to relatively high land values, as compared to total revenue, Concord assets cannot be as productive as other assets. As such, a sustainable vineyard operation will have a low debt/assets ratio. A Debt/Assets ratio needs to be less than 1, and working

toward 0.5. The most sustainable vineyards maintain Debt/Assets ratios under 0.25. These general guidelines may not be very useful for individual operations. To be a little more specific this ratio should be related to age. As a grower gets older the need for growing the business diminishes. As such, the Debt/Assets Ratio should fall. If your ATR is much higher than average, this would indicate you've found ways to make your assets more productive than other growers. In doing so you can justify a higher Debt/Assets Ratio to leverage your success.

Return on Assets. Return on Assets (ROA) is a measure of profitability. Determine this ratio by taking net farm income and dividing by total assets. When determining the "net farm income", subtract a reasonable hourly rate for unpaid labor. Most growers do not pay themselves a salary and I think this flexibility gives them a competitive edge. However, for calculating this ratio, you'll need to assume that you are getting paid a salary to separate your earnings from your labors and earnings from your assets. Trying to figure out how much the business should be paying you for your labor can be challenging. Keep in mind the tasks you normally complete and try to estimate what the labor expenses would be to contract the work done.

Flexibility in family budgeting is a key criterion for success that most growers embrace. Many growers take care of their farms and use the rest to purchase basic family necessities. In a good year, perhaps there is enough left over to make a vehicle purchase, take a vacation or put a new roof on the house. This flexibility might be generational; another school of thought is to pay you a salary first. Profits after that salary are a measurement of ROA. However, farmers are not alone in flexible family budgeting. This is a common trait for small business owners. So then, what good is the ROA? As a measure of fiscal health it is good to separate out your pay from your business profits. This is an accounting measure to determine if your assets are working well for you. It does not have to impact the flexibility you've embraced in family budgeting.

Wineries and vineyards are asset intensive. As an industry, returns on assets are low. In other industries it is an important metric to compare yourself to your peers. In this industry it is important to keep this ratio from going negative. We see success at less than 3%, but becoming successful is a whole lot easier if you can do better than that.

Asset Turnover Ratio. The asset turnover ratio (ATR) is a measure of investment efficiency. To determine your ATR take total revenue and divide by the value of assets. The value of land assets will be two to three times larger than total revenue. Relative to other businesses, Concord growers will have a poor ATR because of land value. Beyond that the ATR can be controlled through yield, equipment, barns, and shops. If, for the last five years, your asset turnover ratio averages less than 0.25, that should cause concern. When calculating the ATR

make sure values for structures and equipment are current. Also, make sure to value land accurately. Low yields should not significantly impact this ratio because low yields will decrease the value of most land. Inversely, high prices also have little impact on the ATR because land values often increase proportionally to price.

Interest/Revenue. The Interest ratio is a measure of interest efficiency. It is calculated by taking all interest expenses and dividing by farm revenue. This is related to the debt ratio but takes into account the motivation behind carrying additional debt. Low interest rates, when managed correctly can be a good thing to take advantage of and possibly time growth when leverage costs are lower.

Putting it all together. Have you made it this far, or are you already out in the snow pruning vines? Variability in practices amongst wineries and vineyards is easily observable. The impact on the bottom line is much more opaque. Something as simple as leaf pulling or bladder pressing could improve wine quality. Without an understanding of business health, the impact of these investments on the bottom line cannot be measured. In truth, there is a tendency in the region to over-invest in the product. While the product becomes better, the consumer behavior often does not match the cost relative to the improvement.

One of the real advantages of understanding business terminology and applying it to your organization goes beyond decision-making. Many wineries and vineyards struggle with scale. There is never profit in a thirty-vine vineyard. Understanding the application of business health metrics will increase your access to capital. Merely being able to communicate with lenders in their language has been demonstrated to improve loan application results across all industries.

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