Should wineries acquire vineyards instead of buying fruit on the open market?

Speakers address trends during Vineyard Economics Symposium; Jan Krupp speaks on the sale of Stagecoach

by Kerana Todorov
June 20, 2018

Speakers Monday included Jan Krupp, Matt Franklin, Dana Sexton Vivier, Tony Correia, Mark Couchman, right, moderating the panel

Should wineries acquire vineyards instead of buying fruit on the open market?

That's one of the questions Dana Sexton Vivier, vice president of strategic planning at Far Niente, raised Monday during the Vineyard Economics Symposium.

Far Niente, a GI partners-owned company, produces Napa Valley Chardonnay from its own vineyards.

Over the past decade, the number of acres in Napa County planted to Chardonnay has steadily decreased.

That would make sense, given that the lowest-priced Cabernet Sauvignon fruit is typically more expensive than the highest-priced Chardonnay.

So why would a winery buy a (highly priced) vineyard in Napa?

"Because you have to," Vivier said.

Chardonnay is in strong demand, Vivier said. And direct-to-consumer wine sales in Napa have increased by 9 percent from 2016 to 2017. "That's faster than the GDP," Vivier noted.

"If you have a large Chardonnay program, I think it's a challenge to rely on being able to buy grapes on the open market."

Direct-to-consumer sales economics have potentially supported higher grape prices, Vivier also said.

Here is the math. According to Silicon Valley Bank, the average winery in Napa sold 49 percent of its wine through the direct-to-consumer channel in 2012. Today, DtC sales are nearly 60 percent of all sales.

Taking into account cost of goods, labor costs, profit and overhead costs, wineries selling $150 Cabernet Sauvignon are left with $5 more income than when DtC sales represented 49 percent of all sales. That $5 increase, if it went entirely to the grower, would represent a $3,500-per-ton increase, according to the graphic Vivier presented Monday.

A ton of Napa Cabernet Sauvignon averaged $4,800 in 2012 – or $2,000 less than today.

As Tony Correia, accredited rural appraiser for The Correia Co. suggested, higher grape prices contribute to higher land prices.

Wineries can invest in vineyards acquisitions as grape prices increase, Vivier concluded.

Other speakers Monday included Matt Franklin, principal at Zepponi and Co.; Jan Krupp, owner Krupp Brothers and co-founder of Stagecoach Vineyards. Mark Couchman, CEO at Silverado Premium Properties, moderated the panel.

A new wave of pension funds, private equity companies are entering the market, according to Zepponi and Co., a firm based in Santa Rosa.

Gallo has made numerous acquisitions over the past decade, including vineyards, wineries and brands, said Matt Franklin, principal at Zepponi and Co. The Wine Group also has been acquiring vineyards in the Central Coast to support its higher-priced programs. About 800 acres of vineyards are under development at the Santa Ynez property which the group acquired last fall.

Mid-size wineries such as Paul Hobbs Wines and Silver Oak also have been acquiring properties as well. Paul Hobbs in November bought Soda Rock Vineyard in Healdsburg and Goldrock Ridge Vineyard near Annapolis. Silver Oak bought Prince Hill Vineyard in Oregon's Dundee Hills and Big River Vineyard in Alexander Valley.

Huneeus Vintners and Constellation Brands and other companies have been buying vineyards as well in Napa and Sonoma. Far Niente in May 2017 purchased DeCarle Vineyard, a 60-acre vineyard in Rutherford.

There has been renewed interest from institutional investors in vineyard properties, Zepponi said. Companies that have purchased vineyards in Napa and the Central Coast include UBS, Homestead Capital, Gladstone Land and Hancock Natural Resource Group.

Correia said the demand for Napa Valley Cabernet Sauvignon has grown over the past few years. Secondary areas such as Oak Knoll are being pushed in terms of value, with buyers willing to pay prime prices to grow Cabernet. "If you can sell 7 tons of Cabernet at district average, you're a pretty camper," he said.

Correia and Couchman cautioned about overplanting vineyards. "There is always overplanting," said Couchman, whose company has invested heavily in the Central Coast. "One of my concerns with the new tax law is people are a little more motivated now to plant a vineyard because of the tax benefit of being able to write off in one year the entire above-ground investment," Couchman said. "There could be some long-term implications from that."

Correia added that was tried in the 70s and 80s. "And remember how that turned out?"

The 2017 Sale of Stagecoach Vineyards

Stagecoach Vineyards was not listed for sale when Jan Krupp was asked to consider selling the iconic Napa Valley property with to E. & J. Gallo.

"Personally, it wasn't my desire to sell it," Krupp recalled Monday as he reflected on the 2017 sale of Napa Valley's biggest contiguous vineyard with 605 planted acres that straddle Atlas Peak and Pritchard Hill.

After all, the vineyard paid 23.6 percent in internal rate of return on initial investments. And Stagecoach supplied fruit to about 100 wineries. The property, whose average elevation is 1,500 feet, has plenty of water. Sixteen wells on site produce on average 100 gallons per minute.

The reasons to sell were both fiduciary and personal, the former physician said at the symposium in Napa.
Many of the 18 partners were more than 60 years old and eager to see the fruits of their investment, Krupp said.
Children of early investors wanted to buy houses, he added.

In addition, two of Krupp's major partners were his brothers, including businessman Bart Krupp. "And they were really anxious to do their estate planning, take care of their kids and grandkids," Krupp said.

"Without those two brothers, I doubt I would have had stagecoach," Jan Krupp said. I really felt I owed them quite a bit."

Krupp, who incorporated Stagecoach Vineyards in 1996, also wanted to diversity his portfolio and eliminate the annual risks that come with harvest.

Krupp praised the work of Matt Franklin at Zepponi and Co., the company that negotiated the transaction.

Krupp settled on Gallo because he wanted a buyer committed to make Stagecoach a great, prestigious vineyard. "I was convinced that Gallo did have a sincere commitment to do that," Krupp said. He also knew Gallo could maintain confidentiality.

Krupp wanted a fair price for the property.

"That part was easy. Matt did a masterful job of proposing a price to Gallo that made sense to them and made a lot of sense to me and even more sense to my partners," Krupp said.

Krupp also negotiated an agreement to retain all existing grape contracts for legal and ethical reasons.
The transaction nearly fell apart over benefits for key employees, Krupp said. Krupp sought a commitment to retain all or nearly all of the Stagecoach employees with similar salaries and benefit packages. In the end, the Krupps achieved almost all they had wanted for the workers, he said.

Under the agreement, the Krupp brothers can purchase grapes for nine years.

"Part of the deal was that I have lifetime dog walking, biking and hiking privileges," he also said.

Wineries purchasing grapes from Stagecoach responded differently. "Some people were pretty upset," Krupp said. Others understood.

The sale closed five months before the deadly October fires hit Napa and Sonoma counties, including Atlas Peak.

Harvest would have been a lot more stressful this past October, Krupp said.

"I'm focused now on my winery, some investments and I'm working five or 6 hours a day instead of eight or 10," said Krupp, proprietor of Krupp Brothers Winery," Krupp said after his talk. "I always found harvest very stressful. So it's nice not to have that stress," he added.