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COVID-19 RESOURCE CENTER

A Pandemic Survival Guide for BC Wineries – How to Weather the Coronavirus

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Introduction

Surviving Covid-19 requires that winery owners be quick to comprehend the overall severity of the pandemic, accept the economic reality of the situation and adjust their business plans accordingly.

The immediate impact of the pandemic has been a significant increase in overall wine and liquor sales, coupled with a seismic shift in distribution channels. Consumers in isolation are both increasing consumption and stockpiling in the face of ongoing uncertainty. Sales through the tasting room and restaurant channels have collapsed; replaced by dramatic increases in direct delivery/internet sales and in the liquor retail and grocery sales channels.

Recovery will be mostly up to us – our hard work, persistence and innovation. But government needs to help by reforming some of the rules that have slowed industry growth and which will now impede our recovery. Examples include the restrictions on the interprovincial shipment of wine, the prohibitions on secondary tasting rooms and the unavailability of wholesale pricing to restaurants in the hospitality industry. Removal of these restrictions would do much to aid the recovery.

We need to batten down the hatches and invest in the sales channels that are continuing to work for us. We need to listen to our customers, and deliver what they want. We need to protect our people and protect our brands. In the end, that is all that is really important. Hard decisions will need to be made, that's for sure, but we are all in this together.

Observations and survival tips

Here are some specific observations and survival tips.

1. **Tasting room closures will continue and reopening will be slow.** The wineries that are being hardest hit are those that rely on tasting room sales as their primary distribution channel. Tasting room closures are likely to continue well into the summer season; and even if they reopen, traffic will be light. The suspension of international travel and the closure of the US border are likely to be prolonged. It is highly unlikely that tourism from Alberta will return any time soon given the

dramatic fall in oil prices and the disinclination of the Trudeau government to offer relief to the oil industry. As long as fear of contagion rages, local politicians will continue to rail against tourists and summer residents travelling into the Valley. If the forest fire season gets out of control again this year, an already bleak situation will be made even worse. There is already a trend away from public, walk-in tastings to pre-booked private tastings which generate much higher sales per customer. Reduced tourist traffic in the Valley will accelerate this trend. On a fully costed basis, including premises, staffing and sample costs, tasting rooms are a more expensive sales channel than many people realize.

2. **Restaurant sales have collapsed and recovery will be slow.** Wineries that depend heavily on restaurant sales are being hit hard; and the hospitality sector is not coming back anytime soon. The Canadian Restaurant Association reports that 10% of Canada's restaurants have already closed permanently; and that another 20% will do so in the next month. Wine sales in the restaurant sector were already in decline; and current events are likely to result in a further overall contraction of the restaurant industry by 50% or more. Business interruption insurance coverage is likely to be of no avail since it generally exempts loss related to a communicable disease; although Thomas Keller is currently challenging this in California courts. Regulatory changes permitting the delivery of wine along with takeout food need to be retained after the crisis subsides; and extended to delivery of wine with weekly meal prep services like HelloFresh. Now is the time for the Province to transition to wholesale pricing in the hospitality sector. Although this will reduce margins to wineries from direct delivery, it will provide timely and necessary stimulus to restaurants seeking to rebuild and will boost sales volumes in the channel.

3. **Conserving cash flow is essential.** Survival is the first step to recovery. Smaller wineries without large wine clubs and an internet presence need to adopt severe measures to conserve cash. The rising costs of imported supplies and equipment as the Canadian dollar crashes will make this all the more difficult. Owners need to retool (or in some cases, create) operating budgets. Projected revenues will be down dramatically, in some cases as much as 70%; but at the same, so will costs, particularly if the decision is made to forego bottling the 2020 crop. Operating funds need to be found to retain the core members of your team. They are the key to your recovery.

4. **Reduction and possible loss of the 2020 Vintage.** Wineries that are dependent on this year's tasting room sales to fund their costs of growing and bottling the 2020 vintage may need to seriously think the unthinkable, skipping the 2020 vintage; or limit harvests to their estate vineyards and forego purchased grapes. There is no point in producing a new vintage if this year's inventory remains unsold into next year. For those building excess inventories, adequate storage may be an issue.

5. **Independent growers will bare the consequences of industry cutbacks.** Production cutbacks will have seriously adverse impacts on independent growers. Grape growers will face serous exposures and challenges akin to those faced in past disaster situations where they have lost crops to killer frosts, forest fires and other natural disasters. Last year's shortage of quality

grapes will shift to a significant supply surplus this year. This will create buying opportunities for well capitalized wineries that continue to grow and that had trouble sourcing sufficient grapes last season. Much will depend on whether the big three producers drop contracts or pick up some of the excess grapes in the open market to expand production of their lower price brands selling in the retail store channels.

6. **Wine clubs and internet sales are best positioned to weather the storm.** Quality wineries with a strong brand and an established internet presence are best positioned to weather the current crisis. Wineries that have historically focused their sales efforts on building their wine club membership and a loyal customer base are sustaining their cash flow through internet orders and the shipment of their spring releases to loyal customers as well as to new customers looking for home delivery during quarantine. As the recession deepens, however, look for an erosion in club memberships and a shift to lower priced product. Free shipment is the new normal. It is here to stay as wineries realize that shipping fees are a serious impediment to consumers considering an online purchase. There is little that wineries that have ignored social media can do in the short term to remedy this mistake; but if they survive they need to prioritize building a loyal customer base and an internet presence. A shoutout to wine growers who continue to build consumer awareness and brand loyalty through social media in this difficult time. Examples include Severine Pinte at Le Vieux Pin, Penelope and Dylan Roche at Roche Wines (Vigneron Video Journal) and Joe Luckhurst at Road 13 (Tireside Tastings). Virtual tastings are likely, however, to wear thin pretty quickly unless very well done. Wine makers should reach out by phone to their best customers. US wineries who have tried this have had great success as their customers, who in normal times may be too busy to talk, have generally appreciated the opportunity to chat. Generally, US wineries are much more sophisticated and advanced in penetrating direct-to-consumer sales channels; and we should spend time studying and adapting their strategies to our market.

7. **Removing the restrictions on the shipment of wine across provincial borders is critically important.** Canada is the only wine producing country in the world that does not drink primarily its own products. Allowing Canadian wineries to sell their wines across Canada is the single most important thing we can do to help our industry to recover from the current crisis. Now is the time to kickstart wine industry recovery by redoubling efforts to eliminate legal restrictions to the direct delivery of wine to consumers across provincial boundaries. Premier Ford should be prevailed upon to lead the way. British Columbia already allows the free entry of Ontario wines into our province, and Ontario should reciprocate. Freer trade between the provinces generally could be a significant contributor to Canada’s overall economic recovery.

8. **Prohibitions on secondary tasting rooms need to go.** As an aid to their recovery, wineries should be permitted to establish secondary or satellite tasting rooms. Locating clusters of tasting rooms in small rural towns would provide economic stimulus by attracting investment in ancillary services such as restaurants and tourist shopping. The success of this model in Woodenville in Washington State proves its popularity among wine tourists. Locating tasting rooms in larger centres would make B.C. wines more readily available to the general population. The current

rules make no sense and bias development towards the construction of large wineries with restaurants and event centres on prime agricultural land while prohibiting farm gate wineries from locating secondary tasting rooms in local communities and urban centres.

9. **Small wineries need to form joint ventures and co-ops**. There are too many under-scaled and unprofitable wineries in the Okanagan; even more so now that the boom has ended and hard times have arrived. To survive in tougher times, these smaller wineries need to abandon insular thinking and collaborate more with their neighbours. They need to consolidate their resources through joint ventures and cooperative activities such as joint production or marketing efforts and by combining operations to reduce overheads. Watch for a shift in industry business models such as the clustering of small wineries in more centralized locations using commercial licenses and sharing crush pads, marketing efforts and other resources.

10. **Future opportunities as the restaurant sector rebuilds.** Restaurants that survive will probably run down cellared inventories before they begin repurchasing; and, if greater social distancing between tables becomes the new norm, total sittings will be reduced as will the demand for wine. As the economy recovers, and as the restaurant industry rebuilds, expect a new generation of restaurants to replace those which have closed. This will include both innovative, entrepreneurial, ‘new concept’ restaurants and the further build out by the well capitalized restaurant chains. The former represent an opportunity for wineries with aggressive sales agents to get on the wine lists of the new entrants. The latter represents an opportunity for larger wineries with the production capacity to service large chains to joint venture with those chains. Witness, for example, the recent investment by the Keg in Blasted Church. Look for more such deals as the restaurant chains tie up a dedicated supply of premium wines.

11. **The grocery store sales channel is booming.** Wineries that have devoted their efforts to building up a strong presence in the grocery sales channel are reaping the reward of a strong growth in sales. Sales in the grocery channel are up by nearly 60%. Consumers like to purchase their wine with their groceries and, now that eating at home has become socially mandatory, this sales channel is growing. Next step is to eliminate the regulatory uncertainties that are inhibiting the delivery of wine with groceries. Sales growth is also strong for wineries dedicating supply to private retail stores.

12. **The BCLDB needs to be pushed to promote local products.** BC wines are underrepresented in BCLDB stores (less than 8% of shelf space versus an overall provincial market share of 18%). Many smaller producers regard the BCLDB as a low margin channel and do not routinely devote product to it; but in reality it can be an attractive channel because of the low costs of supplying product to it. We need to intensify pressure on the BCLDB to dedicate shelf space and to stock and promote domestic wines. The BCLDB is single-mindedly focused on maximizing provincial government revenue through the promotion and sale of low price, high volume foreign wines. The government needs to make it crystal clear to the BCLDB that its mandate includes the promotion of local products and that it will be held accountable for fulfilling this responsibility.

Measures to eliminate abuses of dominant position and other anti-competitive practices by the BCLDB should also be implemented.

13. **Shifting the mix of flagship and flanker brands.** Watch for price discounting by cash strapped producers as a way to move inventory. Price reductions are difficult to effect for super premium producers without tarnishing brand image, so look for these producers to shift more juice from their flagship labels into secondary or flanker labels. Savvy consumers know that secondary labels from reputable producers offer very similar quality product at often significantly discounted pricing.

14. **Concerts, weddings and other events cancelled indefinitely.** Prohibitions on gatherings and large group events are likely to continue indefinitely. Wineries that depend on onsite restaurants, weddings and concerts to increase traffic and revenues will suffer. Trade shows, regional tasting events and wine dinners will be cancelled indefinitely, making it difficult to keep in touch with customers in urban centres. Who knows, but maybe we'll all be attending the next Fortify Conference by Zoom call.

15. **Vineyard labour shortages will be more severe this year.** Vineyard labour shortages will be more severe this summer, with difficulties in sourcing immigrant workers along with a reduction of the usual flow of Quebec students into the Valley. Requirements to quarantine foreign workers in roomier quarters that allow for appropriate social distancing will add cost and delay to the sourcing of immigrant workers, even with the newly announced $1500 per worker federal subsidy. Local seasonal workers will be more readily available because of high local unemployment rates but may be less proficient or productive than the usual sources of agricultural labour supply. Now is the time for regulators to reduce the red tape and expense involved in making applications under the immigrant worker program and to make it easier for immigrant workers to apply for permanent resident status.

16. **Layoffs and Terminations will be necessary though difficult.** As a last resort, wineries may have to lay-off or terminate permanent employees. Laying off employees can offer temporary relief; and, after 14 days, makes the employee eligible for CERB of $2000 per month for up to four months, along with the $1000 of emergency assistance from the Province. However, after a maximum of 13 weeks, the employee must either be rehired or terminated, triggering the obligation to pay severance. Seasonal workers that you have hired for summer positions, but who haven't yet started work, are also eligible for CERB. Work sharing by reducing hours of work may be a more palatable solution, particularly if the winery registers for the federal work sharing program which will permit employees to apply for employment insurance in respect of their reduced hours. Employees being asked to work from home should be provided with T2200 Forms to permit them to deduct internet and other home office expenses.

17. **Government Assistance is available, but only short term.** The federal government's short term wage subsidy program offers temporary relief, covering 75% of salaries up to $847 per week for 12 weeks. It is available for each month in which a winery's revenues fall by 30% or more compared to last year. Although Trudeau has now announced that things are not likely to return to normal for 12-18 months, it is hard to see this short term program being extended much beyond its current three month term given its $73 billion price tag. The $200 billion of total funding being poured into the economy, together with an expansive monetary policy, will lead to massive deficits and hyper-inflation.

18. **Sale and purchase of wineries will continue, but at lower price multiples.** Watch for continued industry consolidation and a resurgence of winery sales, albeit at depressed pricing. The well capitalized larger wineries have completed the integration of recent acquisitions, and will be looking for more bargains. This time round, US buyers will be attracted and advantaged by extremely low exchange rates. Small unprofitable wineries will remain difficult to sell at prices in excess of the appraised value of vineyards plus the depreciated value of buildings and equipment (with inventory valued at cost). Low vineyard acreage or inclusion of an estate home in the business assets will detract from saleability.

19. **We are in for a recession; for how long is anybody's guess.** We are seeing the abrupt end of an amazing twelve years of economic growth and prosperity during which the BC wine industry grew to almost 300 wineries. The social distancing measures implemented to fight the COVID-19 pandemic will induce a severe recession likely to last three to five years. Experience tells us it could be longer, maybe up to ten years. Wine consumption and income are highly correlated, and consumers in financial hardship will reduce consumption and shift to lower priced product. BC wine is a luxury good that will be replaced by cheaper foreign product.

20. **The demographic shift to younger consumers with less disposable income will accentuate the impacts of recession.** As the last of the baby boomers drink down their cellars, the industry will have to start listening to the preferences of the younger generation for healthier lower alcohol product in more convenient packaging. Consumers want wine in kegs, bag-in-box and cans, and industry rules that prohibit the packaging of VQA wines in these formats should be eliminated. Consumer emphasis will be on authenticity, sustainability, transparent product labelling, traceability (local products), and value for money. There will be intense and sustained pressure from the market to lower prices.

21. **We are all in this together.** One thing we have all learned from the current situation is that, even within the sparsity of self-isolated living, wine is an ‘essential’ product. It feeds the soul and spirit. As Andrew Jefford said recently, “it puts the sunshine in our hearts”. Finally, a shoutout to the many wineries who, even during these difficult times, are donating a portion of their sales revenues to charitable causes such as healthcare or food banks. The ones that have come to my attention include Summerhill, Township Seven and Blue Grouse; but there are many others. Such grace in a time of crisis.

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