

WILLAMETTE VALLEY VINEYARDS INC

Form DEF 14A

June 30, 2004

PROXY STATEMENT

for the

ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON July 18, 2004

INTRODUCTION

General

This proxy statement (the "Proxy Statement") is being furnished to the shareholders of Willamette Valley Vineyards, Inc., an Oregon corporation ("the Company"), as part of the solicitation of proxies by the Company's Board of Directors from shareholders of record of outstanding shares of the Company's common stock, no par value (the "Common Stock"), for use at the Company's Annual Meeting of Shareholders to be held on July 18th, 2004, at 1:00 PM at Willamette Valley Vineyards, 8800 Enchanted Way SE, Turner, Oregon 97392 and at any adjournments or postponements thereof, (the "Annual Meeting").

At the Annual Meeting, shareholders will be asked to (i) elect seven members of the Board of Directors, (ii) ratify the appointment by the Board of Directors of PricewaterhouseCoopers LLP as independent auditors of the Company for the year ending December 31, 2004, and (iii) transact such other business as may properly come before the meeting or any adjournments thereof. This Proxy Statement, together with the enclosed Proxy Ballot (Enclosed), is first being mailed to the Company's shareholders on or about June 14, 2004.

Solicitation, Voting and Revocability of Proxies

The Board of Directors has fixed the close of business on May 20th, 2004 as the record date for the determination of the shareholders entitled to notice of and to vote at the Annual Meeting. Accordingly, only holders of record of Common Stock at the close of business on such date will be entitled to vote at the Annual Meeting, with each such share entitling its owner to one vote on all matters properly presented at the Annual Meeting. On the record date, there were 3,056 beneficial holders of 4,486,278 shares of Common Stock then outstanding. The presence, in person or by proxy, of a majority of the total number of outstanding shares of Common Stock entitled to vote at the Annual Meeting is necessary to constitute a quorum at the Annual Meeting.

If the enclosed Proxy Ballot is properly executed and returned in time to be voted at the Annual Meeting, the shares represented thereby will be voted in accordance with the instructions marked thereon. Executed but unmarked proxies will be voted FOR the election of the nominees for election to the Board of Directors and FOR the ratification of the appointment of PricewaterhouseCoopers LLP as the Company's independent auditors for the year ending December 31, 2004. The Board of Directors does not know of any matters other than those described above that are to come before the Annual Meeting. If any other matters are properly brought before the Annual Meeting, the persons named in the proxy will vote the shares represented by such proxy upon such matters as determined by a majority of the Board of Directors.

The presence of a shareholder at the Annual Meeting will not automatically revoke such shareholder's proxy. A shareholder may, however, revoke a proxy at any time prior to its exercise by filing a written notice of revocation with, or by delivering a duly executed proxy bearing a later date to: Board Secretary, Willamette Valley Vineyards, Inc., 8800 Enchanted Way S.E., Turner, Oregon 97392, or by attending the Annual Meeting and voting in person. In order to be effective, all revocations and later-filed proxies not delivered in person at the Annual Meeting must be delivered to the Company at the address listed above not later than 5:00 p.m. local time, on Saturday, July 17, 2004. A shareholder who attends the meeting need not revoke a previously executed proxy and vote in person unless the shareholder wishes to do so. All valid,

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un-revoked proxies will be voted at the Annual Meeting.

ELECTION OF DIRECTORS (PROPOSAL NO. 1) At the Annual Meeting, seven directors will be elected, each for a one-year term. Unless otherwise specified on the proxy, it is the intention of the persons named in the proxy to vote the shares represented by each properly executed proxy for the election as directors the persons named below as nominees. The Board of Directors believes that the nominees will stand for election and will serve if elected as directors. However, if any of the persons nominated by the Board of Directors fails to stand for election or is unable to accept election, the proxies will be voted for the election of such other person as the Board of Directors may recommend. There is no cumulative voting for election of directors. Directors are elected by a plurality of votes; therefore, the seven persons receiving the most votes, even if less than a majority of the votes cast, will be elected directors. Abstentions or failure to vote will have no effect on the election of directors, assuming the existence of a quorum.

Information regarding Nominees. The following table sets for the names of the Board of Directors nominees for election as a director, and each such person's age at March 31, 2004 and position with the Company.

Name	Position(s) with the Company	Age
James W. Bernau ***	Chairperson of the Board, President and Director	50
James L. Ellis * ***	Secretary and Director	59
Thomas M. Brian		55
Delna L. Jones	Director	63
Lisa M. Match		42
Betty M. O'Brien*	Director	60
Stan G. Turel * ** ***	Director	56

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\*Member of the Compensation Committee

\*\*Member of the Audit Committee

\*\*\*Member of the Executive Committee

All directors hold office until the next annual meeting of Shareholders or until their successors have been elected and qualified. Executive officers are appointed by the Board of Directors and serve at the pleasure of the Board of Directors. Mr. Terry Emmert resigned from the Board in May of 2004. In order to expand the number of independent Board members, the Board voted to expand the Board and to appoint Ms. Match in April of 2004 and Mr. Brian in June of 2004 to fill open positions.

Set forth below is additional information as to each nominee and executive officer of the Company.

James W. Bernau. Mr. Bernau has been President and Chairperson of the Board of Directors of the Company since its inception in May 1988. Willamette Valley Vineyards was originally established as a sole proprietorship by Oregon winegrower Jim Bernau in 1983, and he co-founded the Company in 1988 with Salem grape grower, Donald Voorhies. From 1981 to September 1989, Mr. Bernau was Director of the Oregon Chapter of the National Federation of Independent Businesses ("NFIB"), an association of 15,000 independent businesses in Oregon.

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Mr. Bernau has served as the President of the Oregon Winegrowers Association and the Treasurer of the association's Political Action Committee (PAC) and Chair of the Promotions Committee of the Oregon Wine Advisory Board, the State of Oregon's agency dedicated to the development of the industry. In March 2004, Mr. Bernau received the industry's Founder's Award for his service.

James L. Ellis. Mr. Ellis has served as a Director since July 1991 and Secretary since June 1997. Mr. Ellis has served as the Company's Director of Human Resources from January 1993, and Vice President /Corporate since 1998. From 1990 to 1992, Mr. Ellis was a partner in Kenneth L. Fisher, Ph.D. & Associates, a management-consulting firm. From 1980 to 1990, Mr. Ellis was Vice President and General Manager of R.A. Kevane & Associates, a Pacific Northwest personnel-consulting firm. From 1962 to 1979, Mr. Ellis was a member of and administrator for the Christian Brothers of California, owner of Mont La Salle Vineyards and producer of Christian Brothers wines and brandy.

Thomas M. Brian. Mr. Brian was appointed to the Board of Directors in June of 2004. Mr. Brian has served as Chairman of the Washington County Board of Commissioners since 1999. Previously, he served for 10 years in the Oregon House of Representatives. While in the legislature, Mr. Brian was Chairman of the Revenue Committee and served on the Judicial and Ways and Means Committees. He also served 10 years as City Councilor and Mayor of Tigard, OR. Mr. Brian has successfully owned and operated a commercial/industrial real estate company for fifteen years.

Delna L. Jones. Ms. Jones has served as a Director since November 1994. Ms. Jones resigned from the Board in December of 2002 having moved to Southern California and was reappointed by the Board in March of 2004 having returned to Oregon. Currently Ms. Jones is a consultant with CFM Consulting, Portland, Oregon. Ms. Jones was elected in 1998 and served as a County Commissioner for Washington County, Oregon from 1998 to 2000. Ms. Jones has served as project director for the CAPITAL Center, an education and business consortium from 1990 to 1998. From 1985 to 1990, Ms. Jones served as Director of Economic Development with US West Communications. Beginning in 1982, she was elected six times to the Oregon House as the State Representative for District 6. During her tenure, she served as the Assistant Majority Leader; she also chaired the Revenue and School Finance committee, and served on the Legislative Rules and Reorganization committee and the Business and Consumer Affairs committee.

Lisa M. Matich. Ms. Matich was appointed to the Board of Directors in April of 2004. She is the Director of Financial Analysis of PacifiCorp, a multi-state electric utility with over 1.5 million customers. Previously she was a Financial Consultant with SAIC 1996 to 2002, a Fortune 500 company and the nation's largest employee-owned research and engineering company. She was Chief Financial Officer of Egmont Electricity 1991-1996, a New Zealand electricity provider and public company. Ms. Matich also has a background in public accounting with both Price Waterhouse and Coopers & Lybrand. She is a CPA in the state of California (inactive status) and a member of the American Institute of Certified Public Accountants. Ms. Matich has a degree in Business Administration from the University of California, Berkeley.

Betty M. O'Brien. Ms. O'Brien has served as a Director since July 1991. Ms. O'Brien is a partner in Elton Vineyards, a commercial vineyard located in Eola Hills in Yamhill County, Oregon. Ms. O'Brien was the former Executive Director of the Oregon Wine Board from 2001 to 2004. Ms. O'Brien was employed by Willamette University as its Director of News and Publications from 1988 to 2000. She is a member of the Oregon Winegrowers Association, having previously served as its President and Treasurer and as a director.

Stan G. Turel. Mr. Turel has served as a Director since November of 1994. Mr. Turel is president of Turel Enterprises, a real estate management company

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managing its own properties. Prior to his current activities, Mr. Turel was part owner and the CEO of Columbia Turel, Inc., (formerly Columbia Bookkeeping, Inc.) a position he held from 1974 to 2001. Prior to 2001, Columbia Turel, Inc. had fifteen offices in Oregon and Washington, servicing 4,000 small business and 26,000 tax clients annually. In 2001, Columbia Turel, Inc. sold its offices to Fiducial, one of Europe's largest accounting firms. Mr. Turel is a licensed tax consultant, a member of the National Association of Public Accountants, a private pilot, and a former delegate to the White House Conference on Small Business

The Board of Directors met five times during 2002, the majority of Directors attended all meetings. One former director attended less than 75% of the meetings of the Board of Directors.

A majority of the Company's directors are independent as that term is used under applicable SEC and Nasdaq rules and regulations

Board of Directors Committees.

Nominating Committee

The Board of Directors currently acts as a nominating committee for selecting nominees for election as directors. The Board, acting as the Nominating Committee, has nominated seven persons for election to the Board to be voted upon at the Company's Annual Meeting in July 2004. During the year, the Board voted to expand the number of independent Board members, the Board acting as the Nominating Committee appointed Lisa Matich and Tom Brian to fill these positions. Nominations of candidates by shareholders of the Company to be considered by the Committee for membership on the Board of Directors may be submitted at any time, if such nominations are made pursuant to timely notice in writing to the Board Secretary. To be timely, notice must be delivered to, or mailed to and received at, Willamette Valley Vineyards, 8800 Enchanted Way SE, Turner Oregon 97392 not less than 60 days prior to date of the Annual Meeting

Compensation Committee

The Board of Directors also has appointed a Compensation Committee, which reviews executive compensation and makes recommendations to the full Board regarding changes in compensation, and also administers the Company's 1992 Stock Incentive Plan. During the fiscal year ended December 31, 2003, the Compensation Committee held three meetings. The members of the Compensation Committee currently are Betty M. O'Brien, Chair, Stan Turel, and James Ellis.

Executive Committee

In 1997 the Board appointed an Executive Committee, members are: James Bernau, James Ellis, and Stan Turel. The Executive Committee held one meeting during 2003.

Audit Committee

The Board of Directors has appointed a standing Audit Committee that, during the year ended December 31, 2003, conducted one meeting. In 2003 the members of the Audit Committee were Stan G. Turel and Terry Emmert, Ms. Jones had resigned in late December of 2002 having moved to Southern California and was reappointed to the Board in March of 2004 having returned to Oregon. Mr. Emmert resigned from the board in May of 2004. Mr. Turel was designated by the Board of Directors as the "audit committee financial expert" under SEC rules for that period. The Audit Committee reviews the scope of the independent annual audit, the independent accountant's letter to the Board of Directors

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concerning the effectiveness of the Company's internal financial and accounting controls and the Board of Directors' response to that letter, if deemed necessary. The Board of Directors adopted a final version of the Audit Committee's Charter on May 25, 2004. The full charter is attached to this Proxy as Exhibit A. In order to increase the number of independent members of the Board and to increase the number of independent members on the Audit Committee, the Board voted to increase the number of Board members in March of 2004. Members of the Audit Committee at the time of adoption of the Charter on May 25th, 2004 were Lisa Matich, Chair and Financial Expert, Delna Jones and Stan Turel; all are independent under applicable SEC and Nasdaq rules.

### DIRECTOR COMPENSATION

The members of the Company's Board of Directors do not receive cash compensation for their service on the Board, but are reimbursed for out-of-pocket and travel expenses incurred in attending Board meetings. Under the Company's Stock Incentive Plan adopted by the shareholders in 1992 and further amended by the shareholders in 1996, beginning in 1997 an option to purchase 1,500 shares of Common Stock may granted to each Director for service on the Board during the year. The number of options that may be granted on an annual basis was increased to 4,000 per year when the 50-share grant per Director's meeting was discontinued for the year 2000 and beyond.

### COMMUNICATION TO THE BOARD OF DIRECTORS

The Board of Directors welcomes and encourages shareholders to share their thoughts regarding the Company. Towards that end, the Board of Directors has adopted a policy whereby all communications should first be directed to the Company's Secretary. The Secretary will then distribute a copy of the communication to the Chairman of the Board, the Chairperson of the Audit Committee and the Company's outside counsel. Based on the input and decision of these persons, along with the entire Board of Directors if it is deemed necessary, the Company will respond to the communication. Shareholders should not communicate directly with any individual officer or director unless requested to do so.

### CODE OF ETHICS

The Company adopted a code of ethics applicable to its chief executive officer, controller and other finance leaders, which is a "code of ethics" as defined by applicable rules of the Securities and Exchange Commission. A copy of the code of ethics is attached as Exhibit B to this Proxy. Amendments to the code of ethics or any grant of a waiver from a provision of the code of ethics requiring disclosure under applicable SEC rules, if any, will be disclosed on our website at [www.WillametteValleyVineyards.com](http://www.WillametteValleyVineyards.com). Any person may request a copy of the code of ethics, at no cost, by writing to us at the following address:

Willamette Valley Vineyards, Inc.  
8800 Enchanted Way SE  
Turner, OR 97392  
Attention: Corporate Secretary

### MANAGEMENT / EXECUTIVE OFFICERS

Name	Position	Age
James W. Bernau	President, Director and Chairperson of the Board of Directors	50

Information concerning the principle occupation of Mr. Bernau is set forth under "Election of Directors".

### EXECUTIVE COMPENSATION

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### Summary of Cash and Certain Other Compensation

The following table provides certain summary information concerning compensation paid or accrued by the Company, to or on behalf of the Company's Chief Executive Officer, James W. Bernau (the "named executive officer") for the years ending December 31, 2001, 2002, and 2003.

#### SUMMARY COMPENSATION TABLE

Name	Year	Annual Compensation		
		Salary (\$)	Bonus (\$)	Other Annual Compensation (\$)
James W. Bernau	2001	95,357	-	-
	2002	97,027	-	-
	2003	120,318	-	-

  

Name	Year	Long Term Compensation			
		Awards	Payouts		
		Restricted Stock Award(s) (\$)	Securities Underlying Options/SARs (#)	LTIP Payouts (\$)	All Other Compensations
James W. Bernau	2001	-	82,000	-	-
	2002	-	112,000	-	-
	2003	-	112,000	-	-

#### Bernau Employment Agreement

The Company and Mr. Bernau are parties to an employment agreement dated August 3, 1988 and amended in February 1997 and again amended in January of 1998. Under the amended agreement, Mr. Bernau is paid an annual salary of \$90,000 with annual increases tied to increases in the consumer price index. Pursuant to the terms of the employment agreement, the Company must use its best efforts to provide Mr. Bernau with housing on the Company's property. Mr. Bernau and his family currently live in a Company-owned house on the Company's property free of rent and must continue to reside there for the duration of his employment in order to provide additional security and lock-up services for late evening events at the winery and vineyard. The employment agreement provides that Mr. Bernau's employment may be terminated only for cause, which is defined as non-performance of his duties or conviction of a crime.

#### Stock Options

In order to reward performance and retain high-quality employees, the Company often grants stock options to its employees. The Company does not ordinarily directly issue shares of stock to its employees. Options are typically issued at a per share exercise price equal to the closing price as reported by NASDAQ at the time the option is granted. The options vest to the employee over time. Three months following termination of the employee's employment with the Company, any and all unexercised vested options terminate.

#### Option Exercises and Holdings

The following table provides information, with respect to the named executive officer, concerning exercised options during the last fiscal year and unexercised options held as of December 31, 2003.

Name	Options exercised in the last fiscal year	
	Number Of shares	Value Realized(1)
James W. Bernau	-0-	-0-

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	Number of Securities Underlying Unexercised Options at FY-End	
	Exercisable	Unexercisable
James W. Bernau	75,000 (1.65)	
	1,500 (1.81)	
	1,500 (1.50)	
	4,000 (1.5625)	
	30,000 (1.507)	

	Value of Unexercised In-the-Money Options at FY-End(2)	
	Exercisable	Unexercisable
James W. Bernau	35,250	
	465	
	930	
	2,230	
	18,390	

(1) The value realized is based on the difference between the market price at the time of exercise of the options and the applicable exercise price.

(2) Options are "in the money" at the fiscal year-end if the fair market value of the underlying securities on such date exceeds the exercise price of the option. The amounts set forth represent the difference between the fair market value of the securities underlying the options on December 31, 2003 (\$2.12 per share based on the NASDAQ closing price for the Company's Common Stock on the NASDAQ Small Cap Market on that date), and the exercise price of the option, multiplied by the applicable number of options.

### CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

During 2003, 2002, 2001 and 2000, the Company purchased grapes from Elton Vineyards for \$122,780, \$120,589, \$108,672 and \$74,585 respectively. Betty M. O'Brien, a Director of the Company, is a principal owner of Elton Vineyards.

On November 26, 2002, Mr. Bernau was granted 30,000 employee stock options for his personal guarantee of \$1,000,000 of the Company's Line of Credit from GE Commercial Distribution Finance. The options, which were issued pursuant to the stock incentive plan and are, accounted for as non-compensatory employee stock options. The options are exercisable anytime through November 26, 2012, at an exercise price of \$1.507 per share.

On June 1, 1992, the Company granted Mr. Bernau a warrant to purchase 15,000 shares of the Company's Common Stock as consideration for his personal guarantee of the Real Estate Loan and the Line of Credit from Farm Credit Services pursuant to which the Company borrowed \$1.2 million. The warrant is exercisable anytime through June 1, 2012, at an exercise price of \$3.42 per share.

On December 3, 1992, James W. Bernau borrowed \$100,000 from the Company. The loan is secured by Mr. Bernau's stock in the Company, and is payable, together with interest at a rate of 7.35% per annum, on March 14, 2009. At December 31, 2003, the outstanding balance of the loan was \$61,134 including accrued interest.

The Company believes that the transactions set forth above were made on terms no less favorable to the Company than could have been obtained from

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unaffiliated third parties. All future transactions between the Company and its officers, directors, and principal shareholders will be approved by a disinterested majority of the members appointed as a Affiliated Transactions Committee of the Company's Board of Directors, and will be on terms no less favorable to the Company than could be obtained from unaffiliated third parties.

### SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information with respect to beneficial ownership of the Company's Common Stock as of December 31, 2003, by (i) each person who beneficially owns more than 5% of the Company's Common Stock (ii) each Director of the Company (iii) each of the Company's named executive officers, and (iv) all directors and executive officers as a group.

Number of Shares Beneficially Owned	Shares Outstanding Stock	Percent of
James W. Bernau 2545 Cloverdale Road Turner, OR 97392	President/CEO, Chair of the Board 1,071,160.5 (1)	23.9%
James L. Ellis 7850 S.E. King Road Milwaukie, OR 97222	Secretary, Director 52,743 (2)	1.2%
Terry W. Emmert 11811 SE Highway 212 Clackamas, OR 97015	Director 281,200	6.3%
Betty M. O'Brien 22500 Ingram Lane NW Salem, OR 97304	Director 13,950 (3)	**
Stan G. Turel 604 SE 121 Street Vancouver, WA 98683	Director 131,885 (4)	3.0%
All Directors, executive officers and persons owning 5% or more as a group (6 persons)	1,550,939	34.6%

\*\* Less than one percent.

(1) Includes 15,000 shares issuable upon the exercise of an outstanding warrant and 112,000 shares issuable upon exercise of options.

(2) Includes 47,643 shares issuable upon the exercise of options.

(3) Includes 8,500 shares issuable upon the exercise of options.

(4) Includes 8,500 shares issuable upon the exercise of options.

### SECTION 16 REPORTS

Section 16(a) of the Exchange Act requires the Company's directors and officers, and persons who own more than ten percent (10%) of a registered class of the Company's equity securities, to file initial reports of ownership and report of changes in ownership with the Commission. Such persons also are required to furnish the Company with copies of all Section 16(a) reports they file.

Based solely on its review of the copies of such reports received by it with



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respect to fiscal year 2003, or written representations from certain reporting persons, the Company believes that all filing requirements applicable to its directors, officers and persons who own more than ten percent (10%) of a registered class of the Company's equity securities have been complied with for fiscal 2003.

### Compensation Committee Report

The Compensation Committee of the Board of Directors is tasked with administering the Company's 1992 Stock Incentive Plan. The Committee and the Board believe that equity-based compensation ensures that the Company's employees, directors and distributors have a continuing stake in the long-term success of the Company. All options granted by the Company are typically granted with an exercise price equal to the market price of the Company's Common Stock on the date of grant and, accordingly, will only have value if the Company's stock price increases. All options have a vesting schedule and a term of ten years. During 2003 the Committee approved an incentive stock option for 20,000 shares and grants totaling 10,034 shares.

### Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	288,600	\$1.69	611,400
Equity compensation plans not approved by security holders			
<b>Total</b>	<b>288,600</b>	<b>\$1.69</b>	<b>611,400</b>

Betty O'Brien, Chairperson, Compensation Committee 2003

### Audit Committee Report

The general purpose of the Audit Committee is to assist the Board of Directors in the exercise of its fiduciary responsibility of providing oversight of the Company's financial statements and the financial reporting processes, internal accounting and financial controls, the annual independent audit of the Company's financial statements, and other aspects of the financial management of the Company. The Audit Committee is appointed by the Board of Directors All committee members must be financially literate, or shall become financially literate within a reasonable period of time after appointment to the Committee. **Audit Fees:** The aggregate fees billed by PricewaterhouseCoopers for the audit of our annual financial statements and review of our quarterly financial statements included in our Form 10QSB assurance and related services reasonably related to the performance of the audit for the fiscal years ended March 31, 2003 and March 31, 2002, were \$70,700 and \$62,500, respectively.

**Audit-Related Fees:** PricewaterhouseCoopers did not bill us for any assurance and related work in fiscal year 2002 or 2003.

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**Tax Fees:** PricewaterhouseCoopers did bill us for tax compliance, tax advice and tax planning in fiscal year 2002 and 2003 PricewaterhouseCoopers fees in connection with the 2002 federal and state tax returns, which were billed in 2003, were \$8,075, or 11% of the aggregate fees billed for professional services by PricewaterhouseCoopers in 2003. PricewaterhouseCoopers in connection with the 2001 federal and state tax returns, which were billed in 2002, were \$14,175, or 18% of the aggregate fees billed for professional services by PricewaterhouseCoopers in 2002.

**Other Fees:** PricewaterhouseCoopers did not bill us for any other products or services in fiscal year 2002 or 2003.

**Pre-Approval Policies:** It is the policy of the Company not to enter into any agreement for PricewaterhouseCoopers to provide any non-audit services to us unless (a) the agreement is approved in advance by the Audit Committee or (b) (i) the aggregate amount of all such non-audit services constitutes no more than 5% of the total amount we pay to PricewaterhouseCoopers during the fiscal year in which such services are rendered, (ii) such services were not recognized by the Company as constituting non-audit services at the time of the engagement of the non-audit services and (iii) such services are promptly brought to the attention of the Audit Committee and prior to the completion of the audit were approved by the Audit Committee or by one or more members of the Audit Committee who are members of the Board of Directors to whom authority to grant such approvals has been delegated by the Audit Committee. The Audit Committee will not approve any agreement in advance for non-audit services unless (x) the procedures and policies are detailed in advance as to such services, (y) the Audit Committee is informed of such services prior to commencement and (z) such policies and procedures do not constitute delegation of the Audit Committee's responsibilities to management under the Securities Exchange Act of 1934, as amended. To date, the Audit Committee has not established such policies and procedures because we do not intend to have our auditors provide any non-audit services in the foreseeable future. If our intentions change, the Audit Committee will adopt the appropriate pre-approval policies and procedures as outlined above.

**Specific Audit Committee Actions Related to Review of the Company's Audited Financial Statements:** In discharging its duties, the Audit Committee among other actions, has (i) reviewed and discussed the audited financial statements to be included in the company's Annual Report on Form 10-K for the twelve months ended December 31, 2003 with management, (ii) discussed with the Company's independent auditors the matters required to be discussed by SAS 61 (Codification of Statements on Auditing Standard, AU380) related to such financial statements, (iii) received the written disclosures and the letter from the Company's independent accountants required by Independence Standards Board Standard No. 1 (Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees) and has discussed with the independent accountant the independent accountant's independence, and (iv) based on such reviews and discussions, the Audit Committee has recommended to the Board of Directors that the audited financial statements be included in the company's Annual Report on Form 10-K for the twelve months ended December 31, 2003.

Stan Turel, 2003 Audit Committee Chair

### ELECTION OF DIRECTORS (PROPOSAL NO. 1)

At the Annual Meeting seven directors will be elected, each for a one-year term. Unless otherwise specified on the proxy, it is the intention of the persons named in the proxy to vote the shares represented by each properly executed proxy for the election as directors the persons named below as nominees. The Board of Directors believes that the nominees will stand for election and will serve if elected as directors. However, if any of the persons nominated by the Board of Directors fails to stand for election or is unable to accept election,

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the proxies will be voted for the election of such other person as the Board of Directors may recommend. There is no cumulative voting for election of directors. Directors are elected by a plurality of votes; therefore, the seven persons receiving the most votes, even if less than a majority of the votes cast, will be elected directors. Abstentions or failure to vote will have no effect on the election of directors, assuming the existence of a quorum. The Board of Directors unanimously recommends a vote FOR this proposal.

### RATIFICATION OF APPOINTMENT OF INDEPENDENT AUDITORS (PROPOSAL NO. 2)

The Audit Committee of the Board of Directors has appointed PricewaterhouseCoopers LLP to act as independent auditors for the Company for the year ending December 31, 2004 subject to ratification of such appointment by the Company's Board of Directors and the Company's shareholders. The Board ratified this appointment on May 25, 2004. PricewaterhouseCoopers, LLP was the Company's independent auditor for the fiscal year that ended December 31, 2003.

The proposal will be approved if assuming the existence of a quorum at least a majority of the shares of the Company's Common Stock cast on the proposal vote in favor of approval. Abstentions and broker non-votes are counted for purposes of determining whether a quorum exists at the Annual Meeting but will not be counted and will have no effect on the determination of the outcome of the proposal. The proxies will be voted for or against the proposal, or as an abstention, in accordance with the instructions specified on the proxy form. If no instructions are given, proxies will be voted for approval of the ratification of PricewaterhouseCoopers. A representative of PricewaterhouseCoopers LLP has been invited to attend the Annual Meeting at his own expense and will be given an opportunity to make a statement if he desires to do so and will be available to respond to appropriate questions.

The Board of Directors unanimously recommends a vote FOR this proposal. Assuming the existence of a quorum, the appointment of PricewaterhouseCoopers LLP will be ratified if approved by the holders of a majority of the shares present in person or by proxy.

### DATE FOR SUBMISSION OF SHAREHOLDER PROPOSALS

Any shareholder proposal intended for inclusion in the proxy statement and form of proxy relating to the Company's 2005 annual meeting of shareholders must be received by the Company not later than January 17, 2005, pursuant to the proxy soliciting regulations of the Securities and Exchange Commission (the "SEC"). Nothing in this paragraph shall be deemed to require the Company to include in its proxy statement and form of proxy for such meeting any shareholder proposal, which does not meet the requirements of the SEC in effect at the time.

### OTHER MATTERS

As of the date of this Proxy Statement, the Board of Directors does not know of any other matters to be presented for action by the shareholders at the 2004 Annual Meeting. If, however, any other matters not now known are properly brought before the meeting, the persons named in the accompanying proxy will vote such proxy in accordance with the determination of a majority of the Board of Directors.

### COST OF SOLICITATION

The cost of soliciting proxies will be borne by the Company. In addition to use of the mails, proxies may be solicited personally or by telephone by directors, officers and employees of the Company, who will not be specially compensated for such activities.

### ADDITIONAL INFORMATION

A copy of the Company's Annual Report to Shareholders for the fiscal year ended December 31, 2003 accompanies this Proxy Statement. The Company is required to file an Annual Report on Form 10-KSB with the Securities and Exchange

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Commission. Shareholders may obtain, free of charge, a copy of the Form 10-KSB by writing to James L Ellis, Secretary, Willamette Valley Vineyards, Inc., 8800 Enchanted Way S.E., Turner, Oregon 97392. Or they may access a copy through links provided on the Company's web site: [www.WillametteValleyVineyards.com](http://www.WillametteValleyVineyards.com). The information on the Company's website is not part of this Proxy Statement.

By Order of the Board of Directors  
James W. Bernau  
Chairperson of the Board  
June 7th, 2004

Exhibit A  
Willamette Valley Vineyards  
AUDIT COMMITTEE  
CHARTER

This Charter (the "Charter") of the Audit Committee (the "Committee") of Willamette Valley Vineyards, Inc. (the "Company") is adopted effective May 25, 2004 and replaces and restates in its entirety the Company's prior draft Committee charter.

### Status

The Committee is a committee of the Board of Directors.

### Membership

The Audit Committee shall consist of three or more directors, all of whom in the judgment of the Board of Directors shall be independent in accordance with the listing standards of the Nasdaq Stock Market ("Nasdaq"). Each member shall, in the judgment of the Board of Directors, have the ability to read and understand the Company's basic financial statements or shall at the time of appointment undertake training for that purpose. At least one member of the Audit Committee shall, in the judgment of the Board of Directors, be an audit committee financial expert in accordance with the rules and regulations of the Securities and Exchange Commission and at least one member (who may also serve as the audit committee financial expert) shall in the judgment of the Board of Directors have accounting or related financial management expertise in accordance with the Nasdaq listing standards.

The Board of Directors, upon the recommendation of its Nominating Committee, shall elect the chair and other members of the Committee on an annual basis, generally at the first meeting of the Board of Directors following the Company's annual meeting. The Board of Directors may, pursuant to the Company's Bylaws, remove a member of the Committee or replace the chairman, provided the Board of Directors must, at all times, assure that the Committee will have a chairman and sufficient members to satisfy the requirements set forth above relating to the number and qualifications of Committee members.

Each Committee member shall have no other relationship to the Company that may interfere with the exercise of his or her independence from management and the Company, including the receipt from the Company of any compensation other than directors' fees and other compensation related to their service as a director. Committee members may not simultaneously serve as the chairman or on the audit committee of more than three public companies, including the Company, unless the Board of Directors determines that such simultaneous service does not impair the efficacy of Committee service. In addition, each prospective Committee member shall evaluate carefully the existing demands on his or her time before accepting appointment to the Committee.

As of the date hereof, the members of the Committee are as follows:

Stan Turel  
Lisa Matich\*

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Delna Jones

\*Member is an "audit committee financial expert," as that term is defined in Item 401 of Regulation S-K promulgated by the SEC and she is "independent of management" as that term is defined in Item 7(d)(3)(iv) of Schedule 14A promulgated by the SEC.

The Chair of the Committee, or if not present, the senior independent director present shall preside at all meetings of the Committee and provide written minutes of such meetings to the Board of Directors. The Committee shall hold at least four meetings annually. A majority of the Committee members shall constitute a quorum. Each Committee member shall have one vote and actions at meetings may be approved by a majority of members present, assuming the existence of a quorum.

The Company shall provide the Committee with adequate staff support and resources to discharge its responsibilities. The Committee may engage independent legal counsel and other advisors as the Committee deems advisable to carry out its responsibilities. The Company shall provide full funding to engage the Company's independent public accountants as well as to retain independent counsel and other advisors for the Committee.

The Committee shall have full authority at its own discretion to (a) institute investigations of matters brought to its attention, with full access to all books, records, facilities and personnel of the Company, including standing authority to retain special counsel of experts and (b) to review all aspects of the Company's financial operations on a planned basis.

In fulfilling its responsibilities and discharging its duties, the Committee shall maintain free and open communication between the Committee, directors who are not members of the Committee, the Company's management, legal counsel and the independent auditors.

### General Purpose

The Audit Committee shall assist the Board of Directors in the exercise of its fiduciary responsibility of providing oversight of (a) the integrity of the Company's financial statements and the financial reporting processes, internal accounting and financial controls, (b) the Company's compliance with legal and regulatory requirements, (c) the independent auditor's qualifications and independence and (d) the performance of the Company's independent auditor. Except as otherwise required by applicable laws, regulations or listing standards, all major decisions are considered by the Board of Directors as a whole.

### Responsibilities and Duties

The Company's management is responsible for preparing the Company's financial statements and the independent auditors are responsible for auditing those financial statements. The Committee is responsible for overseeing the conduct of these activities by the Company's management and the independent auditors. The financial management and the independent auditors of the Company have more time, knowledge and more detailed information on the Company than do Committee members. Consequently, in carrying out its oversight responsibilities, the Committee is not providing any expert or special assurance as to the Company's financial statements or any professional certification as to the independent auditors' work.

The specific duties of the Audit Committee include the following:

1. Select, retain (subject to approval by the Company's stockholders), and, when appropriate, terminate the engagement of the independent auditor and set the independent auditors' compensation;
2. Pre-approve all permitted non-audit services to be performed by the

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independent auditors and establish policies and procedures for the engagement of the independent auditors to provide permitted non-audit services;

3. Periodically discuss and review with the independent auditors' their independence from management and the Company and the matters included in the written disclosures required by the Independence Standards Board, including whether the provision by the independent auditors of permitted non-audit services is compatible with independence and obtain and review a report from the independent auditors describing all relationships between the independent auditors and the Company;

4. Receive and review: (a) a report by the independent auditors describing the independent auditors' internal quality-control procedures and any material issues raised by the most recent internal quality-control review, or peer review, of the independent auditors, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the firm, and any steps taken to deal with any such issues; and (b) other required report from the independent auditors;

5. Meet with management and the independent auditors prior to commencement of the annual audits to review and discuss the planned scope, the factors considered in planning the scope (including risk factors) and the objectives of the audit;

6. Meet with the independent auditors, with and without management present, after completion of the annual audit to review and discuss the results of the examinations of the independent auditors and appropriate analyses of the financial statements and to confirm that no limitations have been placed on the scope or nature of their audit process;

7. Review the recommendations of the independent auditors for improving internal accounting controls and management's responses thereto;

8. Review and discuss (a) the reports of the independent auditors, with and without management present, as to the state of the Company's financial reporting systems and procedures, the adequacy of internal accounting and financial controls, the integrity and competency of the financial and accounting staff, disclosure controls and procedures, other aspects of the financial management of the Company and (b) current accounting trends and developments, and (c) take such action with respect thereto as may be deemed appropriate;

9. Review the interim financial statements with management and the independent auditors prior to the filing of the Company's Quarterly Reports on Form 10-Q and discuss the results of the quarterly reviews and any other matters required to be communicated to the Committee by the independent auditors under generally accepted auditing standards;

10. Review and discuss with management and the independent auditors the financial statements to be included in the Company's Annual Report on Form 10-K (or the annual report to stockholders if distributed prior to the filing of Form 10-K, including the judgment of the independent auditors about the quality, not just acceptability, of accounting principles, the reasonableness of significant judgments, and the clarity of the disclosures in the financial statements;

11. Recommend to the Board of Directors, based upon the Committee's review, whether the financial statements should be included in the annual report on Form 10-K;

12. Review press releases, as well as Company policies with respect to earnings

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press releases, financial information and earnings guidance provided to analysts and rating agencies and review such releases, information and guidance for compliance with regulations governing the use of non-Generally Accepted Accounting Principles financial measures and related disclosure requirements;

13. Discuss Company policies with respect to risk assessment and risk management, and review contingent liabilities and risks that may be material to the Company and major legislative and regulatory developments that could materially impact the Company's contingent liabilities and risks;

14. Review (a) the status of compliance with laws, regulations, and internal procedures, including, without limitation, the Company's policies on ethical business practices; and (b) the scope and status of systems designed to promote Company compliance with laws, regulations and internal procedures, through receiving reports from management, legal counsel and third parties as determined by the Committee and report on the same to the Board of Directors;

15. Establish procedures for the confidential and anonymous receipt, retention and treatment of complaints regarding the Company's accounting, internal controls, auditing matters and compliance with the Company's ethical business policies;

16. Establish policies for the hiring of employees and former employees of the independent auditor;

17. Prepare a report of the Committee each year for inclusion in the Company's proxy statement in accordance with SEC rules;

18. Review and assess the adequacy of this Charter annually with the Board of Directors as a whole and report to the Board of Directors any proposed changes or significant matters as they occur during the year; and

19. Conduct such other duties and undertake such other tasks as may be appropriate to the overall purposes for the Committee and as may be assigned from time to time by the Board of Directors consistent with such purposes.

### Exhibit B

#### Code of Ethics for CEO and Finance Leaders

In my financial leadership role with Willamette Valley Vineyards, Inc, I recognize that I hold an important and elevated role in corporate governance. I am charged with ensuring that stakeholders' interests are appropriately balanced, protected and preserved. Accordingly, this Code provides principles to which I am expected to adhere.

To the best of my knowledge and ability, in executing my job responsibilities:

1. I act with honesty and integrity, avoiding actual or apparent conflicts of interest.

2. I provide internal and external constituents with appropriate and objective information that is full, fair, accurate, timely and understandable.

3. I act in good faith, responsibly, with due care, competence and diligence, without misrepresenting material facts or allowing my independent judgment to be compromised.

4. I respect the confidentiality of information acquired in the course of my work except when authorized or otherwise legally obligated to disclose. I will not use confidential information acquired in the course of my work for personal advantage.

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5. I proactively promote ethical behavior as a responsible partner among others in my work environment. I understand my accountability for adhering to this code and my responsibility to report violations of this code to the Audit Committee or other appropriate officials in accordance with Willamette Valley Vineyard's Employee Handbook and Policies.

6. I exercise responsible stewardship over company assets and resources and maintain appropriate internal controls.

Annual Report to Shareholders

### DESCRIPTION OF BUSINESS.

Willamette Valley Vineyards, Inc. (the "Company") was formed in May 1988 to produce and sell premium, super premium and ultra premium varietal wines (i.e., wine which sells at retail prices of \$7 to \$14, \$14 to \$20 and over \$20 per 750 ml bottle, respectively). Willamette Valley Vineyards was originally established as a sole proprietorship by Oregon winegrower Jim Bernau in 1983. The Company's wines are made from grapes grown at its vineyard (the "Vineyard") and from grapes purchased from other nearby vineyards. The grapes are crushed, fermented and made into wine at the Company's winery (the "Winery") and the wines are sold principally under the Company's Willamette Valley Vineyards label. The Company's Vineyard and Winery are located on 75 acres of Company-owned land adjacent to Interstate 5, approximately two miles south of Salem, Oregon.

The Company owns 146 acres of vineyard land, fifty acres of planted vineyards—42 acres producing and 8 acres in development at the Turner site. In April 1997, the Company acquired 100 percent of the outstanding stock of Tualatin Vineyards, Inc. (TVI), adding 83 acres of producing vineyard, 60 additional plantable acres and an additional 20,000 cases of winemaking capacity. The purchase price paid by the Company to the Tualatin Vineyards' shareholders in exchange for their shares was \$1,824,000 plus Tualatin Vineyards' current assets minus TVI's current and long-term liabilities as reflected in its balance sheet dated April 15, 1997. The Company paid 35 percent of the purchase price in the form of cash with the balance paid through the issuance of shares of the Company's common stock at an agreed price per share. The final purchase price was \$1,988,601. In 1999, the Company purchased 33 acres of vineyard land adjoining Tualatin Estate for future plantings and used lot line adjustments to create three separate land parcels at Tualatin Estate.

In December 1999, the Company sold one parcel of three parcels offered for sale at its Tualatin Estate Vineyard. The Company entered into an agreement with the new owners to lease back the land for growing grapes for use in the Company's Estate bottling program. The final purchase price paid was \$1,500,000 for the 80-acre parcel. The lease is for twenty years with three 5-year renewals at the Company's option. The Company continues to offer the two remaining properties and equipment on the same type of sale/leaseback arrangement. One parcel contains 75 acres priced at \$725,000 and the last parcel, which contains the Tualatin Estate winery plus 115 acres, is priced at \$1,605,000.

The Company also leases Belle Provenance Vineyards, formerly known as O'Connor Vineyards, on a ten-year contract adding an additional 59 producing acres. All of these vineyards are within the Willamette Valley Appellation.



#### Products

Under its Willamette Valley Vineyards label, the Company currently produces and sells the following types of wine in 750 ml bottles: Pinot noir, the brand's flagship and its largest selling varietal in 2002, from \$15 to \$60 per bottle; Chardonnay, from \$14 to \$25 per bottle; Pinot gris, \$14 per bottle; Riesling and Oregon Blossom (blush blend), \$9 per bottle, all bottle prices included herein are the suggested retail prices. The Company's mission for this brand is to become the premier producer of Pinot noir from the Pacific Northwest.

The Company currently produces and sells small quantities of Oregon's Nog (a seasonal holiday product), \$10 per bottle, and Edelweiss, \$9 per bottle, under a "Made in Oregon Cellars" label, all bottle prices are suggested retail prices.

Under its Tualatin Estate Vineyards label, the Company currently produces and sells the following types of wine in 750 ml bottles: Pinot noir, the brand's flagship, \$28 per bottle; Chardonnay, \$14 per bottle; Semi-Sparkling Muscat, \$15 per bottle; Late Harvest Gewurztraminer, \$20 per bottle; and Pinot blanc, \$14 per bottle, all bottle prices are suggested retail prices. The Company's mission for this brand is to be among the highest quality estate producers of Burgundy and Alsatian varietals in Oregon.

In November 1998, the Company released a new label under the Griffin Creek brand name, which the Company owns. This represents a joint effort between the Company and Quail Run Vineyards to develop a new brand of wines from the Southern Oregon growing region. Currently, the Company has several varieties under this label: Merlot, the brand's flagship, \$30 per bottle; Syrah, \$35 per bottle; Cabernet Sauvignon, \$35 per bottle; Cabernet Franc, \$35 per bottle; The Griffin (a Bordeaux blend), \$70 per bottle; Pinot gris, \$18 per bottle; Viognier, \$25 per bottle; and Pinot noir, \$25 per bottle, all bottle prices are suggested retail prices. This brand's mission is to be the highest quality producer of Bordeaux and Rhone varietals in Oregon.

#### Market Overview

**Wine Consumption Trends:** Wine consumption in the United States declined from 1987 to 1994 due to increased consumer health concerns and a growing awareness of alcohol abuse. That decline was led by sharp reductions in the low-cost non-varietal ("jug") wine and wine cooler segments of the market, which, prior to 1987, were two of the fastest growing market segments. Beginning in 1994, per capita wine consumption began to rise. The Company estimates that premium, super premium and ultra premium wine consumption will experience a moderate increase over the next few years. Consumers have restricted their drinking of alcoholic beverages and view premium, super premium and ultra premium wines as a beverage of moderation. The Company believes this change in consumer preference from low quality, inexpensive wines to premium, super premium and ultra premium wines reflects, in part, a growing emphasis on health and nutrition as a principal element of the contemporary lifestyle as well as an increased awareness of the risks associated with alcohol abuse.

#### The Oregon Wine Industry.

Oregon is a relatively new wine-producing region in comparison to California and France. In 1966, there were only two commercial

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wineries licensed in Oregon. By contrast, in 2003, there were over 200 commercial wineries licensed in Oregon and over 13,400 acres of wine grape vineyards, 10,700 acres of which are currently producing. Total production of Oregon wines in 2003 is estimated to be approximately 1,379,162 cases. Oregon's entire 2003 production would have an estimated retail value of approximately \$206.9 million, assuming a retail price of \$150 per case, and a FOB value of approximately one-half of the retail value, or \$103.5 million.

Because of climate, soil and other growing conditions, the Willamette Valley in western Oregon is ideally suited to growing superior quality Pinot noir, Chardonnay, Pinot gris and Riesling wine grapes. Some of Oregon's Pinot noir, Pinot gris and Chardonnay wines have developed outstanding reputations, winning numerous national and international awards.

Oregon wine producers enjoy certain cost advantages over their California and French competitors due to lower costs for grapes, vineyard land and winery sites. For example, the average cost of unplanted vineyard land in Napa County, California is approximately \$40,000 per acre as compared to approximately \$6,000 per acre in Oregon. In the Burgundy region of France, virtually no new vineyard land is available for planting.

Oregon does have certain disadvantages, however. As a new wine-producing region, Oregon's wines are relatively little known to consumers worldwide and the total wine production of Oregon wineries is small relative to California and French competitors. Greater worldwide label recognition and larger production levels give Oregon's competitors certain financial, marketing, distribution and unit cost advantages.

Furthermore, Oregon's Willamette Valley has an unpredictable rainfall pattern in early autumn. If significantly above-average rains occur just prior to the autumn grape harvest, the quality of harvested grapes is often materially diminished, thereby affecting that year's wine quality.

Finally, phylloxera, an aphid-like insect that feeds on the roots of grapevines, has been found in several commercial vineyards in Oregon. Contrary to the California experience, most Oregon phylloxera infestations have expanded very slowly and done only minimal damage. Nevertheless, phylloxera does constitute a significant risk to Oregon vineyards. Prior to the discovery of phylloxera in Oregon, all vine plantings in the Company's Vineyard were with non-resistant rootstock. As of December 31, 2003, the Company has not detected any phylloxera at its Turner site. Beginning with the Company's plantings in May 1992, only phylloxera-resistant rootstock was planted until 1997, when the previous management planted non-resistant rootstock on approximately 10 acres at the Tualatin Vineyard. In 1997, the Company purchased Tualatin Vineyards, which has phylloxera at its site. Since the third quarter of 1997, all plantings have been and all future planting will be on phylloxera resistant rootstock. The Company takes all necessary precautions to prevent the spread of phylloxera to its Turner site. Also phylloxera is active at the Belle Provenance Vineyard for which the Company has a 10-year lease. Any planting, training, and care of new plants at the Belle Provenance vineyard will not be at the expense of the Company, because under the terms of the lease, it would be the responsibility of the landowner.

In 1994, the largest development in the Oregon wine industry, King Estate Winery, was completed. The facility, which is located 22 miles

southwest of Eugene, is approximately 100,000 square feet in size surrounded by a 180-acre vineyard. King Estate is focused on serving the national market. The Company views King Estate as a welcome addition to the Oregon wine industry and believes they could have the same positive effect on wine exports as St. Michelle Winery has had on the Washington wine industry. The most recent high-profile move in Oregon was the Benziger family's purchase of 65 acres, including 32 producing acres of vineyard, near Scholls. The Benziger family created the Glen Ellen wine brand in California, before selling it to Grand Metropolitan. Well-known California winemaker Tony Soter is making Oregon Pinot noir under the Etude label. The Company believes that further investments by other experienced wine producers will continue, ultimately benefiting the Company and the Oregon wine industry as a whole by bringing increased national and international recognition to the quality of Oregon wines.

As a result of these factors, subject to the risks and uncertainties identified above, the Company believes that long-term prospects for growth in the Oregon wine industry are excellent. The Company believes that over the next 20 years the Oregon wine industry will grow at a faster rate than the overall domestic wine industry, and that much of this growth will favor producers of premium, super premium and ultra premium wines such as the Company's.

#### Vineyard

The Property. The Company's estate vineyard at the Turner site currently has 50 acres planted and 40 acres producing which includes 17 acres of Pinot noir and 8 acres of Riesling grape vines planted in 1985, which were grafted to Pinot noir in 1999. The Company planted 8 acres of Pinot gris vines in May 1992 and 6 acres of Chardonnay vines in 1993. In 1996, the Company planted its remaining 11 acres in Chardonnay and Pinot gris. Grapevines do not bear commercial quantities until the third growing season and do not become fully productive until the fifth to eighth growing season. Vineyards generally remain productive for 30 to 100 years, depending on weather conditions, disease and other factors.

The Vineyard uses an elaborate trellis design known as the Geneva Double Curtain. The Company has incurred the additional expense of constructing this trellis because it doubles the number of canes upon which grape clusters grow and spreads these canes for additional solar exposure and air circulation. Research and practical applications of this trellis design indicate that it will increase production and improve grape quality over traditional designs.

Beginning in 1997, The Company embarked on a major effort to improve the quality of its flagship varietal by planting new Pinot noir clones that originated directly from the cool climate growing region of Burgundy rather than the previous source, Napa California where winemakers believe the variety adopted to the warmer climate over the many years it was grown there.

These new French clones are called "Dijon clones" after the University in Burgundy who assisted in their selection and shipment to a US government authorized quarantine site, and then seven years later to Oregon winegrowers. The most desirable of these new clones are numbered 113, 114, 115, 667 and 777. In addition to certain flavor advantages, these clones ripen up to two weeks earlier, allowing growers to pick before heavy autumn rains. Heavy rains can dilute concentrated fruit flavors and promote bunch rot and spoilage. These new Pinot noir clones were planted at the Tualatin Estate on disease resistant rootstock and the 667 and 777 clones have been

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grafted onto 8 acres of self rooted, non disease resistant vines at the Company's Estate Vineyard near Turner.

New clones of Chardonnay preceded Pinot noir into Oregon also arranged by the University of Dijon, which were planted at the Company's Estate Vineyard on disease resistant rootstock.

The purchase of Tualatin Vineyards, Inc. in April 1997 (including the subsequent sale-leaseback of a portion of the property in December 1999) added 83 acres of additional producing vineyards and approximately 60 acres of bare land for future plantings. In 1997, the Company planted 19 acres at the Tualatin site and planted another 41 acres in 1998, the majority being Pinot noir, which is the Company's flagship varietal. All of the new planting will be available to harvest in the next one to two years.

Also in 1997, the Company entered into a 10-year lease with O'Connor Vineyards, now known as Belle Provenance, (59 acres) located near Salem to manage and obtain the supply of grapes from Belle Provenance Vineyards.

In 1999, the Company purchased 33 acres of vineyard land adjoining Tualatin Estate for future plantings and used lot line adjustments to create three separate land parcels at Tualatin Estate.

The Company now controls 280 acres of vineyard land. At full production, these vineyards should enable the Company to grow approximately 50% of the grapes needed to meet the Winery's ultimate production capacity of 298,000 gallons (124,000 cases).

### Grape Supply

In 2003, the Company's 40 acres of producing estate vineyard yielded approximately 119 tons of grapes for the Winery's thirteenth crush. Tualatin Vineyards produced 503 tons of grapes in 2003. Belle Provenance Vineyards produced 102 tons of grapes in 2003. In 2003, the Company purchased an additional 193 tons of grapes from other growers. The Winery's 2003 total wine production was 219,227 gallons (92,208 cases) from its 2001 and 2002 crushes. The Company expects to produce 141,713 gallons in 2004 (59,605 cases) from its 2002 crush. The Vineyard cannot and will not provide the sole supply of grapes for the Winery's near-term production requirements. The Company has also entered into grape purchase contracts with certain directors or their respective affiliates of the Company. See "CERTAIN TRANSACTIONS."

The Company fulfills its remaining grape needs by purchasing grapes from other nearby vineyards at competitive prices. The Company believes high quality grapes will be available for purchase in sufficient quantity to meet the Company's requirements except in the Pinot noir varietal, where there is increasing demand. The grapes grown on the Company's vineyards establish a foundation of quality upon which the purchase of additional grapes is built. In addition, wine produced from grapes grown in the Company's own vineyards may be labeled as "Estate Bottled" wines. These wines traditionally sell at a premium over non-estate bottled wines.

### Viticultural Conditions

Oregon's Willamette Valley is recognized as a premier location for growing certain varieties of high quality wine grapes, particularly Pinot noir, Chardonnay, Riesling and Pinot gris. The Company believes that the Vineyard's growing conditions, including its soil, elevation, slope, rainfall, evening marine

breezes and solar orientation are among the most ideal conditions in the United States for growing certain varieties of high-quality wine grapes. The Vineyard's grape growing conditions compare favorably to those found in some of the famous Viticultural regions of France. Western Oregon's latitude (42o-46o North) and relationship to the eastern edge of a major ocean is very similar to certain centuries-old wine grape growing regions of France. These conditions are unduplicated anywhere else in the world except the great wine grape regions of Northern Europe.

The Vineyard's soil type is Jory/Nekia, a dark reddish-brown silky clay loam over basalt bedrock noted for being well drained, acidic, of adequate depth, retentive of appropriate levels of moisture and particularly suited to growing high quality wine grapes.

The Vineyard's elevation ranges from 533 feet to 700 feet above sea level with slopes from 2 percent to 30 percent (predominately 12-20 percent). The Vineyard's slope is oriented to the south, southwest and west. Average annual precipitation at the Vineyard is 41.3 inches; average annual air temperature is 52 to 54 degrees Fahrenheit, and the length of each year's frost-free season averages from 190 to 210 days. These conditions compare favorably with conditions found throughout the Willamette Valley viticultural region and other domestic and foreign viticultural regions, which produce high quality wine grapes.

In the Willamette Valley, permanent vineyard irrigation is not required. The average annual rainfall provides sufficient moisture to avoid the need to irrigate the Vineyard. However, if the need should arise, the Company's property contains one water well which can sustain sufficient volume to meet the needs of the Winery and to provide auxiliary water to the Vineyard for new plantings and unusual drought conditions.

#### Winery

Wine Production Facility. The Company's Winery and production facilities, built at an initial cost of approximately \$1,500,000, were originally capable of producing up to 75,000 cases of wine per year, depending on the type of wine produced. In 1996 the Company invested an additional \$750,000 to increase its capacity from 75,000 cases to its present capacity of 104,000 cases (250,000 gallons). It added one large press, six stainless steel fermenters, and handling equipment to increase its capacity to the new level. It also expanded the size of its crush pad to meet the needs of the additional tons of grapes crushed. In 2003, the Winery produced 219,227 gallons (92,208 cases) from its 2001 and 2002 crushes. The Winery is 12,784 square feet in size and contains areas for the processing, fermenting, aging and bottling of wine, as well as an underground wine cellar, a tasting room, a retail sales room and administrative offices. A 12,500 square foot outside production area was added for the crushing, pressing and fermentation of wine grapes. In 1993, a 4,000 square foot insulated storage facility with a capacity of 30,000 cases of wine was constructed at a cost of approximately \$70,000. This facility was converted to barrel storage in 1998 in order to accommodate an additional 750 barrels for aging wines. This change increases the Company's barrel aging capacity at the Turner site. The production area is equipped with a settling tank and sprinkler system for disposing of wastewater from the production process in compliance with environmental regulations. The settling tank and sprinkler system were installed at a total cost of approximately \$20,000.

In 1997, the Company constructed a 20,000 square foot storage building to store all of its bottled product at an approximate cost of \$750,000. Previously, the Company rented a storage facility with an annual rental cost to the Company of \$96,000.

With the purchase of Tualatin Vineyards, Inc., the Company added 20,000 square feet of additional production capacity. Although the Tualatin facility was constructed over twenty years ago, it adds 20,000 cases of wine production capacity to the Company, which the Company felt at the time of purchase was needed. To date, production and sales volumes have not expanded enough to necessitate the utilization of the Tualatin facilities. The Company decided to move current production to its Turner site to meet short-term production requirements. The capacity at Tualatin is available to the Company to meet any anticipated future production needs.

#### Hospitality Facility

In May 1995, the Company completed construction of a large tasting and hospitality facility of 19,470 square feet (the "Hospitality Center"). The first floor of the Hospitality Center includes retail sales space and a "great room" designed to accommodate approximately 400 persons for gatherings, meetings, weddings and large wine tastings. An observation tower and decking around the Hospitality Center enable visitors to enjoy the view of the Willamette Valley and the Company's Vineyard. The Hospitality Center is joined with the present Winery by an underground cellar tunnel. The facility includes a basement cellar of 10,150 square feet (including the 2,460 square foot underground cellar tunnel) to expand storage of the Company's wine in a proper environment. The cellar provides the Winery with ample space for storing up to 1,600 barrels of wine for aging.

Just outside the Hospitality Center, the Company has planned a landscaped park setting consisting of one acre of terraced lawn for outdoor events and five wooded acres for picnics and social gatherings. The area between the Winery and the Hospitality Center forms a 20,000 square foot quadrangle. As designed, a removable fabric top making it an all-weather outdoor facility to promote sale of the Company's wines through outdoor festivals and social events can cover the quadrangle. The Company utilizes this space to host numerous events, most notably the annual fundraiser for the Marion-Polk Food Share, "Chefs' Nite Out."

The Company believes the addition of the Hospitality Center and the park and quadrangle has made the Winery an attractive recreational and social destination for tourists and local residents, thereby enhancing the Company's ability to sell its wines.

#### Mortgages on Properties

The Company's winery facilities are subject to two mortgages with a principal balance of \$2,777,779 at December 31, 2003 and \$3,003,720 at December 31, 2002. The mortgages are payable in annual aggregate installments including interest of approximately \$350,000 through 2012. After 2012, the Company's annual aggregate mortgage payment including interest will be approximately \$75,000 until the year 2014. The mortgage on the Turner site had a principal balance of \$2,140,159 on December 31, 2003. The mortgage on the Tualatin Valley property, issued in April 1997 to fund the acquisition of the property and development of its vineyard, had a principal balance of \$637,620 on December 31, 2003.

#### Wine Production

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The Company operates on the principle that winemaking is a natural but highly technical process requiring the attention and dedication of the winemaking staff. The Company's Winery is equipped with current technical innovations and uses modern laboratory equipment and computers to monitor the progress of each wine through all stages of the winemaking process.

Beginning with the Company's first vintage in 1989, the Company's annual grape harvest and wine production are as follows:

Crush Year	Tons of Grapes Crushed	Production Year	Cases Produced
1989	203		
1990	206	1990	13,200
1991	340	1991	13,400
1992	565	1992	22,100
1993	633	1993	38,237
1994	590	1994	41,145
1995	885	1995	40,411
1996	1290	1996	53,693
1997	1426	1997	91,793
1998	1109	1998	77,064
1999	1383	1999	81,068
2000	1223	2000	98,936
2001	1859	2001	85,554
2002	1091	2002	110,063
2003	917	2003	92,208

The quantity of grapes crushed in 1997 does not include 228 tons of grapes that were purchased and resold on the open market because the Company had contracted for more grapes than were needed. The Company was unable to sell 270 tons of grapes before crush; this tonnage converts to 44,000 gallons of bulk wine that the Company sold in 1998.

### Sales and Distribution

**Marketing Strategy.** The Company markets and sells its wines through a combination of direct sales at the Winery, sales directly and indirectly through its shareholders, self-distribution to local restaurants and retail outlets in Oregon, directly through mailing lists, and through distributors and wine brokers who sell in specific targeted areas outside of the state of Oregon. As the Company has increased production volumes and achieved greater brand recognition, sales to other domestic markets have increased both in terms of absolute dollars and as a percentage of total Company sales.

**Direct Sales.** The Company's Winery is located adjacent to the state's major north-south freeway (Interstate 5), approximately 2 miles south of the state's third largest metropolitan area (Salem), and 50 miles in either direction from the state's first and second largest metropolitan areas (Portland and Eugene, respectively). The Company believes the Winery's unique location along Interstate 5 has resulted in a greater amount of wines sold at the Winery as compared to the Oregon industry standard. Direct sales from the Winery are an important distribution channel and an effective means of product promotion. To increase brand awareness, the Company offers educational Winery tours and product presentations by trained personnel.

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The Company holds four major festivals and events at the Winery each year. In addition, open houses are held at the Winery during major holiday weekends such as Memorial Day, Independence Day, Labor Day and Thanksgiving, where barrel tastings and cellar tours are given. Numerous private parties, wedding receptions, political and other events are also held at the Winery. Finally, the Company participates in many wine and food festivals throughout Oregon. Each of these events results in direct sales of the Company's wines and promotion of its label to event attendees.

Direct sales are profitable because the Company is able to sell its wine directly to consumers at retail prices rather than to distributors or retailers at wholesale prices. Sales made directly to consumers at retail prices result in an increased profit margin equal to the difference between retail prices and distributor or wholesale prices, as the case may be. For 2003, direct sales make up approximately 22% of the Company's revenue.

Self-Distribution. The Company has established a self-distribution system to sell its wines to restaurant and retail accounts located in Oregon. Eighteen sales representatives who take wine orders and make deliveries on a commission-only basis, currently carry out the self-distribution program. Company provided trucks and delivery drivers support several of these sales representatives. The Company believes this program of self-representation and delivery has allowed its relatively new wines to gain a strong presence in the Oregon market with over 1,200 restaurant and retail accounts established as of December 31, 2003. The Company further believes that the location of its Winery along Interstate 5 facilitates self-distribution throughout the entire Willamette Valley, where approximately 70% of Oregon's population resides.

The Company has expended significant resources to establish its self-distribution system. The system initially focused on distribution in the Willamette Valley, but then expanded to the Oregon coast, and then into southern Oregon. For 2003, approximately 46% of the Company's net revenues were attributable to self-distribution.

Distributors and Wine Brokers. The Company uses both independent distributors and wine brokers primarily to market the Company's wines in specific targeted areas where self-distribution is not feasible. Only those distributors and wine brokers who have demonstrated knowledge of and a proven ability to market premium, super premium, and ultra premium wines are utilized.

Shareholders. As a public company, the Company has a unique marketing opportunity available to only a few of its competitors. The Company has approximately 3,091 shareholders of record, which represents approximately 5,000 wine consumers since family members hold many shares jointly. The Company's shareholders, as a group, purchase a significant portion of the Company's cork-finished wines directly from the Winery.

Tourists. Oregon wineries are experiencing an increase in on-site visits by consumers. In California, visiting wineries is a very popular leisure time activity. Napa Valley is one of California's largest tourist attractions with over 3.4 million visitors in 2001. Wineries in Washington are also experiencing strong interest from tourists. Chateau Ste. Michelle, located near Woodinville, Washington, attracts approximately 200,000 visitors per year.

The Winery is located less than one mile from The Enchanted Forest, a



gingerbread village/forest theme park that, in 2002, was Oregon's twentieth most visited tourist attraction. The Enchanted Forest, which operates from March 15 to September 30 each year, attracts approximately 130,000 paying visitors per year. Adjacent to the Enchanted Forest is the Thrillville Amusement Park and the Forest Glen Recreational Vehicle Park, which contains approximately 110 overnight recreational vehicle sites. Many of the visitors to the Enchanted Forest and RV Park visit the Winery. More importantly, the Company believes its convenient location, adjacent to Interstate 5, enables the Winery to attract a significant number of visitors.

#### Competition

The wine industry is highly competitive. In a broad sense, wines may be considered to compete with all alcoholic and nonalcoholic beverages. Within the wine industry, the Company believes that its principal competitors include wineries in Oregon, California and Washington, which, like the Company, produce premium, super premium, and ultra premium wines. Wine production in the United States is dominated by large California wineries that have significantly greater financial, production, distribution and marketing resources than the Company. Currently, no Oregon winery dominates the Oregon wine market. Several Oregon wineries, however, are older and better established and have greater label recognition than the Company.

The Company believes that the principal competitive factors in the premium, super premium, and ultra premium segment of the wine industry are product quality, price, label recognition, and product supply. The Company believes it competes favorably with respect to each of these factors. The Company has received Excellent to Recommended reviews in tastings of its wines and believes its prices are competitive with other Oregon wineries. Larger scale production is necessary to satisfy retailers' and restaurants' demand and the Company believes that its current level of production is adequate to meet that demand for the foreseeable future. Furthermore, the Company believes that its ultimate forecasted production level of 298,000 gallons (124,000 cases) per year will give it significant competitive advantages over most Oregon wineries in areas such as marketing, distribution arrangements, grape purchasing, and access to financing. The current production level of most Oregon wineries is generally much smaller than the projected production level of the Company's Winery. With respect to label recognition, the Company believes that its unique structure as a consumer-owned company will give it a significant advantage in gaining market share in Oregon as well as penetrating other wine markets.

#### Governmental Regulation of the Wine Industry

The production and sale of wine is subject to extensive regulation by the Federal Bureau of Alcohol, Tobacco and Firearms and the Oregon Liquor Control Commission. The Company is licensed by and meets the bonding requirements of each of these governmental agencies. Sale of the Company's wine is subject to federal alcohol tax; payable at the time wine is removed from the bonded area of the Winery for shipment to customers or for sale in its tasting room. The current federal alcohol tax rate is \$1.07 per gallon; however, wineries that produce not more than 250,000 gallons during the calendar year are allowed a graduated tax credit of up to \$0.90 per gallon on the first 100,000 gallons of wine (other than sparkling wines) removed from the bonded area during that year. The Company also pays the state of Oregon an excise tax of \$0.67 per gallon on all wine sold in Oregon. In addition, all states in which the Company's wines are sold impose varying excise taxes on the sale of alcoholic beverages. As an

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agricultural processor, the Company is also regulated by the Oregon Department of Agriculture and, as a producer of wastewater, by the Oregon Department of Environmental Quality. The Company has secured all necessary permits to operate its business. The Company estimates that its costs of compliance with federal and state environmental laws is \$3,000 per year.

Prompted by growing government budget shortfalls and public reaction against alcohol abuse, Congress and many state legislatures are considering various proposals to impose additional excise taxes on the production and sale of alcoholic beverages, including table wines. Some of the excise tax rates being considered are substantial. The ultimate effects of such legislation, if passed, cannot be assessed accurately since the proposals are still in the discussion stage. Any increase in the taxes imposed on table wines can be expected to have a potentially adverse impact on overall sales of such products. However, the impact may not be proportionate to that experienced by producers of other alcoholic beverages and may not be the same in every state. Recently, there have been national efforts to reduce the legal blood alcohol level to .08 to combat driving under the influence. The Company believes that if such legislation is passed, it may discourage wine consumption in restaurants. Although the .08 rule is in effect in Oregon, the Company's principal sales territory, it has not yet affected local restaurant sales although it is possible that it will on a national level.

### Employees

As of December 31, 2003 the Company had 49 full-time employees and 31 part-time employees. In addition, the Company hires additional employees for seasonal work as required. The Company's employees are not represented by any collective bargaining unit. The Company continues to believe it maintains positive relations with its employees.

### Additional Information

The Company files quarterly and annual reports with the Securities and Exchange Commission. The public may read and copy any material that the Company files with the SEC at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington D.C. 20549. The public may also obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. As the Company is an electronic filer, filings may be obtained via the SEC website at ([www.sec.gov](http://www.sec.gov)). Also visit the Company's website ([www.wvv.com](http://www.wvv.com)) for links to stock position and pricing.

There are no material legal proceedings pending to which the Company is a party or to which any of its property is subject, and the Company's management does not know of any such action being contemplated.

### Company Strategy

The Company, one of the largest wineries in Oregon, believes its success is dependent upon its ability to: (1) grow and purchase high quality vinifera wine grapes; (2) vinify the grapes into premium, super premium and ultra premium wine; (3) achieve significant brand recognition for its wines, first in Oregon and then nationally and internationally; and (4) effectively distribute and sell its products nationally. The Company's goal is to continue as one of Oregon's largest wineries, and establish a reputation for producing some of

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Oregon's finest, most sought after wines.

Based upon several highly regarded surveys of the US wine industry, the Company believes that successful wineries exhibit the following four key attributes: (i) focus on production of high-quality premium, super premium and ultra premium varietal wines; (ii) achieve brand positioning that supports high bottle prices for its high quality wines; (iii) build brand recognition by emphasizing restaurant sales; and (iv) development of the strong marketing advantages (such as a highly visible winery location and successful self-distribution).

The Company has designed its strategy to address each of these attributes.

To successfully execute this strategy, the Company has assembled a team of accomplished winemaking professionals, and has constructed and equipped a 22,934 square foot state-of-the-art Winery and a 12,500 square foot outdoor production area for the crushing, pressing and fermentation of wine grapes.

The Company's marketing and selling strategy is to sell its premium, super premium and ultra premium cork finished wine through a combination of (i) direct sales at the Winery, (ii) self-distribution to local and regional restaurants and retail outlets, and (iii) sales through independent distributors and wine brokers who market the Company's wine in specific targeted areas where self-distribution is not economically feasible.

The Company believes the location of its Winery next to Interstate 5, Oregon's major north-south freeway, significantly increases direct sales to consumers and facilitates self-distribution of the Company's products. The Company believes this location provides high visibility for the Winery to passing motorists, thus enhancing recognition of the Company's products in retail outlets and restaurants. The Company's Hospitality Center has further increased the Company's direct sales and enhanced public recognition of its wines.

### MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

The Company's Common Stock is traded on the NASDAQ Small Cap Market under the symbol "WVVI." As of December 31, 2003, there were 3,091 stockholders of record of the Common Stock.

The table below sets forth for the quarters indicated the high and low bids for the Company's Common Stock as reported on the NASDAQ Small Cap Market. The Company's Common Stock began trading publicly on September 13, 1994.

#### Quarter Ended

	3/31/03	6/30/03	9/30/03	12/31/03
High	\$1.74	\$1.53	\$2.05	\$2.30
Low	\$1.26	\$1.08	\$1.18	\$1.64

#### Quarter Ended

	3/31/02	6/30/02	9/30/02	12/31/02
High	\$1.94	\$1.84	\$1.60	\$1.77
Low	\$1.51	\$1.10	\$1.18	\$1.00

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The Company has not paid any dividends on the Common Stock, and it is not anticipated that the Company will pay any dividends in the foreseeable future. The Company intends to use its earnings to grow the distribution of its brands, improve quality and reduce debt. The Management does not intend to use earnings to pay dividends and if it chooses to recommend to the Board it approve such an action, management would first seek approval of its lender providing the credit facility.

### MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.

#### Forward Looking Statement

This Management's discussion and Analysis of Financial Condition and Results of Operation and other sections of this Form 10KSB contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "expects", "anticipates", "intends", "plans", "believes", "seeks", "estimates", and variations of such words and similar expressions are intended to identify such forward-looking statements. Such forward-looking statements include, for example, statements regarding general market trends, predictions regarding growth and other future trends in the Oregon wine industry, expected availability of adequate grape supplies, expected positive impact of the Company's Hospitality Center on direct sales effort, expected positive impacts on future operating results from restructuring efforts, expected increases in future sales, expected improvements in gross margin. These forward-looking statements involve risks and uncertainties that are based on current expectations, estimates and projections about the Company's business, and beliefs and assumptions made by management. Actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements due to numerous factors, including, but not limited to: availability of financing for growth, availability of adequate supply of high quality grapes, successful performance of internal operations, impact of competition, changes in wine broker or distributor relations or performance, impact of possible adverse weather conditions, impact of reduction in grape quality or supply due to disease, impact of governmental regulatory decisions, and other risks detailed below as well as those discussed elsewhere in this Form 10KSB and from time to time in the Company's Securities and Exchange Commission filing and reports. In addition, such statements could be affected by general industry and market conditions and growth rates, and general domestic economic conditions.

#### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses Willamette Valley Vineyards' consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles. As such, management is required to make certain estimates, judgments and assumptions that are believed to be reasonable based upon the information available. On an on-going basis, management evaluates its estimates and judgments, including those related to product returns, bad debts, inventories, investments, income taxes, financing operations, and contingencies and litigation. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The Company's principal sources of revenue are derived from sales and

distribution of wine. Revenue is recognized from wine sales at the time of shipment and passage of title. Our payment arrangements with customers provide primarily 30 day terms and, to a limited extent, 60, 90 or 120 day terms. Shipping and handling costs are included in general and administrative expenses.

The Company values inventories at the lower of actual cost to produce the inventory or market value. We regularly review inventory quantities on hand and adjust our production requirements for the next twelve months based on estimated forecasts of product demand. A significant decrease in demand could result in an increase in the amount of excess inventory quantities on hand. In the future, if our inventory cost is determined to be greater than the net realizable value of the inventory upon sale, we would be required to recognize such excess costs in our cost of goods sold at the time of such determination. Therefore, although we make every effort to ensure the accuracy of our forecasts of future product demand, any significant unanticipated changes in demand could have a significant impact on the ultimate selling price and, therefore, the carrying value of our inventory and our reported operating results.

We capitalize internal vineyard development costs subsequent to the developing vineyard land becoming fully productive. These costs consist primarily of the costs of the vines and expenditures related to labor and materials to prepare the land and construct vine trellises. Amortization of such costs as annual crop costs is done on a straight-line basis for the estimated economic useful life of the vineyard, which is estimated to be 30 years. The Company regularly evaluates the recoverability of capitalized costs. Amortization of vineyard development costs are included in capitalized crop costs that in turn are included in inventory costs and ultimately become a component of cost of goods sold.

The Company pays depletion allowances to the Company's distributors based on their sales to their customers. The Company sets these allowances on a monthly basis, and the Company's distributors bill them back on a monthly basis. All depletion expenses associated with a given month are expensed in that month as a reduction of revenues. The Company also pays a sample allowance to the Company's distributors in the form of a 1.5% discount applied to invoices for product sold to the Company's distributors. The expenses for samples are expensed at the time of sale in the selling, general and administrative expense. The Company's distributors use the allowance to sample product to prospective customers.

Amounts paid by customers to the Company for shipping and handling expenses are included in the net revenue. Expenses incurred for shipping and handling charges are included in selling, general and administrative expense. The Company's gross margins may not be comparable to other companies in the same industry as other companies may include shipping and handling expenses as a cost of goods sold.

In connection with its ongoing transition to a national network of affiliated distributors, the Company has entered into an agreement with fourteen affiliated distributors under which the Company's products are distributed in certain states. As part of that agreement, the distributors paid the company \$1,500,000 for a base amount of bottled wine to be retained by the Company, which was not recorded as a sale. The Company recorded a Distributor Obligation liability to recognize the future obligation of the Company to deliver the wine to the distributors, and recorded the wine as an asset at cost. The Company will hold the base amount of \$1,500,000

of wine until 2006, when the balance will be depleted on a straight-line basis until 2010. Also as part of that agreement, the Company has agreed to pay the distributors incentive compensation if certain sales goals are met over the next five years. The incentive compensation will be paid only in the event of a transaction in excess of \$12 million in value in which either the Company sells all or substantially all of its assets or a merger, sale of stock, or other similar transaction occurs, the result of which is that the Company's current shareholders do not own at least a majority of the outstanding shares of capital stock of the surviving entity. Assuming the \$12 million threshold is met and the distributors meet certain sales goals, the distributors will be entitled to incentive compensation equal to 20% of the total proceeds from the sale or transaction and up to 17.5% of the difference between the transaction value and approximately \$8.5 million.

#### OVERVIEW

#### RESULTS OF OPERATIONS

The Company's net income in the first three Quarters of 2003 is primarily a result of increased margins from the sale of wines that have lower production costs. Since Management reduced production volumes due to higher inventories, per unit costs are increasing, reducing gross margins and net income per case in the final quarter of 2003. Production costs were reduced in 2003 and are expected to decline over the next several years due to new lower cost winegrape contracts. Per unit costs will not decline until bottled inventory is reduced and wine production returns to current sales levels.

Annual operating performance was affected significantly by Fourth Quarter events. A large portion of the higher expenses was the result of planned investment by the Company. Management took advantage of the stronger net profits and recent federal business tax incentives by making substantial repairs to the winery buildings and equipment, adding delivery vehicles to its Wholesale Department, a warehouse office, new network servers, group software, accounting software upgrades permitting wholesale sales orders to be entered contemporaneously with remote handheld devices, a new Retail Point of Sale system and new computers for the Retail Key Customer Service Representatives for recording sales and customer information.

Management chose the Fourth Quarter to expand the sales and delivery infrastructure of its Oregon Wholesale Department named Bacchus Fine Wines. The Company is increasing its representation of brands other than its own through its Oregon sales force. The Company expects to increase its inventories of these wines, which will place additional demands on the use of cash. The Company is protecting the loyalty and focus of its sales force by limiting representation of only Oregon brands the Company owns and out-of-state brands which fill other product needs of retail licensees the Company does not produce. The Company is engaging in this strategy to provide more value to its retail licensees, improve sales management and representation and increase profits.

Although the Bacchus Fine Wines department experienced record growth of 42% in the Fourth Quarter, net results declined from the same period in the prior year due to this expansion. This department finished the year contributing the most increase in net operating results as compared to other departments. Bacchus gross margins were expected to decline and are expected to continue to decline as sales of wines purchased from other suppliers and resold to retail accounts at lower margins increase.

During the first part of 2003, many of the lower cost 2001 Willamette Valley Vineyards vintage wines were sold and replaced later in the year by new higher cost vintages reducing gross margins, particularly in the Retail Department. Combined with unplanned and substantially higher expenses, Retail posted its weakest financial performance in the Fourth Quarter in some time. Management has identified the causes of the higher sample use, higher sales commissions and inventory losses and has taken corrective action. Prior to the Fourth Quarter, Retail outperformed the prior year.

Out-of-state sales to distributors grew in the Fourth Quarter by 30%. This sales growth more than offset the higher cost of goods. The CEO continued in 2003 the extensive travel schedule making sales presentations to distributor staffs and their retail customers. The Company increased its role in the industry's Oregon Pinot Camp and conducted a national sales contest for selected distributor sales staffs that resulted in a trip to Oregon. Among the winners was top performer Premier Beverage of Florida increasing sales 93% earning nine places on the trip.

During 2003 Company officials discovered a significant loss of wine inventory in the control of a now former sales representative of approximately \$100,000 at wholesale prices. This inventory was WVW wines and was not a result of the new distribution enterprise, Bacchus Fine Wines. The Company filed an insurance claim, which was accepted, paid and is recorded under Other Income.

Management has strengthened inventory controls in the wake of this significant loss of wine inventory. Sales representative handling of inventory is physically inspected at random and all samples reviewed by the General Sales Manager. Tasting Room daily sales and sampling are reconciled against daily deliveries from the warehouse. Management is implementing a system where all inventory movements in and out of the warehouse are to be recorded in the Company's accounting system contemporaneously with the movement.

Management is planning to reduce wine inventories and its accompanying credit line requirements by reducing the 2004 and 2005 crush volumes from historic highs and focus its production operations by reducing the number of products to those that most contribute to the reputation of its core brand and product, Willamette Valley Vineyards vintage Pinot noir and the Company's earnings and sales growth.

#### Wine Quality

The Company's wine ratings are among the highest given to Oregon produced wines. By focusing on expanding vineyard plantings at Tualatin Estate over the last several years, the Company has greatly enhanced control over producing high quality fruit in that unique microclimate.

Plantings of the new French Pinot noir clones (113, 114, 115, 667 & 777) on selected resistant rootstock have accelerated ripening and improved flavor attributes. The Company now has 55 acres of young, closely spaced Pinot noir vines, including these new clones on computer controlled drip irrigation at the Forest Grove vineyard, and 8 acres of 667 & 777 clones on self-rooted, grafted vines at the Turner vineyard. The management believes this investment will begin to be realized as these vines mature and their fruit find their way into the market through the distribution of Willamette Valley Vineyards Pinot noir. The Tualatin Estate Pinot noir is made from a

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small, designated block of 25-year-old Pommard clone vines and a designated block in the new French clone planting.

As noted below, the following publications review wines according to the testing procedures described.

### WINE SPECTATOR

The Wine Spectator is one of the most popular magazines for wine connoisseurs. It is a monthly magazine with thorough reports on wineries, restaurants and travel, along with a highly reputable wine rating system. The wine writers are among the most experienced and knowledgeable and their goals are to cover every aspect of wine, from buying to tasting, with descriptions of different varietals and wine-growing regions.

Their wine rating system is as follows:

95-100: Classic

90-94: Outstanding

85-89: Very good

80-84: Good

70-79: Average

Below 70: Below Average

### WINE ENTHUSIAST

As the fastest growing wine publication in the world today, Wine Enthusiast's mission is to promote the wine "lifestyle" and to educate its readers on how to buy, taste, and appreciate wine. It is also a catalog, which sells anything related to wine, from cellars to cork screws. They provide and in-depth wine descriptions and a reputable rating scale. Within their rating system, they note their "Best Buys", which incorporates both price and taste, to ensure the best value. Both wine novices and experience connoisseurs enjoy and respect this monthly publication.

Rating system:

96-100: Classic, Highest Recommendation

90-95: Superb, Highly Recommended

85-89: Very good, Recommended

There are over 100,000 paid subscriptions to Wine Enthusiast today.

### BEVERAGE TESTING INSTITUTE

This is a journal strictly for wine ratings. They have a very technical rating system and numerous tasters are involved in one score. First they start with a 4-point scale:

1)