

WILLAMETTE VALLEY VINEYARDS INC
Form 10QSB
November 14, 2006

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the quarterly period ended September 30, 2006

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from _____ to _____

Commission file number
Commission File Number 0-21522

WILLAMETTE VALLEY VINEYARDS, INC.

(Exact name of registrant as specified in charter)

Oregon	93-0981021
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

8800 Enchanted Way, S.E., Turner, Oregon 97392
(503)-588-9463

(Address, including Zip code, and telephone number,
including area code, of registrant's principal executive offices)

Check whether the issuer (1) filed all reports required to be filed by Section
13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter
period that the registrant was required to file such reports), and (2) has
been subject to such filing requirements for the past 90 days.

YES NO

Indicate by check mark whether the registrant is a shell company (as defined
in Rule 12b-2 of the Exchange Act).

YES NO

Number of shares of common stock outstanding as of September 30, 2006
4,784,702 shares, no par value

Transitional Small Business Disclosure

YES NO

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PART 1

FINANCIAL INFORMATION

ITEM 1

Financial Statements

WILLAMETTE VALLEY VINEYARDS, INC.

Balance Sheet

	September 30, 2006 (unaudited)	December 31, 2005
	_____	_____
ASSETS.		
Current Assets:		
Cash and cash equivalents	\$ 2,414,142	\$ 415,591
Accounts receivable trade, net	799,071	1,568,255
Inventories	6,062,563	6,950,993
Prepaid expenses and other current assets	244,450	22,561
Deferred income taxes	91,000	91,000
Total current assets	9,611,226	9,048,400
Vineyard development cost, net	1,481,555	1,526,073
Property and equipment, net	3,969,677	4,037,160
Debt issuance costs, net	30,046	35,410
Other assets	79,126	80,071
Total assets	\$15,171,630	\$14,727,114

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LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities			
Current portion of long term debt	\$ 283,334		\$ 283,334
Accounts payable	825,095		811,141
Accrued expenses	345,592		348,169
Income taxes payable	62,527		344,987
Grapes payable	281,331		471,873
	<u>1,797,879</u>		<u>2,259,504</u>
Long-term debt	1,774,182		1,986,531
Deferred rent liability	182,704		164,771
Deferred gain	418,143		442,214
Deferred income taxes	148,000		148,000
	<u>4,320,908</u>		<u>5,001,020</u>
Shareholders' equity			
Common stock, no par value - 10,000,000			
shares authorized, 4,784,702 and 4,660,202			
shares issued and outstanding at September 30,			
2006 and December 31, 2005	7,893,287		7,613,222
Retained earnings	2,957,435		2,112,872
	<u>10,850,722</u>		<u>9,726,094</u>
Total liabilities and shareholders' equity	<u>\$15,171,630</u>		<u>\$14,727,114</u>
	=====		=====

The accompanying notes are an integral part of this financial statement.

WILLAMETTE VALLEY VINEYARDS, INC.

Statement of Operations

(unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2006	2005	2006	2005
Net revenues				
Case revenue	\$ 3,293,144	\$ 3,609,228	\$10,414,158	\$ 9,394,542
Custom crush-facility lease-				
bulk revenue	14,899	8,828	32,485	111,090
	<u>3,308,043</u>	<u>3,618,056</u>	<u>10,446,643</u>	<u>9,505,632</u>
Cost of sales				
Case	1,745,683	1,944,787	5,476,376	5,106,703
Bulk	-	-	4,631	55,926
	<u>1,745,683</u>	<u>1,944,787</u>	<u>5,481,007</u>	<u>5,162,629</u>
Total cost of sales	1,745,683	1,944,787	5,481,007	5,162,629
Gross profit	1,562,360	1,673,269	4,965,636	4,343,003
Selling, general and administrative expenses	1,160,318	1,085,852	3,490,063	3,047,836
Net operating income	402,042	587,417	1,475,573	1,295,167
Other income (expense)				
Interest income	19,729	349	42,885	775

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Interest expense	(41,667)	(57,355)	(127,750)	(175,735)
Other income (expense)	-	-	16,895	17,336
Net income before income taxes	380,104	530,411	1,407,603	1,137,543
Income tax	152,041	212,165	563,040	455,018
Net income	228,063	318,246	844,563	682,525
Retained earnings beginning of period	2,729,372	1,320,212	2,112,872	955,933
Retained earnings end of period	\$ 2,957,435 =====	\$ 1,638,458 =====	\$ 2,957,435 =====	\$ 1,638,458 =====
Basic earnings per common share	\$.05	\$.07	\$.18	\$.15
Diluted earnings per common share	\$.05	\$.07	\$.17	\$.15
Weighted average number of basic common shares outstanding	4,781,055	4,514,635	4,722,636	4,498,019
Weighted average number of diluted common shares outstanding	4,978,955	4,621,115	4,920,536	4,604,499

The accompanying notes are an integral part of this financial statement.

WILLAMETTE VALLEY VINEYARDS, INC.

Statement of Cash Flows
(unaudited)

	Nine months ended September 30, 2006	2005
Cash flows from operating activities:		
Net income	\$ 844,563	\$ 682,525
Reconciliation of net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	404,748	422,355
Loss on disposal of fixed assets	-	-
Stock based compensation expense	25,170	9,610
Changes in assets and liabilities:		
Accounts receivable trade	769,184	(145,726)
Inventories	888,430	1,169,566
Prepaid expenses and other current assets	(221,889)	(12,336)
Note receivable	-	5,000
Other assets	945	1,806
Accounts payable	13,954	280,751
Accrued expenses	(2,577)	(251,352)
Income taxes payable	(282,460)	(23,800)
Grape payables	(190,542)	(240,566)
Deferred rent liability	17,933	24,739
Deferred gain	(24,071)	(24,071)

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Net cash provided by operating activities	2,243,388	1,898,491
Cash flows from investing activities:		
Additions to property and equipment	(270,456)	(193,101)
Vineyard development expenditures	(16,927)	(171,095)
Net cash used in investing activities	(287,383)	(364,196)
Cash flows from financing activities:		
Debt issuance costs	-	(4,622)
Net (decrease) increase in line of credit balance	-	(1,232,251)
Proceeds from stock options exercised	254,895	100,249
Repayments of distributor obligation	-	(1,500,000)
Issuance of long-term debt	-	1,500,000
Repayments of long-term debt	(212,349)	(748,351)
Net cash used in financing activities	42,546	(1,884,975)
Net increase (decrease) in cash and cash equivalents	1,998,551	(350,680)
Cash and cash equivalents:		
Beginning of period	415,591	851,492
End of period	\$ 2,414,142 =====	\$ 500,812 =====

The accompanying notes are an integral part of this financial statement.
NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS

1) BASIS OF PRESENTATION

The accompanying unaudited financial statements as of and for the three and nine months ended September 30, 2006 and 2005, have been prepared in conformity with accounting principles generally accepted in the United States ("GAAP"). The financial information as of December 31, 2005 is derived from the audited financial statements presented in the Willamette Valley Vineyards, Inc. (the "Company") Annual Report on Form 10-KSB for the year ended December 31, 2005. Certain information or footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, the accompanying financial statements include all adjustments necessary (which are of a normal recurring nature) for the fair statement of the results of the interim periods presented. The accompanying financial statements should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2005, as presented in the Company's Annual Report on Form 10-KSB.

Operating results for the three and nine months ended September 30, 2006, are not necessarily indicative of the results that may be expected for the entire year ending December 31, 2006, or any portion thereof.

The Company has a single operating segment consisting of the retail, instate self-distribution and out-of-state sales departments. These departments have similar economic characteristics, offer comparable products to customers, and utilize similar processes for production and distribution.

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Basic earnings per share are computed based on the weighted-average number of common shares outstanding each period. Diluted earnings per share are computed using the weighted average number of shares of common stock and potentially dilutive common shares outstanding during the year. Potentially dilutive shares from stock options and other potentially dilutive shares are excluded from the computation when their effect is anti-dilutive. Potentially dilutive shares of 197,900 shares are included in the computation of dilutive earnings per share for the three and nine months ended September 30, 2006. Total potentially dilutive shares of 106,480 shares are included in the computation of dilutive earnings per share for the three and nine months ended September 30, 2005.

2) STOCK BASED COMPENSATION

The Company has two stock option plans, the 1992 Stock Incentive Plan ("1992 Plan") and 2001 Stock Option Plan ("2001 Plan"). No additional grants may be made under the 1992 Plan. The 2001 Plan, which is shareholder approved, permits the grant of stock options and restricted stock awards for up to 900,000 shares. All stock options have an exercise price that is equal to the fair market value of the Company's stock on the date the options were granted. Administration of the plan, including determination of the number, term, and type of options to be granted, lies with the Board of Directors or a duly authorized committee of the Board of Directors. Options are generally granted based on employee performance with vesting periods ranging from date of grant to seven years. The maximum term before expiration for all grants is ten years.

The following table presents information on stock options outstanding for the periods shown:

	Three months ended September 30, 2006		Nine months ended September 30, 2006	
	Shares	Weighted Average Exercise price	Shares	Weighted average exercise price
Outstanding at beginning of period	530,500	\$ 3.82	609,500	\$ 3.57
Granted	-	-	-	-
Exercised	(30,500)	\$ 1.71	(109,500)	\$ 1.85
Forfeited	-	-	-	-
	-----		-----	
Outstanding at end of period	500,000	\$ 3.95	500,000	\$ 3.95

The following table presents information on stock options outstanding for the periods shown:

	Three months ended September 30, 2006		Nine months ended September 30, 2005	
Intrinsic value of options exercised in the period		\$ 179,550		\$ 90,807
Stock options fully vested and expected to vest				
Number	500,000		491,500	

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Weighted average exercise Price	\$ 3.95	\$ 2.71
Aggregate intrinsic value	\$ 881,756	\$1,140,536
Weighted average contractual term of options	7.17 years	7.89 years

Stock options vested and		
Currently exercisable		
Number	451,100	
Weighted average exercise		
Price	\$ 3.99	
Aggregate intrinsic value	\$ 775,560	
Weighted average contractual		
term of options	7.04 years	

At January 1, 2006, the Company began recognizing compensation expense for stock options with the adoption of Statement of Financial Accounting Standards ("SFAS") No. 123 (Revised), "Share-Based Payment," ("SFAS 123R"). The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes based stock option valuation model. This model uses the assumptions listed in the table below. Expected volatilities are based on implied volatilities from the Company's stock, historical volatility of the Company's stock, and other factors. Expected dividends are based on the Company's plan not to pay dividends for the foreseeable future. The Company uses historical data to estimate option exercises and employee terminations within the valuation model. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

Black-Scholes assumptions

September 30, 2006

Risk Free interest rates	4.26%
Expected dividend	0%
Expected lives, in years	5-10
Expected volatility	46%

The Company expenses stock options on a straight line basis over the options' related vesting term. For the three and nine months ended September 30, 2006, the Company recognized pretax compensation expense related to stock options of \$8,390 and \$25,170, respectively. The following table, presented to aid the reader's ability to compare the relevant periods from 2005 if the Company had applied FASB123R to such periods in the same manner as the Company applied FASB123R in the current periods, illustrates the effect on net income and earnings per share if the fair value method established in SFAS 123R had been applied to all outstanding and unvested awards in the prior period.

	Three Months Ended September 30, 2005 (unaudited)	Nine Months Ended September 30, 2005 (unaudited)
	_____	_____
Net income, as reported	\$ 318,246	\$ 682,525
Add Stock-based employee compensation expense included in reported net income, net of related tax effects	-	-

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Deduct total stock based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(64,199)	(192,597)
Pro forma net income	\$ 254,047	\$ 489,928
Earnings per share:		
Basic - as reported	\$ 0.07	\$ 0.15
Basic - pro forma	\$ 0.06	\$ 0.11
Diluted - as reported	\$ 0.07	\$ 0.15
Diluted - pro forma	\$ 0.05	\$ 0.11

During the three months ended September 30, 2006, the following transactions related to stock option and warrant exercise occurred:

	Shares	Exercise price
Stock Options Exercised	25,000	\$ 1.75
	4,000	1.5625
	1,500	1.50

3) INVENTORIES BY MAJOR CLASSIFICATION ARE SUMMARIZED AS FOLLOW:

	September 30, 2006 (unaudited)	December 31, 2005
Winemaking and packaging materials	\$ 34,542	\$ 223,389
Work-in-progress (costs relating to unprocessed and/or bulk wine products)	1,715,590	1,790,472
Finished goods (bottled wines and related products)	4,312,431	4,937,132
Current inventories	\$ 6,062,563 =====	\$ 6,950,993 =====

4) PROPERTY AND EQUIPMENT CONSIST OF THE FOLLOWING:

	September 30, 2006 (unaudited)	December 31, 2005
Land and improvements	\$ 787,454	\$ 769,644
Winery building and hospitality center	4,751,930	4,707,802
Equipment	4,184,170	3,975,652
	9,723,554	9,453,098

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Less accumulated depreciation	(5,753,877)	(5,415,938)
	<u>\$ 3,969,677</u>	<u>\$ 4,037,160</u>
	=====	=====

ITEM 2

Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward Looking Statements

This Management's Discussion and Analysis of Financial Condition and Results of Operation and other sections of this Form 10-QSB contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. 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. 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. Therefore, 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 10-QSB and from time to time in the Company's Securities and Exchange Commission filings 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:

The foregoing discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, collection of accounts receivable, valuation of inventories, and amortization of vineyard development costs. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. A description of our critical accounting policies and related judgments and estimates that affect the preparation of our financial statements is set forth in our Annual Report on Form 10-KSB for the year ended December 31, 2005. Except with respect to accounting for stock-based compensation expenses (see Note 2 of Notes to Financial Statements, above), such policies were unchanged during the three and nine months ended September 30, 2006.

Overview

Demand for Willamette Valley Vineyards Pinot Noir and Pinot Gris continues to exceed available inventories. The Company has and continues to receive orders from its distributors it cannot completely fill, rather all available

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inventory has been fairly allocated to each distributor based upon their historical sales.

The lack of available inventory is a result of high demand experienced in the recent past and of previous sales made to distributors which has drawn down available supplies.

Management continues to develop both short and long term wine grape and wine supplies to address this demand. This year's harvest aided our effort by producing higher quality and volumes, approximately 20% more than expected in tonnage.

Continued awareness of the Company and its wines was enhanced by national and regional media coverage.

The Winery's founder and CEO, Jim Bernau presented Oregon Pinot Noirs to the Smithsonian Institution's wine program in Washington DC this October. Scott Greenberg of the DC Examiner recommended the '04 Willamette Valley Estate Pinot Noir in his November 9th column. Food columnist Dick Rosano of the Washington Post recommended our '05 Whole Cluster Pinot Noir in a food pairing and northwest wine critic and publisher of the Wine Iconoclast, Robert Mayfield recommended the '02 Willamette Valley Vineyards '02 Signature Cuvee Pinot Noir in his November 9th column for the Statesman Journal.

The Wine Spectator magazine, in its October 31st issue, named the Willamette Valley Vineyards '05 Pinot Gris as one of the Top 100 Wine Values in the World. Wine and Spirits magazine published a 91 score for this wine in its August issue. Washington Times wine writer Paul Lukas called it "the best white" of the Seattle Enological Society Wine Competition. The winery's '05 Whole Cluster Pinot Noir was recommended by national wine author Leslie Sbrocco for Thanksgiving in her new book, "Simple and Savvy Wine Guide".

The Winery continues to receive national and regional attention for its sustainable practices. In the September/October issue of Sierra Magazine, the winery's employee biofuel policy was highlighted in the article "Grape Vine." The Winery was featured for its biofuel program on the front page of the September 27th edition of The Oregonian newspaper Business section in the article "Perks take Greener Shade." On October 10th, the Portland Tribune published a feature on Willamette Valley Vineyards, highlighting the Winery's use of biofuel and our sustainable farming practices, as did the Capital Press in their November 3rd issue.

The Company was included as one of Oregon's top 50 public companies on the front page of the Business Section in the July 2nd issue of The Oregonian newspaper and featured as the state's highest performing public common stock for the first 6 months of 2006. Forbes Magazine, in its November issue named the Company as one of the 200 Best Small Companies in America. Salem Monthly readers voted the Winery as "Best Winery" in their July issue.

The Winery received much attention from local TV news stations during harvest, appearing on KOIN, KATU, and KGW. The Company's annual Oregon Grape Stomp Championship was a feature on both KATU AM Northwest and KGW, as well as being featured in the September/October Home & Lifestyle magazine, a publication of the Statesman Journal.

RESULTS OF OPERATIONS

Revenue

Winery Operations

The Company's revenues from winery operations are summarized as follows:

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	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Tasting Room Sales and Rental Income	\$ 559,669	\$ 514,424	\$ 1,367,837	\$ 1,308,431
On-site and off-site festivals	38,600	17,504	88,685	65,617
In-state sales	1,834,900	1,751,116	5,102,144	4,777,055
Out-of-state sales	942,395	1,458,141	4,117,865	3,490,478
Bulk wine/ Misc. sales	14,900	8,828	32,485	111,090
Total Revenue	<u>3,390,464</u>	<u>3,750,013</u>	<u>10,709,016</u>	<u>9,752,671</u>
Less Excise Taxes	82,421	131,957	262,373	247,039
Net Revenue	<u>\$ 3,308,043</u> =====	<u>\$ 3,618,056</u> =====	<u>\$10,446,643</u> =====	<u>\$ 9,505,632</u> =====

Net revenues for the three months ended September 30, 2006 decreased \$310,013, or 9%, compared to the corresponding period in the preceding year. This decrease is due primarily to the decrease in out-of-state sales during the 3 months ended September 30, 2006 as a result of inventory constraints. Net revenue for the nine months ended September 30, 2006 increased \$941,011, or 10%, compared to the corresponding prior year period. This increase is due primarily to the increases in out-of-state sales and in-state sales.

Tasting room sales and rental income for the three months ended September 30, 2006 increased \$45,245, or 9%, compared to the corresponding prior year period, primarily as a result increased purchases in the tasting room and increased key customer phone sales. Tasting room sales increased during the nine months ended September 30, 2006 \$59,406, or 5% due primarily to increased purchases in the tasting room.

Sales in the state of Oregon, through the Company's wholesale department, Bacchus Fine Wines, increased \$83,784, or 5%, in the three months ended September 30, 2006, compared to the corresponding prior year period. The Company's direct instate sales to its largest customer increased \$47,099, or 18%, in the three months ended September 30, 2006, over the comparable prior year period. These increases are largely the result of the increased sales of the wholesale department's portfolio of brands produced by wineries outside of Oregon, driven by the Company's largest instate customer. Sales of Company produced products by this department decreased during the third quarter. Sales in the state of Oregon, through Bacchus Fine Wines increased \$325,089, or 7%, in the nine months ended September 30, 2006, compared to the corresponding prior year period. This increase is largely the result of increased sales of the broader product lines presented and increased product placements through the development of the wholesale department's portfolio of brands produced by wineries outside of Oregon.

Out-of-state sales in the three months ended September 30, 2006 decreased \$515,746, or 35%, over the comparable prior year period. The decreased sales are primarily the result of inventory constraints. Out-of-state sales in the nine months ended September 30, 2006 increased \$627,387, or 18%, over the comparable prior year period. This increase is due primarily to the higher sales in the first six months of 2006 that were primarily a result of strong demand for the Company's varietals, significant sales efforts undertaken by the Company's out-of-state sales force and depletion allowances on particular products, resulting in significant by-the-glass restaurant placements.

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Excise taxes

The Company's excise taxes for the three months ended September 30, 2006 decreased 38% compared to the corresponding prior year period. This was due primarily to decreased sales, thereby decreasing overall sales volumes and taxes calculated based on volume during the three months ended September 31, 2006. The Company's excise taxes for the nine months ended September 30, 2006 increased 6% as compared to the corresponding prior year period. This was due primarily to the increased sales, thereby increasing overall sales volumes and taxes calculated based on volume.

Gross Profit

Winery Operations

As a percentage of net revenue, gross profit increased to 47% in the three months ended September 30, 2006, compared to 46% in the comparable prior year period. As a percentage of net revenue, gross profit increased to 48% in the nine months ended September 30, 2006, compared to 46% in the comparable prior year period. The revenue generated by the sale of the Company's higher margin products to out-of-state distributors, and the select, upward price adjustments used to address inventory constraints, in the nine months ended September 30, 2006, reversed the trend of decreasing margins in prior periods. While the Company is continuing to focus on improving distribution of higher margin products as well as reducing grape and production costs, we anticipate that our increased representation of brands other than our own through our Oregon sales force will erode gross margins due to the lower margins associated with selling those brands. While gross margin may erode due to such representation, the Company does not anticipate that net income attributable to those sales will follow that trend.

Selling, General and Administrative Expense

Selling, general and administrative expenses for the three and nine months ended September 30, 2006 increased 7% and 15%, respectively, compared to the corresponding prior year periods. These increases are due primarily to higher fixed Oregon wholesale sales and delivery costs, increased shipping and fuel costs, and expenses related to the investment in building a professional staff and sales mechanism to support anticipated production volumes. As a percentage of net revenue from winery operations, selling, general and administrative expenses increased to 35% for the three months ended September 30, 2006, compared to 30% for the comparable prior year period, primarily as a result of increased expenses. As a percentage of net revenue from winery operations, selling, general and administrative expenses increased to 33% for the nine months ended September 30, 2006, compared to 32% for the comparable prior year period.

Interest Income, Other Income and Expense

Interest income increased to \$19,729 and \$42,885, respectively, for the three and nine months ended September 30, 2006, compared to \$349 and \$775 for the corresponding prior year periods. Interest income increased primarily to the Company's increased deposits in interest bearing accounts. Interest expense decreased 27% for both the three and nine months ended September 30, 2006 compared to the corresponding prior year periods. Interest costs were lower primarily due to less debt outstanding during the period.

Other income for the three and nine months ended September 30, 2006 was an

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interest rebate from Farm Credit Services for interest paid on the Company's long-term debt in 2005, in the amount of \$16,895, received in the first quarter of 2006, compared to \$17,336, received from Farm Credit Services for interest paid on the Company's long-term debt in 2004, during the first quarter of 2005.

Income Taxes

Income tax expense was \$152,041 and \$563,040, respectively, for the three and nine months ended September 30, 2006, compared to \$212,165 and \$455,018, respectively for the prior year periods due to the Company's net profit for the three and nine months ended September 30, 2006. The Company's estimated tax rate for the three and nine months ended September 30, 2006 and 2005 was 40 percent.

Net Income and Earnings per Share

As a result of the factors listed above, net income for the three and nine months ended September 30, 2006 was \$228,063 and \$844,563, or \$0.05 and \$0.17 per diluted share, respectively, compared to net income of \$318,246 and \$682,525, or \$0.07 and \$0.15 per diluted share, respectively, in the comparable prior year periods.

Liquidity and Capital Resources

At September 30, 2006, the Company had a working capital balance of \$7.8 million and a current ratio of 5.35:1. At December 31, 2005, the Company had a working capital balance of \$6.8 million and a current ratio of 4.00:1. The Company had a cash balance of \$2,414,142 at September 30, 2006, compared to a cash balance of \$415,591 at December 31, 2005. The increase in cash was primarily due to the Company's increased revenue and collection of accounts receivable.

Total cash provided by operating activities in the nine months ended September 30, 2006 was \$2,243,388, compared to \$1,898,491 for the corresponding prior year period, primarily due to an increase in net income, collection of receivables, and conversion of inventory to cash through sales in the nine months ended September 30, 2006 compared to the prior year period. Cash provided by operating activities in the nine months ended September 30, 2006 consisted of net income of \$844,563, plus depreciation of \$404,748, plus changes in assets and liabilities and other non-cash charges of \$994,077.

Total cash used in investing activities in the nine months ended September 30, 2006 was \$287,383, compared to \$364,196 in the prior year period. Cash used in investing activities consisted of property and equipment additions.

Total cash provided by financing activities in the nine months ended September 30, 2006 was \$42,546, compared to \$1,884,975 used in financing activities in the prior year period. Cash provided by financing activities primarily consisted of stock option proceeds offset by payments on the long term debt.

At September 30, 2006, the line of credit balance was \$0, on a maximum borrowing amount of \$2,000,000. The Company has a loan agreement with Umpqua Bank that contains, among other things, certain restrictive financial covenants with respect to total equity, debt-to-equity and debt coverage, that must be maintained by the Company on a quarterly basis. As of September 30, 2006, the Company was in compliance with all of the financial covenants.

At September 30, 2006, the Company had a total long-term debt balance of \$2,057,516 owed to Farm Credit Services. The debt with Farm Credit Services

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was used to finance the Hospitality Center, invest in winery equipment to increase the Company's winemaking capacity, complete the storage facility, and purchase Tualatin Vineyards.

At September 30, 2006, the Company owed \$281,331 on grape contracts. This amount is primarily owed to a single grape grower, which will be paid as the wine made from those grapes is sold.

The Company believes that cash flow from operations and funds available under its existing credit facilities will be sufficient to meet the Company's foreseeable needs.

ITEM 3

Controls and Procedures

a) We carried out an evaluation, under the supervision and with the participation of the Chief Executive Officer, Chief Financial Officer and other management personnel, of the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities and Exchange Act of 1934 as of September 30, 2006. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of September 30, 2006 were effective to ensure that information required to be disclosed by the Company in the reports it files or submits under the Securities and Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

The Company does not expect that its disclosure controls and procedures will prevent all error and all fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The Company considered these limitations during the development of its disclosure controls and procedures, and will continually reevaluate them to ensure they provide reasonable assurance that such controls and procedures are effective.

b) There were no changes in the Company's internal control procedures over financial reporting that occurred during the three and nine months ended September 30, 2006 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting, except as noted above.

PART II.

OTHER INFORMATION

Item 1. Legal proceedings. None.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.
None.

Item 3. Default Upon Senior Securities. None.

Item 4. Submission of Matters to a Vote of Security holders. None.

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4.2 Amendment dated July 25, 1998 (incorporated by reference to the Company's Registration Statement on Form S-8 (333-61181) filed September 10, 2001)

4.3 Amendment dated April 15, 1999 (incorporated by reference to the Company's Registration Statement on Form S-8 (333-61181) filed September 10, 2001)

4.4 Amendment dated July 25, 2000 (incorporated by reference to the Company's Registration Statement on Form S-8 (333-61181) filed September 10, 2001)

4.5 Sample Incentive Stock Option Agreement (incorporated by reference to the Company's Registration Statement on Form S-8 (333-61181) filed September 10, 2001)

4.6 Sample Nonqualified Stock Option Agreement (incorporated by reference to the Company's Registration Statement on Form S-8 (333-61181) filed September 10, 2001)

31.1 Certification by James W. Bernau pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934

31.2 Certification by Sean M. Cary pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.