

Wine Business Strategies for a Global Industry

September 23, 2008

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CEO Interview Participants

Ted Baseler	St. Michelle Wine & Estates	John Ledbetter	Vino Farms, Inc.
Andy Beckstoffer	Beckstoffer Vineyards	Dan Leese	585 Wine Partners
Warren Bogle	Bogle Vineyards & Winery	Erle Martin	Crimson Wine Group
Jack Cakebread	Cakebread Cellars	Mike McEvoy	Joseph Phelps Vineyards
Dennis Carroll	Purple Wine Co.	Charles Merinoff	Charmer Industries, Inc.
Joe Ciatti	Vintage Wine Trust	Peter Mondavi	Charles Krug/Peter Mondavi Family
Hugh Davies	Schramsberg Vineyards	Chuck Palombini	Kobrand Corporation
Mel Dick	Southern Wine & Spirits	Michaela Rodino	St. Supery Winery & Vineyards
Jose Fernandez	Constellation Wines US	Alex Ryan	Duckhorn Vineyards
Joseph Gallo	E&J Gallo Winery	Tom Selfridge	Hess Collection
Randall Grahm	Bonny Doon Vineyard	Bob Torkelson	Trincherro Family Estates
Clay Gregory	Kendall Jackson Wine Estates	Doug Walker	585 Wine Partners
Chris Indelicato	Delicato Family Vineyards	Scott Weiss	Fosters Wine Estates Americas
Tom Klein	Rodney Strong Vineyards	Warren Winiarski	Stag's Leap Wine Cellars



Interview Questions for the CEO Survey

1. Has the current economic downturn affected your business and if so, how?
2. Has distributor and/or winery consolidation affected your organization?
3. “Going green”-what are you doing to address it and are you telling the consumer about it?
4. Are you concerned about long-term domestic grape supply?
5. What will we be talking about in 5-10 years that we’re not discussing now-what’s on the horizon?

Interview Excerpts Question #1

Has the current economic downturn affected your business and if so, how?

- I think what has affected us the most revolves around economic conditions-the price of oil. That affects our development costs and production costs and everything from gas and diesel to fertilizer to sulfur and pest control, rodent control, all that.
- The economy has definitely had an impact on us and I think it's not going to turn around any time soon.

Interview Excerpts Question #1

How has the economic downturn affected your business?

- Consumers are trading their dining out dollars for gasoline dollars.
- With gas prices going up, dining out is one of the first areas of discretionary spending people cut back on.
- At the higher end of the spectrum we're seeing softening in the more exclusive restaurants, the very high end. I think that is related to expense account money beginning to dry up.

Interview Excerpts Question #1

How has the economic downturn affected your business?

- There is some trading down at retail though we still see people buying premium on-premise. We definitely see the impact on dining, especially in the casual sector like Applebee's or Friday's, where the average American is going out with their family. The commodity prices -gas and everything else- have really taken a bite out of that.
- I think if you walked into a grocery store what you would see on the floor is wine priced at \$9.99, \$10.99 or \$16.99. I think retailers, at least in the last 6 to 8 months or so, have been putting their display towards cheaper-priced wines.

Interview Excerpts Question #1

How has the economic downturn affected your business?

- One of the things we're not going to do is get into heavy discounting. We want to come out the other side with brands that have some margin in them.
- It's absolutely affecting the sales. We are as interested now in direct-to-consumer sales as we are with our national business. We have flirted with discounts and more value-added propositions, like gifts or waiving of tasting fees or discounts on shipping. We are using a whole host of 'disguised' price reductions to make it more palatable for the direct consumer to want to do business with us in the discretionary world of wine.

Interview Excerpts Question #1

How has the current economic downturn affected your business?

- The retailers and distributors have cut back on inventory, they're being much more cautious. I think it's taken 30 days inventory out of the system.
- If we thought that distributors managed inventory before, they are micromanaging inventory now.
- People are feeling that they should be scared even if their business looks OK. They're being more cautious so it's having an impact-our distributors thought the retailers were pushing back on them and therefore they're pushing back on their suppliers.

Interview Excerpts Question #1

How has the economic downturn affected your business?

- We continue to see “premiumization” trends that have been true for the last three or four years, and we’re seeing channel expansion- more and more retailers are getting into wine in a material way, all of which is helping sustain the growth trend.
- From our perspective the wine industry is outperforming the economy, and we’ve gone back and looked at the last recessions and we’ve always outperformed the economy as a whole. The off-premise business will also outperform the on-premise business going back historically.

Summary Question #1

How has the current economic downturn affected your business?

Conclusions

- The cost of inputs (gas, electricity, supplies, transportation) has risen significantly and is affecting business costs as well as revenues, as consumers spend discretionary income on gas and food instead of wine and fine dining.
- Most have seen the consumer trading down in price point at both on- and off-premise venues, while on-premise sales, especially at the “casual dining” and “very high end dining” levels are suffering.
- Though some are pessimistic, a majority of executives believe the wine industry will survive the current downturn, with off-premise sales, \$10-\$14 wines and the Millennial generation’s love of wine contributing to its strength.

Interview Excerpts Question #2

“Going Green”- what are you doing to address it and are you telling the consumer about it?

- What we find is that there’s no good definition and no good understanding between “green”, biodynamic, sustainable, organic- so we’re trying to come up with a cohesive and meaningful answer to the marketplace when they ask about our level of green involvement. The issue is semantics and we want to be honest and accurate.
- I think that’s perceived as marketing more than reality, so we let people know- consumers are always going to be very aware of this aspect of things. As an industry we do better than most in terms of being kind to the environment, but one of the things that’s confusing to the customer is the difference between organic wine and wine made from organic grapes.
- We’re not communicating it to the consumer because it’s complicated to say what we’re doing. When I speak to consumer groups I talk about those things-but it’s hard to do that in the printed form because it’s too complicated and takes too much time.

Interview Excerpts Question #2

“Going Green”- what are you doing to address it and are you telling the consumer about it?

- We’ve done a lot over the years environmentally because prior to all the publicity surrounding the topic, it really made good business sense, to take care of the vineyards you’re farming, and to be careful with wastewater. It’s good business sense in a cost sense. We’ve been farming sustainably for a while, we farm some parcels biodynamically. We’re making advancements thanks to UC Davis.
- We find it very important to our positioning and have evidence it’s helped sales. We’ve basically doubled our bottle price to the consumer across the board on the back of this notion that our farming techniques are more costly, more handcrafted, and the consumer is buying it. It’s enabled us to increase price and not suffer substantially in volume.

Interview Excerpts Question #2

“Going Green”- what are you doing to address it and are you telling the consumer about it?

- We are doing a great deal, in fact one thing we’re doing well is that we’re waiting to have a big consumer push on it until we have our ducks in a row-the last thing we want to be involved with is what they call “greenwashing,” which is talking green without being green.
- ...whatever you do on the environmental side better be real because eventually someone is going to come along and measure it and they are going to be looking to embarrass people who have made environmental claims that are untrue.

Interview Excerpts Question #2

“Going Green”- what are you doing to address it and are you telling the consumer about it?

- We have within our portfolio a couple of organic wines which became a successful national program. We’ve seen increased interest in organic and sustainable wine. Our products are “eco friendly” and have gotten really great reception in the marketplace.
- Our own vineyard is biodynamic and we’re coaching all of our growers on biodynamic as well, and that’s helping them move in that direction- so we’re certainly moving very far away from chemical inputs and so forth.
- We believe that the sustainable route on a long term basis is a much better proposition than organic. In our minds, sustainable is a better, long-term help and solution to the environment than organic.

Interview Excerpts Question #2

“Going Green”- what are you doing to address it and are you telling the consumer about it?

- We have a “green team” here- they’re on the same par as our safety committee. They report regularly and we have a blurb on an email that goes out to all employees so it’s at the front of everyone’s mind. We’re not really publicizing it to our customers- the point here is to be green, not greedy. OK, sure, we’re green, but I’m not going to go out there and pound the drum on it.
- We do stuff for the environment, but it’s no big deal. We find that if you start to talk about your environmental efforts, then people say, what else aren’t you doing, why aren’t you doing this, why aren’t you doing that? And the thing is you’re never going to win that battle.

Interview Excerpts Question #2

“Going Green” - what are you doing to address it and are you telling the consumer about it?

- We introduced some new PET packaging in Canada, and it's selling just fine. We plan to continue to introduce it around the world. It looks just like a traditionally-shaped bottle.
- Over the horizon we plan to try to phase out Styrofoam shippers- which we use because our bottle sizes vary so much.
- We're doing more at our plants to make them more environmentally-friendly- wastewater treatment plants and things of that sort. We're looking to cut back on the amount of water we put on the land, recycling the water, and taking out certain chemicals that have salts.

Summary Question #2

“Going Green”- what are you doing to address it and are you telling the consumer about it?

Conclusions

- All companies interviewed were actively engaged in a surprisingly large amount of “green business” activity, from package re-design to biodiesel to wastewater reclamation and green building plans. Many have new teams or company divisions devoted entirely to the issue.
- Industry principals acknowledge their consumer base and the industry itself remains unclear on what “sustainable”, “green” or “low carbon footprint” really means- and how best to address these issues. Education and clarity are needed to address the consumer desire for information.
- Businesses are just beginning to communicate their efforts to the consumer- many interviewed are wary of a “greenwashing” backlash and are trying to be open about efforts.

Interview Excerpts Question #3

Has distributor and/or winery consolidation affected you and how?

- How does it not affect anyone in this industry? The wholesale channel is the largest channel and when the distributors merge it's like a tectonic shift. Every time it happens it puts more pressure on the smaller guys. How does the smaller supplier get the attention of the wholesaler, especially when the end consumer is not brand loyal?
- Distributors are quite honestly very disconnected from anything but the large wineries. It's a to-scale business and I understand it, anyone understands it, but if you're a little guy in the three-tier system you're going to need help.
- Frankly for smaller wineries, they have a heck of a time unless they get reviews that are so good that the distributor doesn't actually have to sell your wine, they can just deliver it. It's tough for the smaller guys.

Interview Excerpts Question #3

Has distributor/winery consolidation affected you and how?

- I see a minor impact. The consolidation you're seeing tends to be more towards secondary smaller markets; it seems to be a lot of partnerships with smaller distributors and things like that.
- Again, it's kind of a systemic problem for the industry, the shrinkage of midsize distribution and really the shrinkage of distribution altogether. Theoretically this should lead to a proliferation of small, independent wholesalers but I'm not sure if it's yet lead to the proliferation of small, independent, *financially-solvent* wholesalers.....

Interview Excerpts Question #3

Has distributor/winery consolidation affected you and how?

- Look, we're in a world of consolidation. We've had consolidation at the wholesale end, at the winery end- people who have been in the business for generations and they want to get out, or the new generation doesn't have the belly for the industry- it's a part of our industry life.
- We're large enough where we can still have a significant share of voice with distributors but certain markets are really consolidating down to 2 players, like in Oregon and Illinois. To some extent the liquor business is the principal business that our distributors are in. Wine is becoming a more important part of their portfolio but spirits is a very, very profitable part of what they do.

Interview Excerpts Question #3

Has distributor/winery consolidation affected you and how?

- Even with all the consolidation, the industry is still pretty fragmented, using almost any measure. Distributor and winery consolidation is related- retailers are getting larger and more powerful so you have to have the size and scale relative to them to be able to compete in those big accounts.
- The big guys are all trying to get bigger than one another, that's been going on for years and I don't see what advantage that gives them, to tell you the truth. They don't seem to have any common threads across borders- we can do something in one state and the people in the same house in another state will have no idea what's going on. They don't seem very well-coordinated at the headquarters level.

Interview Excerpts Question #3

Has distributor/winery consolidation affected you and how?

- We used to deal with non-professional grape-buyers- a failed winemaker was the guy who bought grapes. Now they're professional grape buyers, corporate types- they're well-educated and are good business people. Where we used to deal with four guys we now deal with one and now there's a real inability to get things done. Anytime you want to do something creative or innovative you don't deal with the decision-maker anymore- now they have to go back to headquarters to check.

Interview Excerpts Question #3

Has distributor/winery consolidation affected you and how?

- We're going to see more players coming in from overseas, like with Chateau Montelena. I see more Europeans, more Indians, Chinese coming in and buying properties. It'll have an effect on everyone in the industry but- you may find that a lot of these new faces are private equity players, so you won't necessarily see central consolidation.
- Has it affected the grower right down to the ground? Absolutely. Ten years ago we were doing business with 5-6 different wineries that are now all owned by the big winery conglomerates. They search out the lowest price and they force it down and you don't have a lot of options.

Summary Question #3

Has distributor/winery consolidation affected you and how?

Conclusions

- Large players are content in their healthy positions in the books of the consolidating distributors and report they're only marginally affected by distributor consolidation.
- Small to medium-sized brands/organizations exhibit continued (and growing) frustration with the three-tier system and the difficulty of gaining the attention of distributors. They are increasingly developing alternative channels like wine clubs and other consumer-direct outlets.

Interview Excerpts Question #4

Are you concerned about long-term domestic grape supply?

- The wine industry is globalizing, certainly supply is globalizing. When things are tight there is still a lot of bulk wine flowing in from all over the world. The option to import bulk has been easier and more accessible to wineries than every before.
- Certainly, at the high end, distinctive wines that can garner the highest prices won't be in jeopardy but for everyday wines, who knows, we'll be drinking wine from China in 20 years.
- If oil prices decline and the US dollar strengthens and the economy strengthens, then I think imports will gain serious market share. If imports really flood the country, we'll have plenty of grapes, there'll be no problem.

Interview Excerpts Question #4

Are you concerned about long-term domestic grape supply?

- There's no place to put Cabernet anymore. Lake County is just about the last frontier for any decent north coast acreage. Sonoma has next to no Cabernet land, Napa is all planted up-we're just out of land for Cabernet.
- I would be concerned about Napa domestic grape supply because as more of the producers shift to public ownership, there's less passion devoted to land use issues and less attention given to actual dangers to grape-growing as a primary economic base in Napa Valley. Public companies don't devote a lot of time to this- you don't see big public company reps at planning commission meetings or at the Supervisor's offices.

Interview Excerpts Question #4

Are you concerned about long-term domestic grape supply?

- Frankly, I'd rather be in a situation of short supply rather than long supply- there's less competitive pressure. When there's a ton of supply you get 110,000 SKU's approved by the TTB- that was last year. That's a huge number.
- We're still able to find the grapes we need or grow the grapes we need. I'm concerned with too much supply! Just drive on Hwy 101 anytime and it's just wall to wall grapes- I think there are never enough great grapes, there are always too many ordinary grapes. We're definitely over-planted.

Interview Excerpts Question #4

Are you concerned about long-term domestic grape supply?

- Everybody's short on water now and that's starting to affect the crop- people are cutting back on watering. If we think the industry's in balance the price has to come back up and if growers can make some money, they'll put grapes in. Right now there are too many things that compete against grapes, alfalfa, almonds, walnuts, tomatoes, so until the market moves up, people aren't planting enough grapes.
- People got their financial fingers burned very badly in the last crunch we had in 2001. Almonds are hotter than a pistol so the growers are making a lot of money planting almonds- a lot of people have ripped out wine grapes in favor of almonds and in the Central Valley it's going to be very difficult to get people to go back to grapes.

Interview Excerpts Question #4

Are you concerned about long-term domestic grape supply?

- If you look at the cost of land in California and the cost of doing business here, I guess you could ask yourself, in 20 years will grapes be economically viable given the cost of land in California?
- It's becoming more difficult and heck of a lot more expensive- how do you make great wine with a \$250,000/acre vineyard, how do you pay \$1,000 for a barrel and \$5,000 for a ton of grapes? How do you make a business plan on those kinds of numbers?
- At the end of the day, will the bank lend the money to develop a vineyard and have not even be worth market price? The Central Valley is already that way, the Delta and Lodi are somewhat there and the Central Coast is there depending on where you are. Unfortunately, somehow demand will be met, with imports- bulk or bottled.

Interview Excerpts Question #4

Are you concerned about long-term domestic grape supply?

- We're in part of the cycle where there will be slow planting going on- as of now, the major buyers aren't willing to pay enough for new plantings to have a rush on it. In a normal cycle you'd have a couple of years of building up demand and then a rush to plant. I think we'll see that rush in a couple of years, but it'll be a longer rush because it's now so expensive to plant.
- We'll manage through it like we have in the past. I take a fairly rational view of it, especially now with real estate values going backwards, it's easier to get a return on the land.

Summary Question #4

Are you concerned about long-term domestic grape supply?

Conclusions

- Some feel a shortage is happening/will happen only in Napa and Sonoma Counties, especially only with hot varieties there like Cabernet Sauvignon and Pinot Noir.
- In the Central Valley (and in some places on the Central Coast) it is a question of grapes vs. other crops- can the price of grapes be high enough for growers to plant them and keep them in the ground? An open question.
- Some feel a shortage will be avoided by imports rushing in the minute the dollar strengthens; some believe that rising land and input costs will further make planting a vineyard in California an economic non-starter.

Interview Excerpts Question #5

What will we be talking about in 5-10 years- what's on the horizon?

- Packaging is going to move a lot in the next 5-10 years and it's going to be exacerbated because of the environmental issue. The trend towards heavier bottles won't be profitable from a cost and transportation viewpoint. I think there will be some small percentage at the higher end that stays in cork forever because of the tradition and ceremony, but a majority of wines will be in screw caps if they're in a bottle. We'll see things like tetra packs for less expensive wines.
- I see this carbon footprint thing becoming a bigger deal. Retailers, restaurateurs and consumers will continue to weigh in- it's an extension of the global warming challenge and it's something we all have to worry about.

Interview Excerpts Question #5

What will we be talking about in 5-10 years- what's on the horizon?

- The war for talent is high. We have to work to attract the best and brightest into our industry if we are going to fully capitalize on the growth potential in front of us. How are we going to attract and retain them to sustain our operations? Does our industry attract talent and does it retain talent?
- In California it's labor, especially if construction picks up. There are other issues- one is water. In California there is an anti-business climate going on at the legislature level and it makes it really hard to jump through all these labor laws. All this sort of stuff makes it hard to do business.

Interview Excerpts Question #5

What will we be talking about in 5-10 years- what's on the horizon?

- Water, more state regulations, anywhere from just growing the grapes to making the wine, just dealing with state and regional water control boards. Every time you turn around there's a new tax for something and we're always fighting for our water rights. We have riparian rights where we're at and it's a constant battle to keep those.
- The environmental issue will become more and more center stage. Striking the balance between being responsible environmentally but also in terms of sustaining the business economically. How can you do the right thing but also be competitive?

Interview Excerpts Question #5

What will we be talking about in 5-10 years- what's on the horizon?

- We'll still be talking about the three tier system and distributors. It's supposed to be value added and what the &*\$%# are they doing? They are a very expensive trucking company! If all they're doing is delivering wine from point A to point B, there are a lot of other players who could get involved.
- I'd be surprised if we're not still talking about the three tier system. It's just going to go bust. It is an antiquated dinosaur in a global village lead now by the internet, information, and the likes of UPS and FedEx. The virtual guys will happen and people will get the idea of creating alliances with Fed Ex, UPS and DHL about how you intermediate the distribution of wine. There's going to have to be some kind of meltdown- we're going to be looking back on this curious fix that the distributors had us in for 70 years.

Interview Excerpts Question #5

What will we be talking about in 5-10 years- what's on the horizon?

- I think California wines in general don't deliver great value. As the economy becomes more stretched people need more value. I think wines are going to be pretty marginal right now and if they get squeezed any more I just don't see prices getting driven down- I think a lot of wineries are just not going to survive.
- I think there will be more opportunity long term to export. You'd better be exporting- you have to be a part of that. A lot of those markets- China would be the best example- will take 5-10 years to develop so we need to be poised to take advantage of it when they're ready.

Interview Excerpts Question #5

What will we be talking about in 5-10 years- what's on the horizon?

- I think the big issue is going to be the issue of alcohol abuse. You're going to have a tremendous backlash with the public between teenage drinking and drunk driving- it's just the beginning. Look what's happened in Australia, look what happened in England. Once these movements start they go around the world.
- The route to market for wine is getting more and more difficult. There's not a clear way for that to get better in the future. We'll see some small distributors popping up but their costs of doing business are going to get higher and higher. That's where the big distributors will ultimately win because their cost of delivery and economies of scale work in their favor.

Interview Excerpts Question #5

What will we be talking about in 5-10 years- what's on the horizon?

- It's nice to see that the wine industry may be one of the brighter stars in the economy as we go forward.
- We're not going to see any slow down in the move towards premium wine. It's not like people are going back and drinking inexpensive jug wines. That's a trend that's been going on for 30 years now. That growth has transcended all of the economic cycles over the years and it's more of a long term trend- it'll continue.
- Long term demand looks great, when I look at the Millennial generation I think all that looks good. I just think we have to be innovative and on our toes because competition isn't going to loosen up at all.

Summary Question #5

What will we be talking about in 5-10 years- what's on the horizon?

Conclusions

- Demand for labor and water, and the high cost of inputs, make doing business increasingly difficult; frustrations with the three-tier system persist.
- The industry needs to be sensitive to a growing public backlash about alcohol abuse and underage drinking.
- Environmental issues, global warming and decreasing our carbon footprint will grow in importance-the global consumer is watching.
- There are some short term concerns but optimism is high.

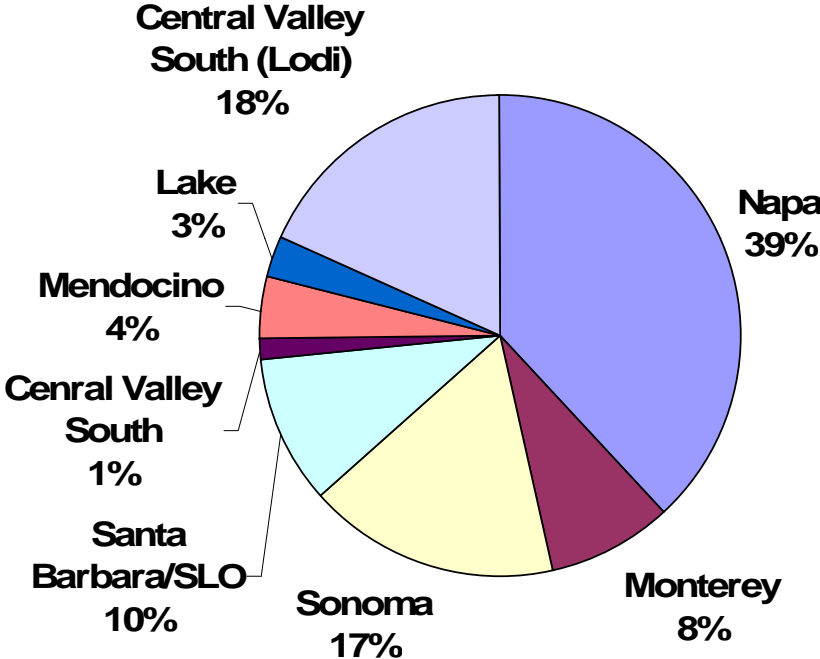
The Industry Trends Survey

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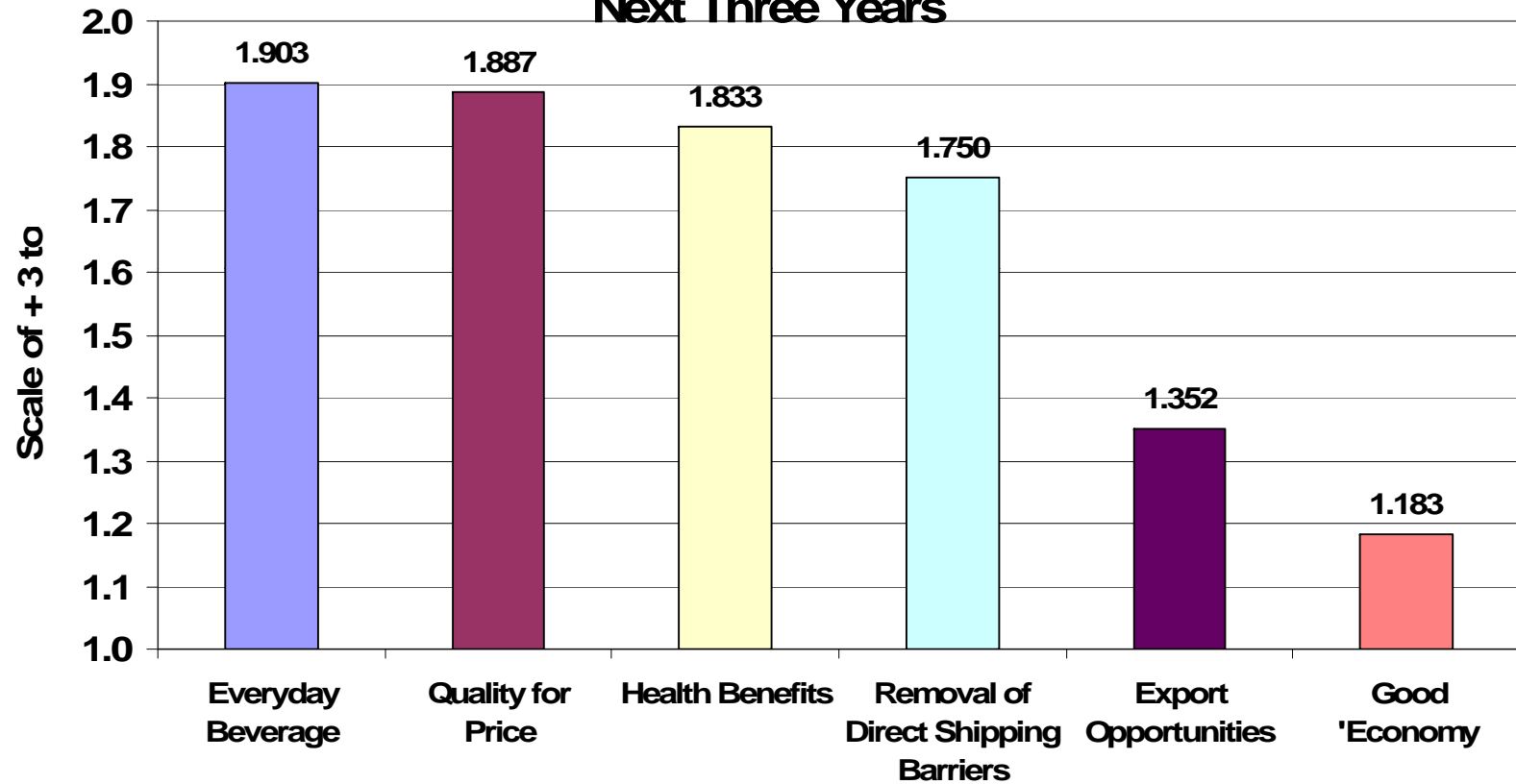


Location of Vineyard & Winery Respondents

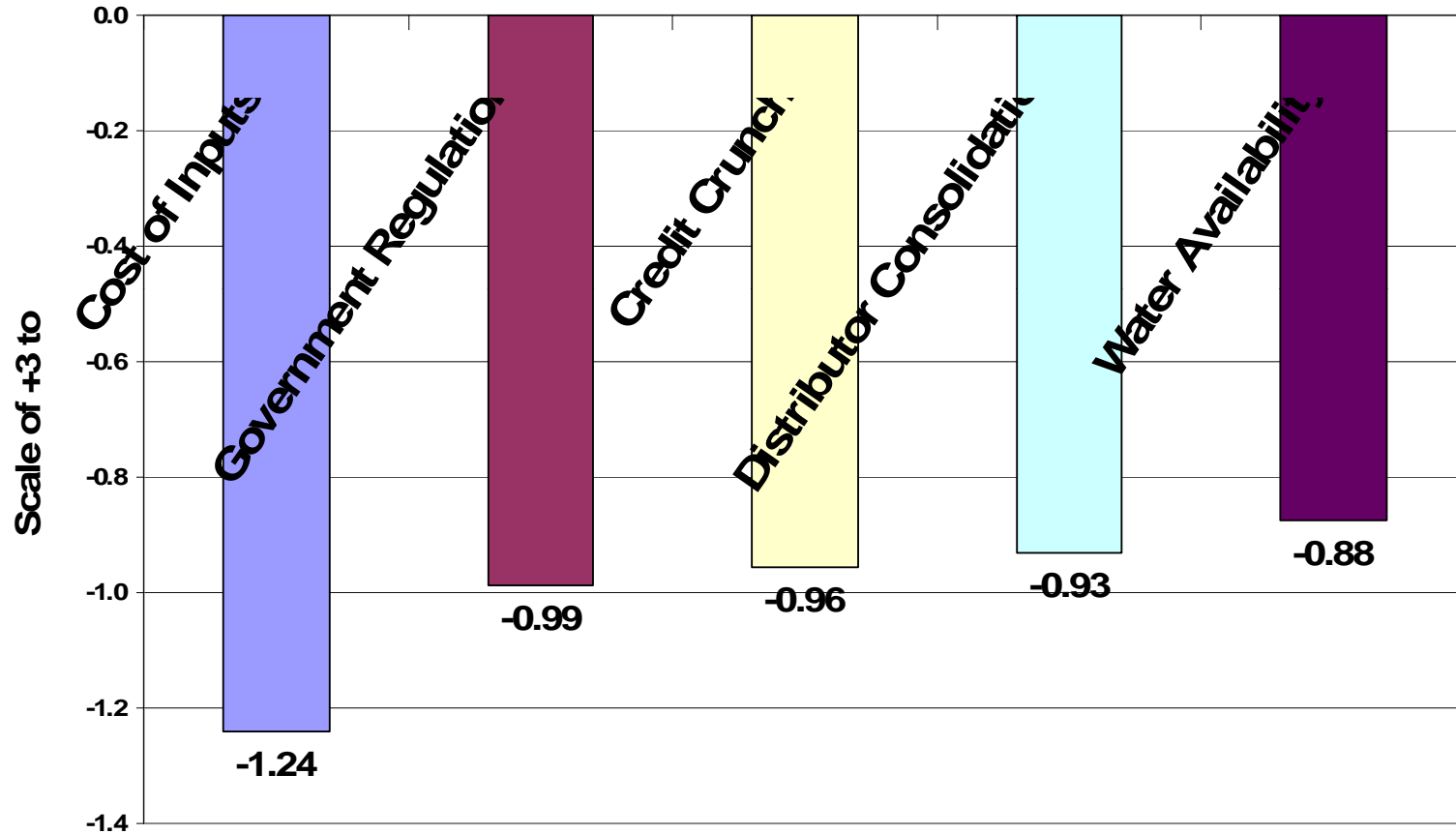
73 respondents



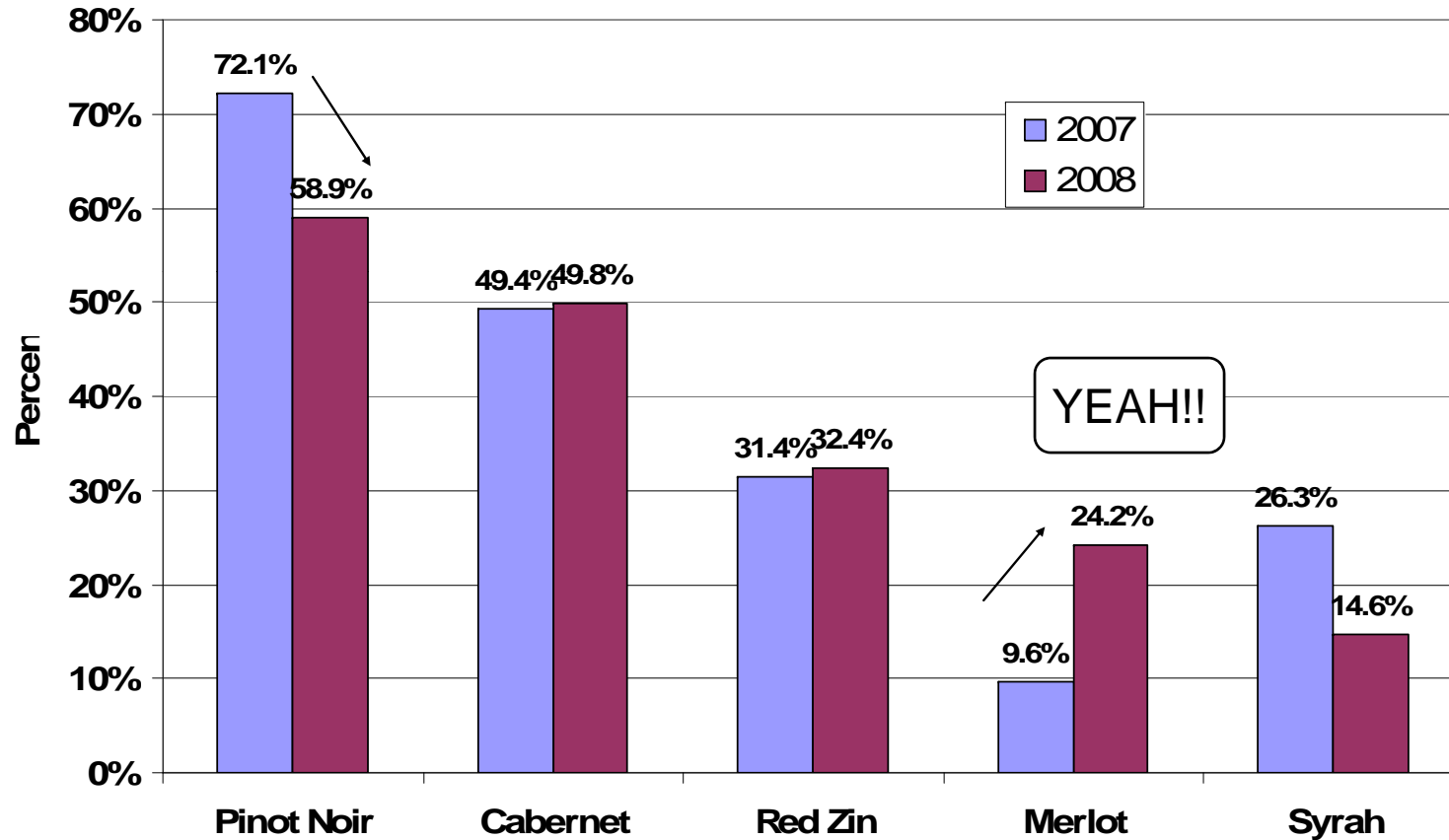
TOP SIX Positive Factors for California Wine Sales For Next Three Years



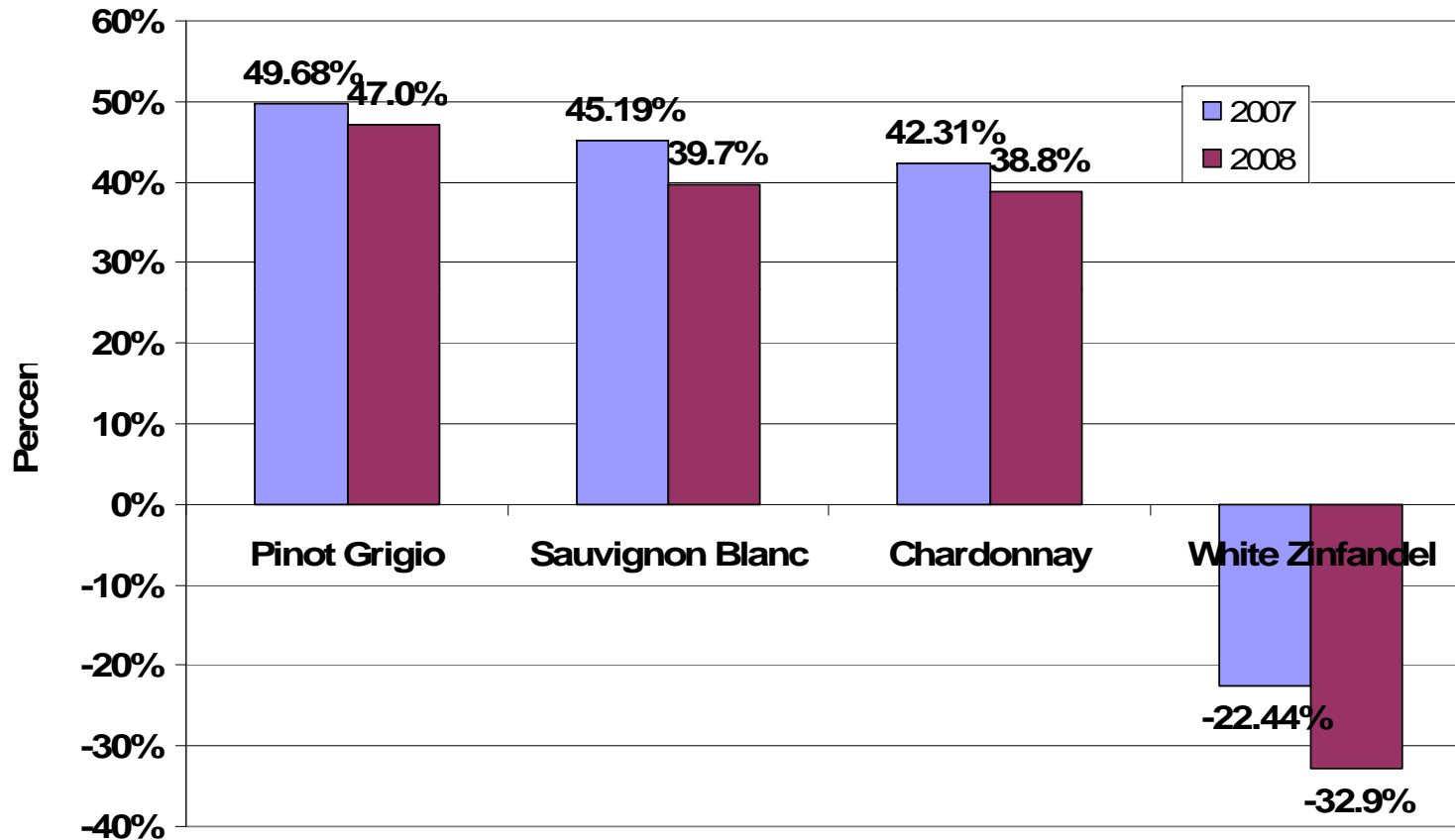
TOP FIVE Negative Factors for California Wine Sales Over the Next Three Years



2007/2008 Comparison of How Strong the Growth of Red Wine Sales Will Be Over the Next Three Years



2007/2008 Comparison of Respondents Opinions of Growth of White Wine Sales Over the next Three Years



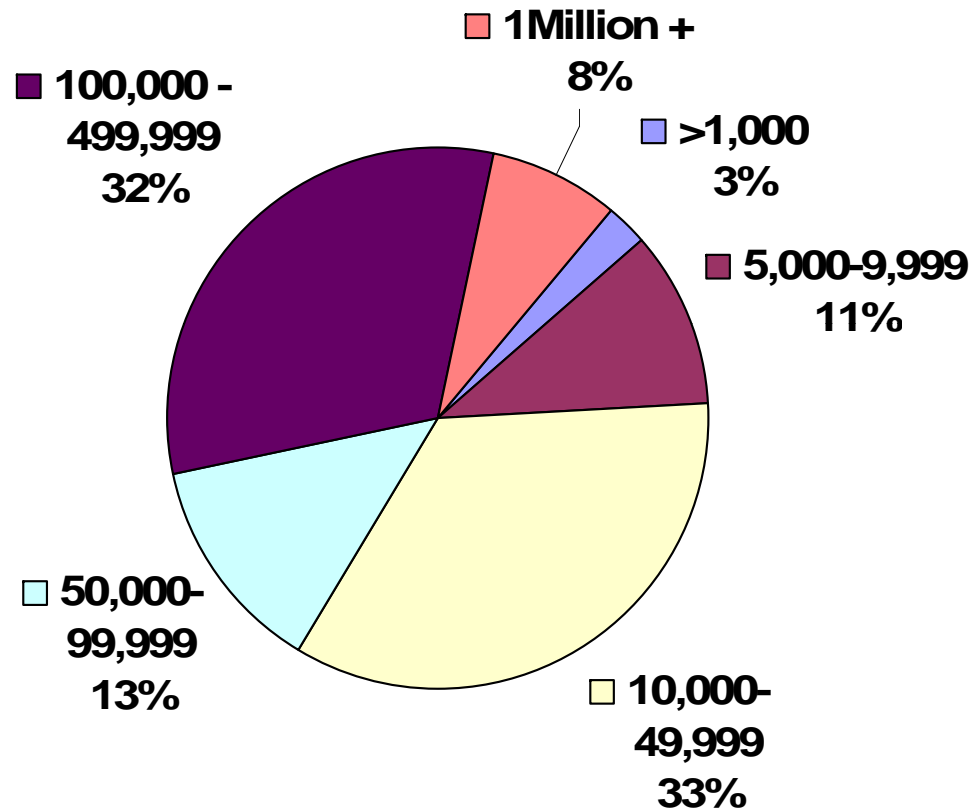
The Winery Survey

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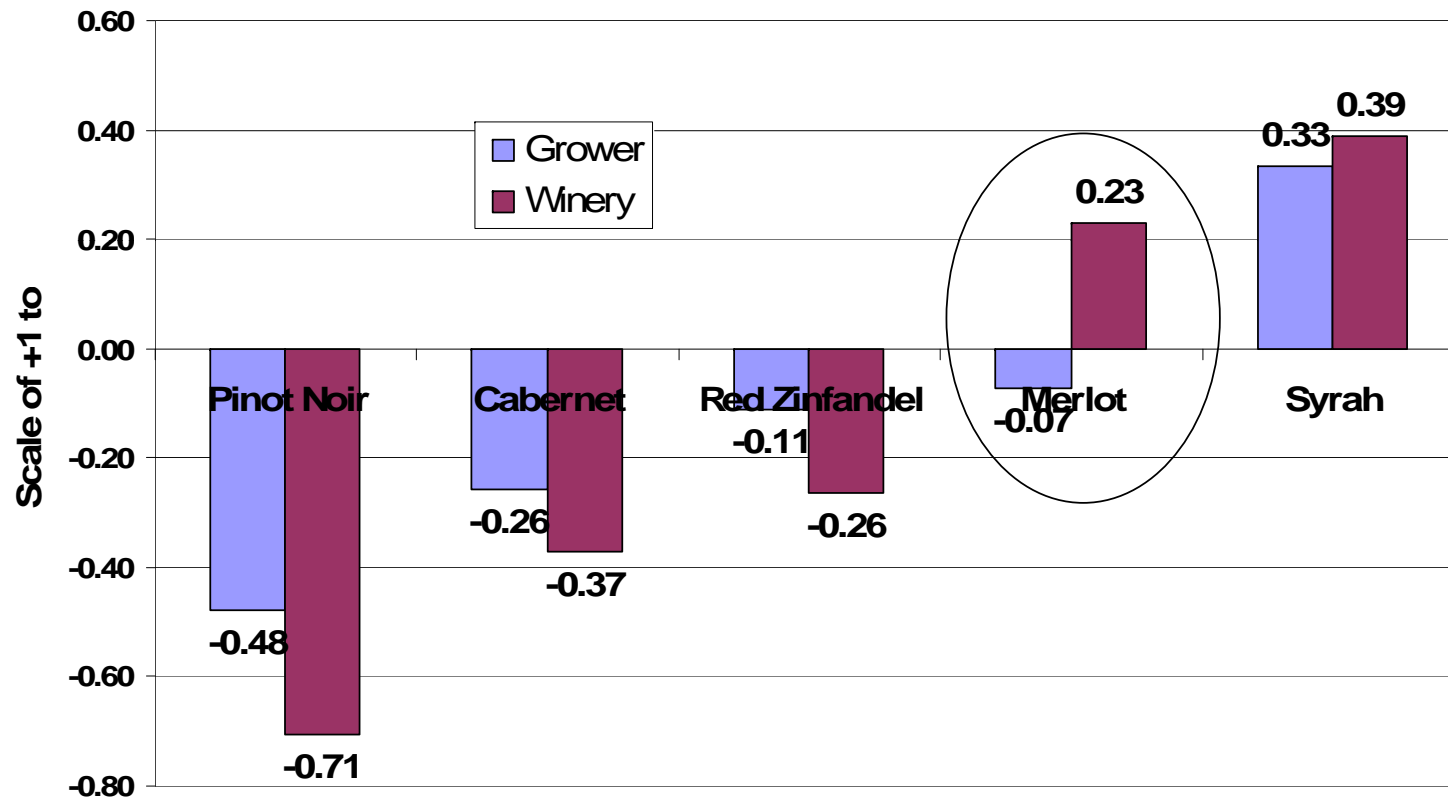


38 Wineries

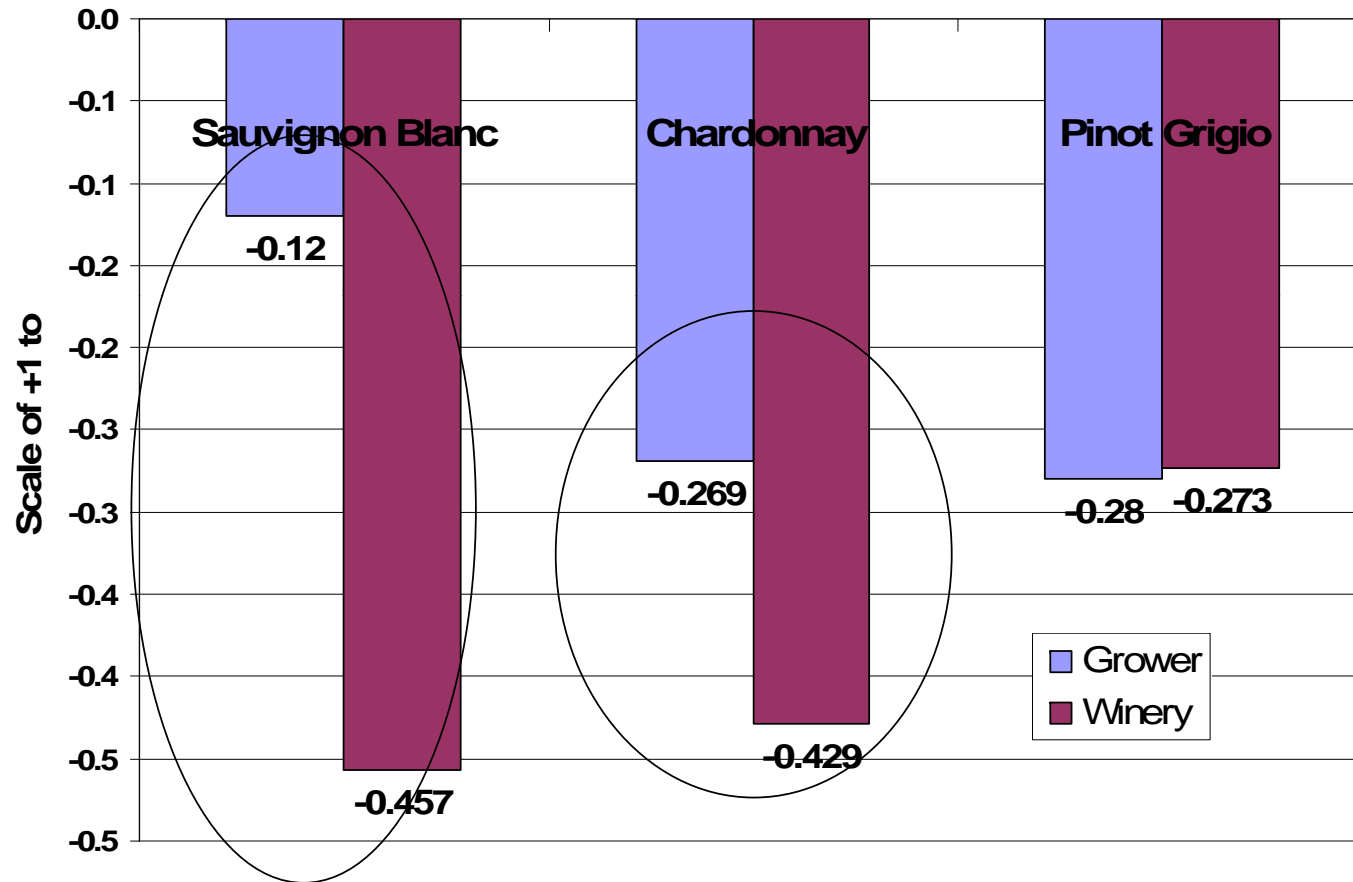
Winery Size by Case Production



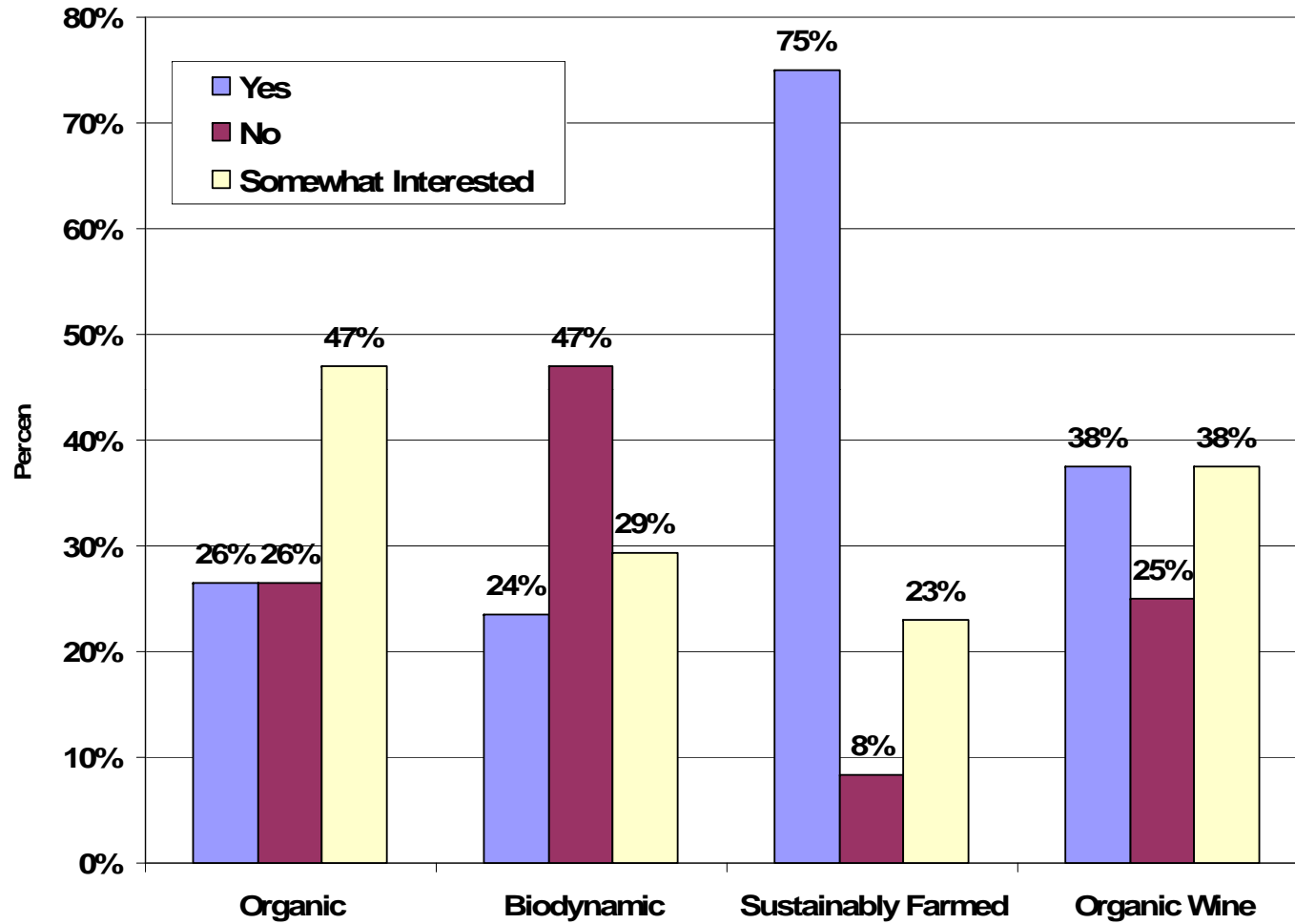
Comparison of Winery and Grower Responses About Supply of Red Grapes Over the Next Three Years (Net Number)



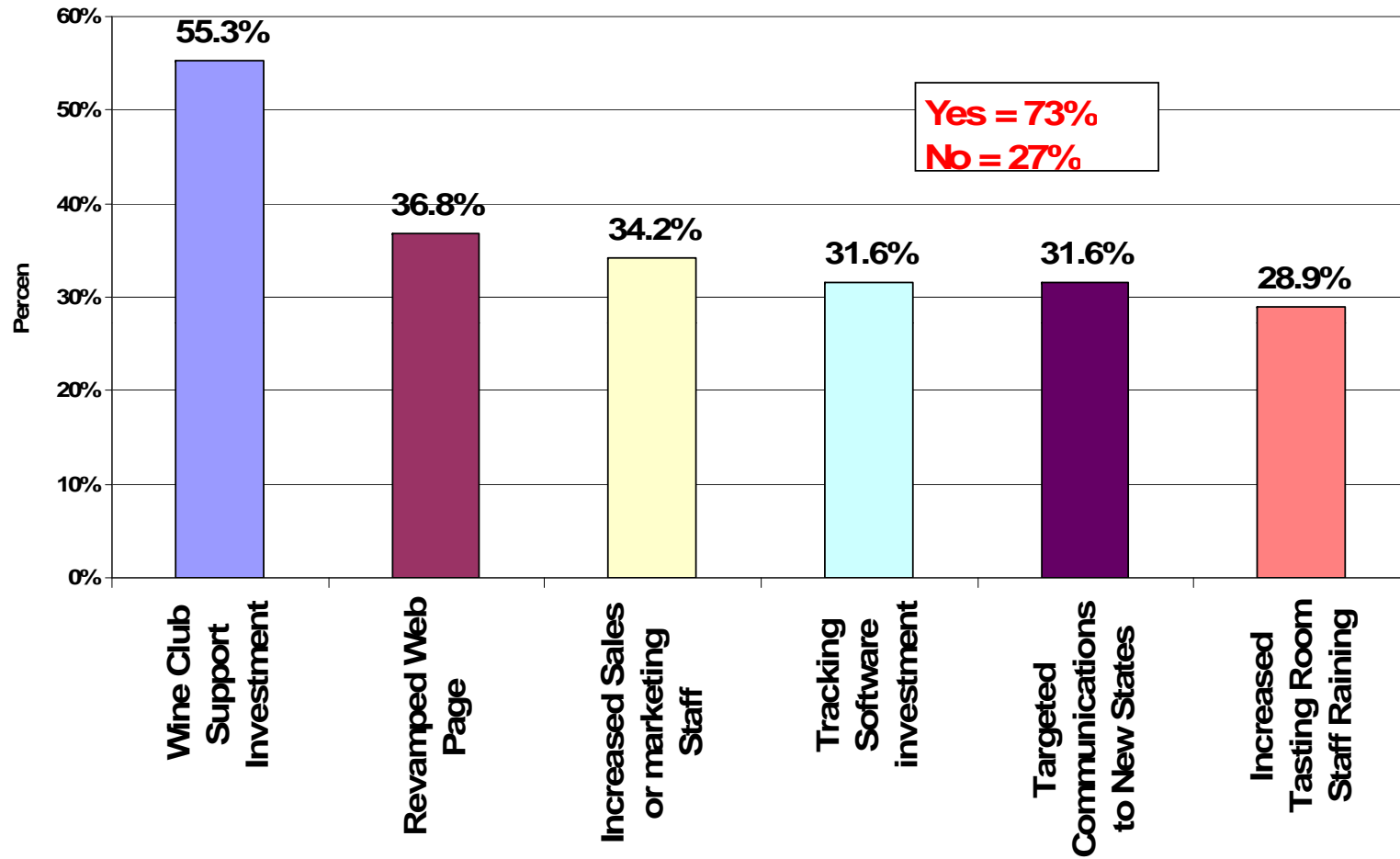
Winery and Grower Responses to Supply of White Grapes over the Next Three Years (Net Number)



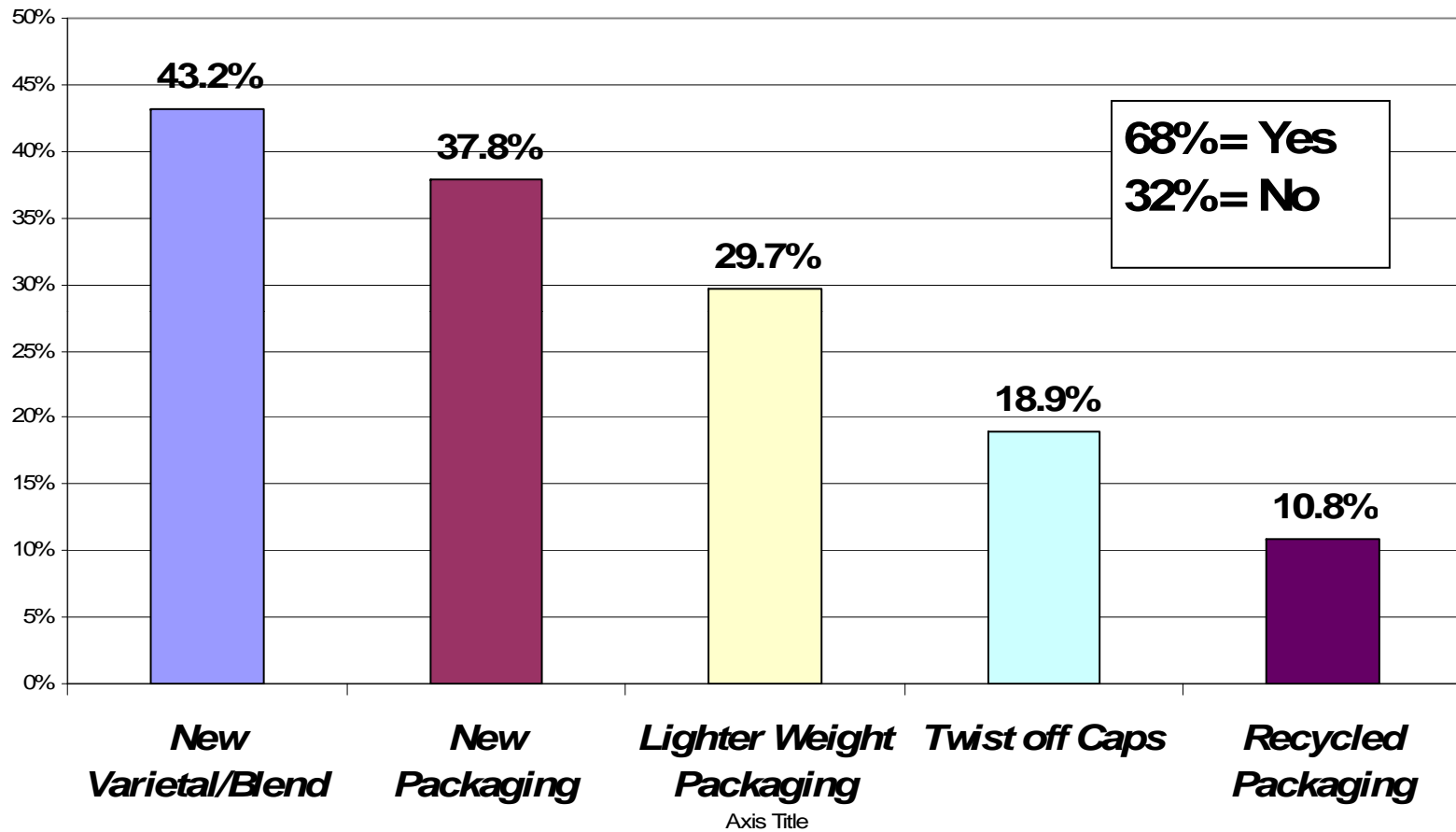
Is Your Customer Base Interest in :



Has Direct Shipping Increased Sales? If So, Do What to You Attribute the Increase?



Are Wineries Introducing New Packaging/Products Over the Next 12 Months?



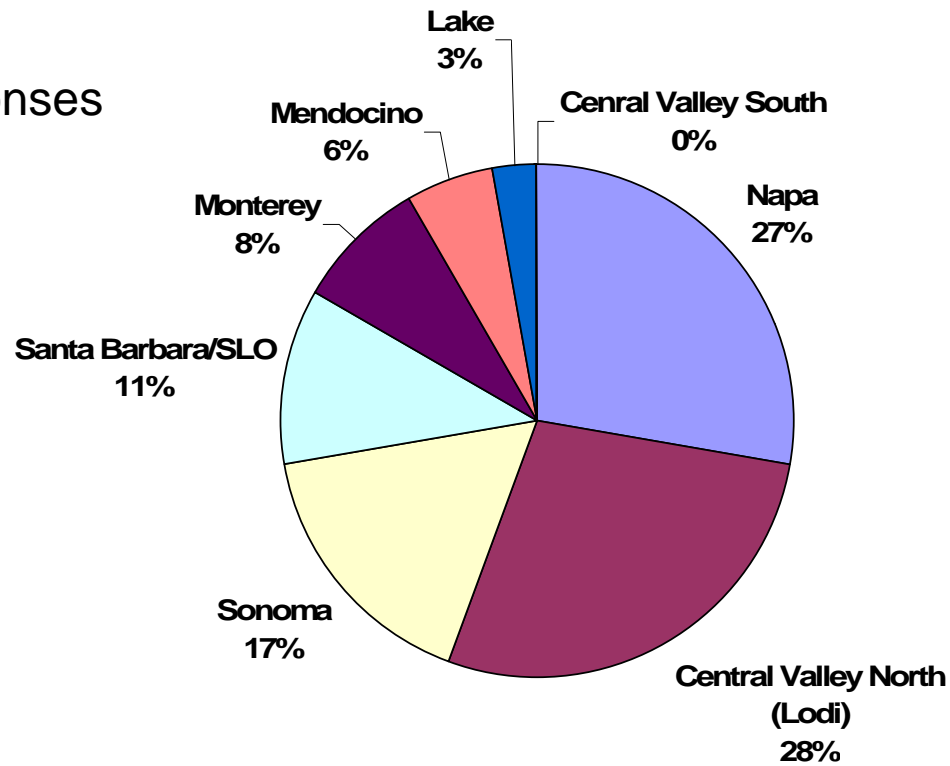
The Vineyard Survey

September 23, 2008

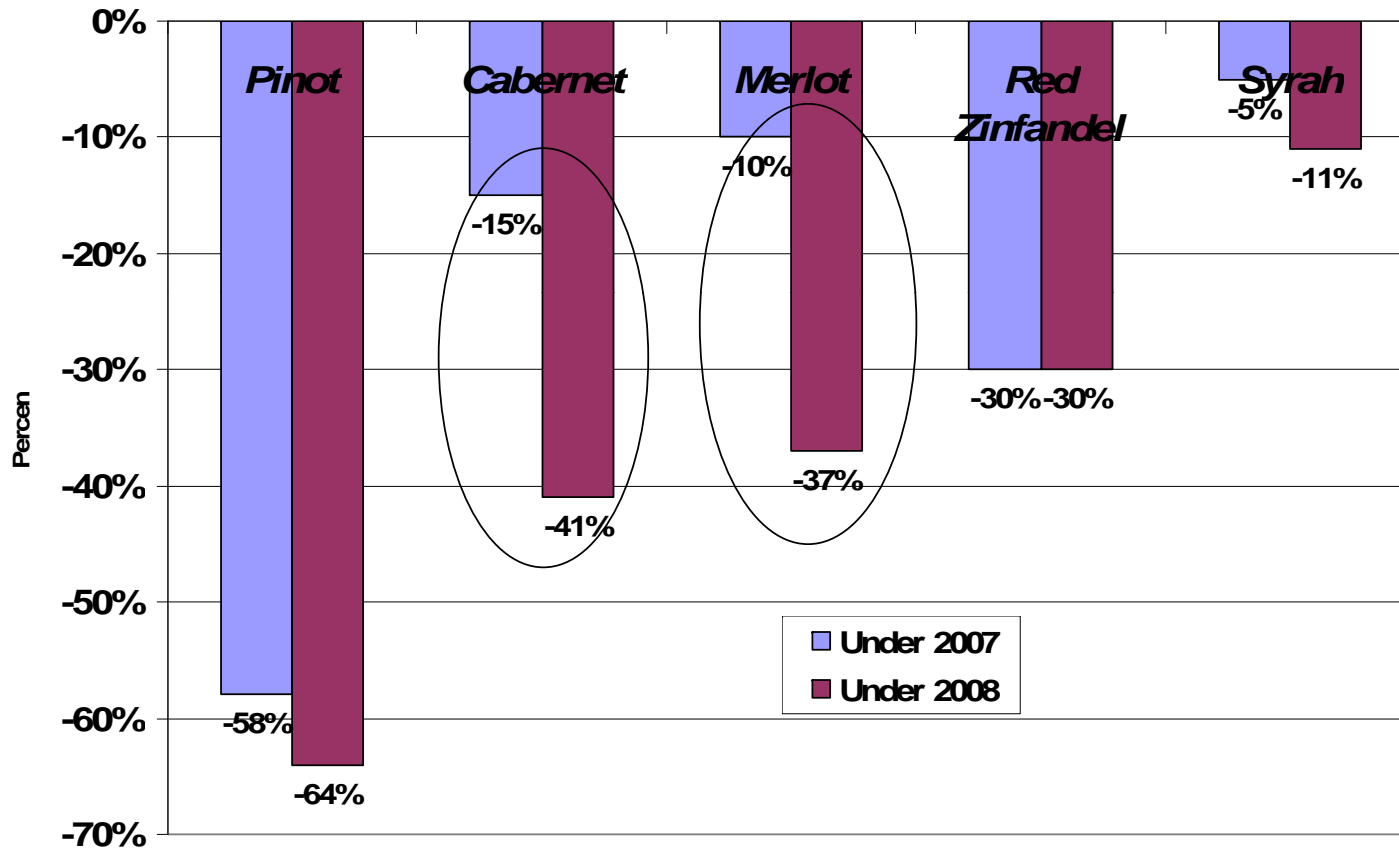


Vineyard Location of Grower Respondents

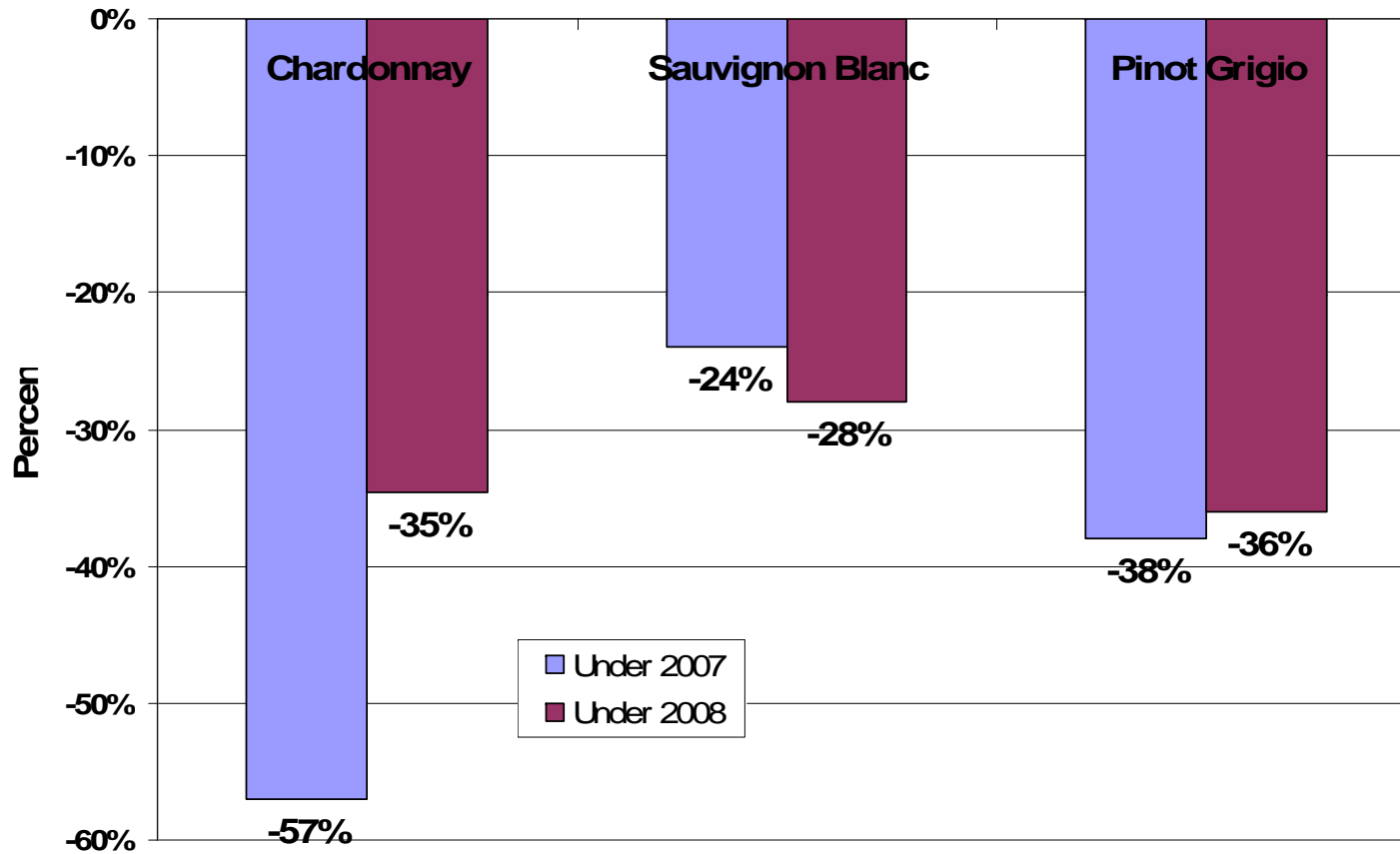
31 responses



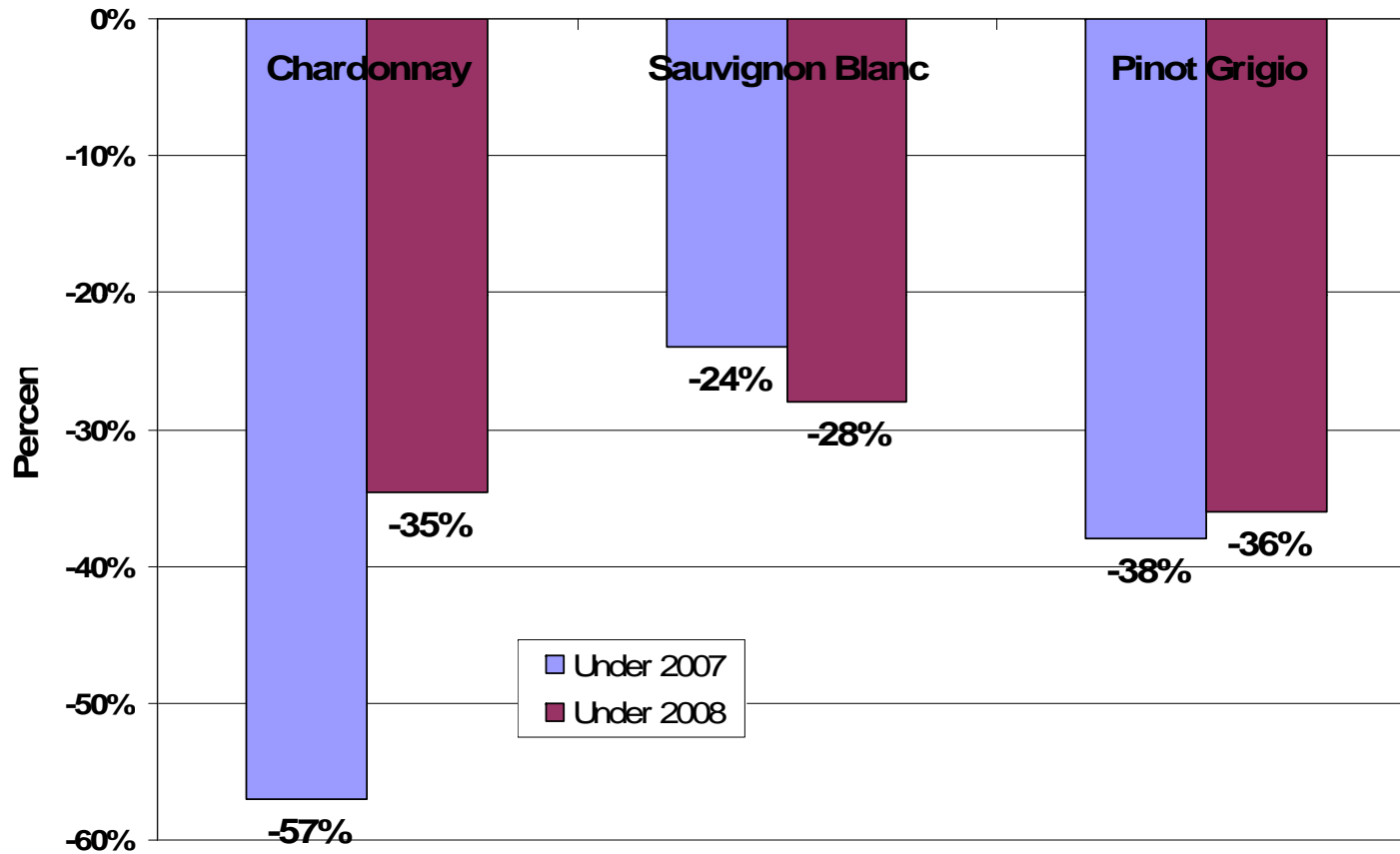
2007/2008 Comparison of Percent of Grower Respondents Who Believe There is an Undersupply of Red Grapes



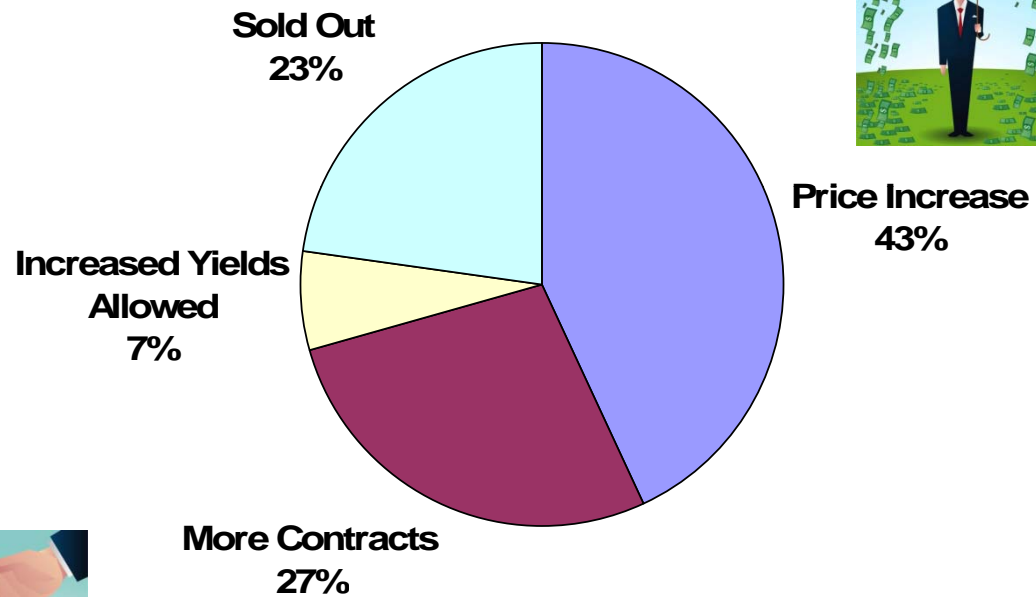
2007/2008 Comparison of What Growers Think About the Supply of White Grapes Over the Next Three Years



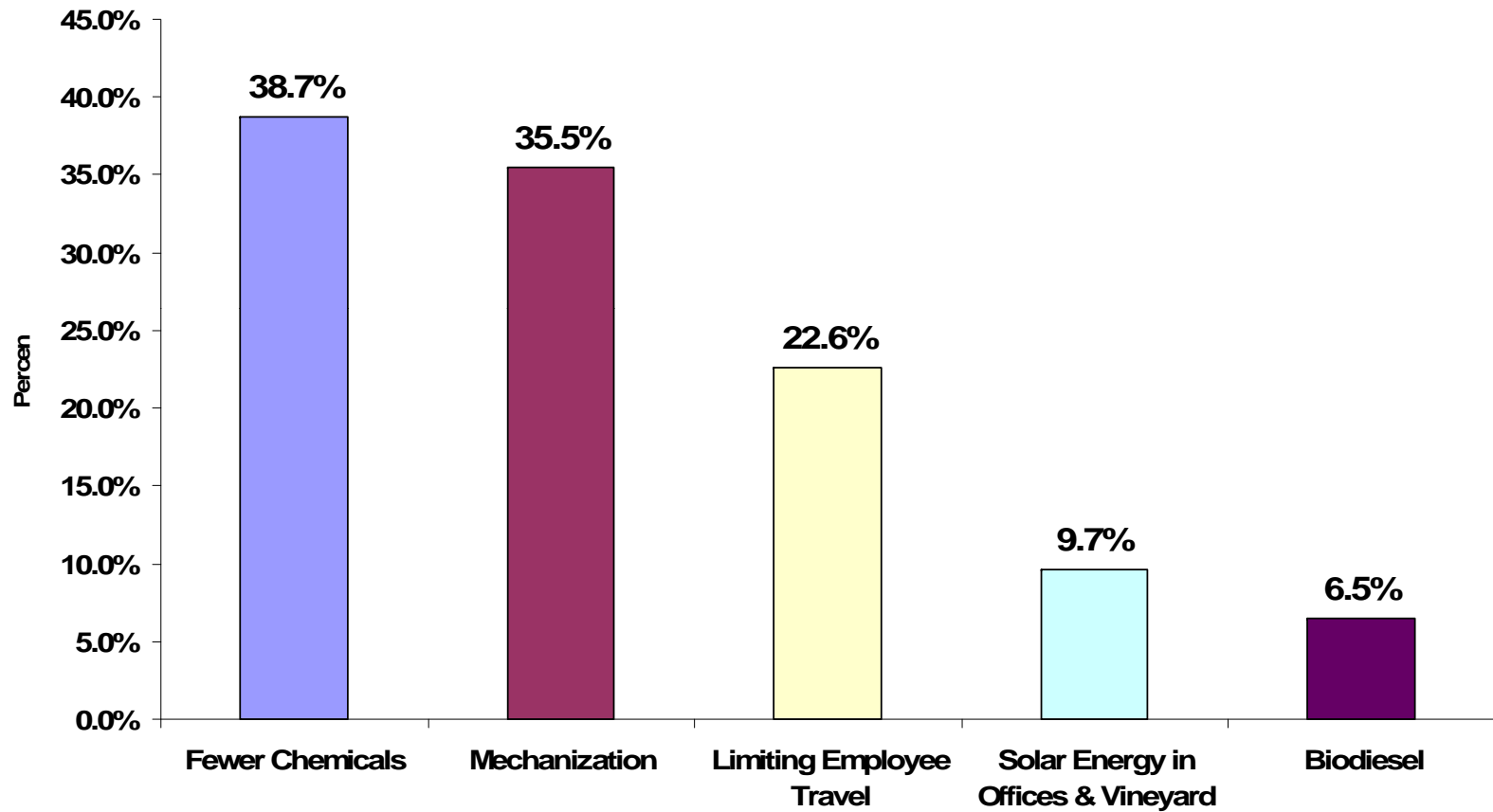
2007/2008 Comparison of What Growers Think About the Supply of White Grapes Over the Next Three Years



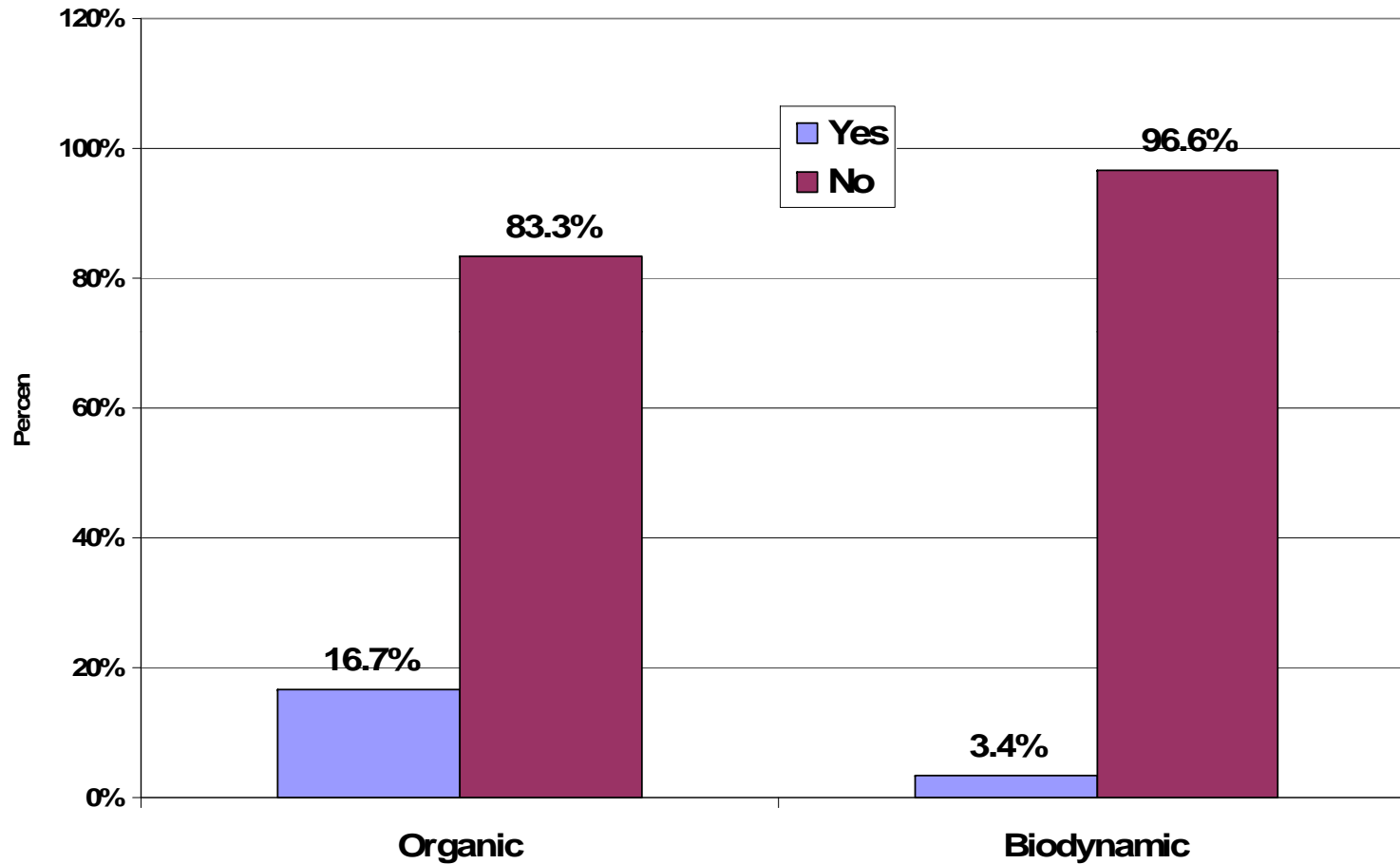
Why Growers Think The Industry is More Positive



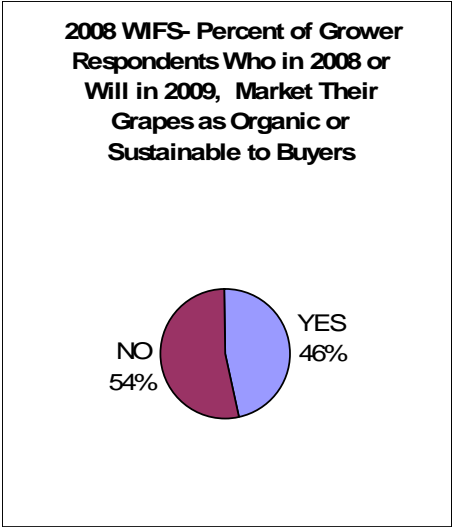
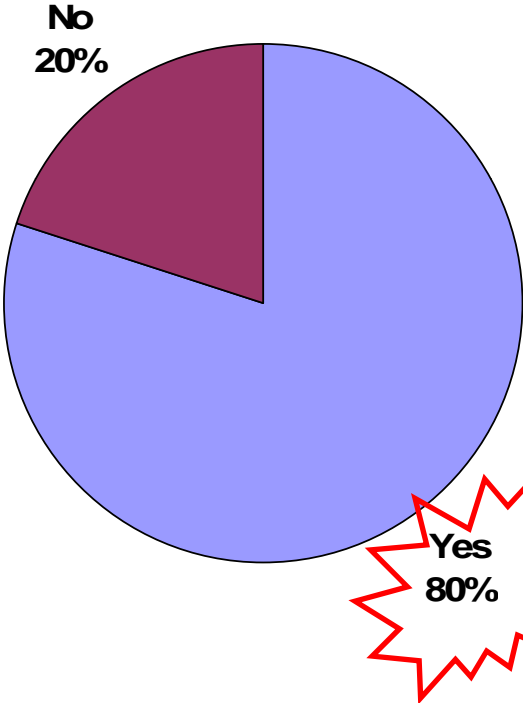
What Growers Are Doing to Mitigate the Rising Cost of Inputs in the Vineyard?



Organically Farmed vs. Biodynamically Farmed



Growers Who Farmed Any of Their Acreage as "Sustainable" in 2008

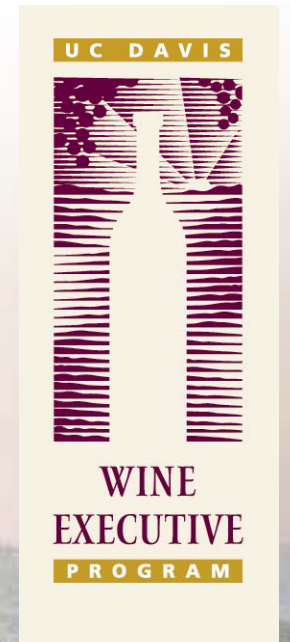


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Wine Business Strategies for a Global Industry

September 23, 2008

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