



## Here Come the Clones

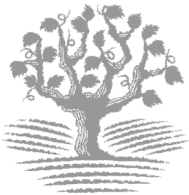
The wine business tends to be highly cyclical. When wine sales are strong and grapes are short, bulk wine and grape prices go up. This stimulates extensive planting. But those new vines are not ready to produce grapes for three or four years. In the meantime, demand grows and prices move even higher. With these higher prices, planting typically goes crazy. Finally all of the new production comes into bearing and supply gets ahead of demand. Grape prices plummet and plantings cease. Marketers pounce on the excess supply and create new demand. The growing demand finally catches up with supply and the market becomes short again. This cycle is well established in the history of the California wine business.

Almost everyone now agrees that the California wine business has finally moved out of the excess of the previous seven years and has entered a period of relative shortage. Some observers are skeptical, however, that supply will become short enough to put much upward pressure on prices. And many people doubt that this developing shortage will, over the next five to seven years, ignite a planting boom, even though that has always been the result in the past. The following factors could inhibit the development of a planting boom:

1. The high cost of land and of environmental compliance
2. Strong demand for competing crops
3. High cost and limited availability of water
4. High cost for all elements of vineyard development
5. Adjusted for inflation, the relatively low price for premium grapes compared to the high points of the past
6. Intense competition from wine-producing countries around the world

Given these factors, can grape prices climb high enough in California to eventually fire another planting boom? Or will lower-cost producers from around the world be able to fulfill growing demand in the U.S. market to the exclusion of substantial growth in California brands?

In fact, the development of a planting boom over the next five to seven years depends on some magic. This magic has always appeared in the past, but there is no guarantee it will appear this time. The magic is pricing power. In the past, when the supply of California wines has tightened up



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and demand has continued to grow, the owners of brands priced over about \$5/bottle retail have found - to their surprise - that they could eliminate discounts and take some price increases and still

experience demand growth. During the years of shortage between 1994 through 2000, pricing power got stronger at higher price points. Many premium and luxury brands found that they could take multiple price increases and still remain on allocation. Marketers are skeptical that this will happen again. Even in the midst of a protracted economic downturn, however, the scan data shows that dollar sales are increasing faster than volume sales. In other words, average prices are inching up even when the economy is bad and the supply situation has not yet become really short. What will happen when the economy rebounds and supply has become really short?

We think that high land prices, high development costs, and worldwide competition will indeed moderate an eventual planting boom. But, agriculture being agriculture, these factors will probably not prevent a boom altogether in many areas of the state. We think the market will get warm and then hot over the next several years. When the market is hot - and the numbers finally pencil out - people will plant. They will plant carefully and strategically at first. If prices continue to climb in the historic pattern, planting will finally become at least somewhat wild and irrational. Like most booms, those who get in early will do well. Those who get in late might get stung. Given the inhibiting factors, it will take a number of years to get there - and we might be wrong. But history is on our side.

## Weird Year

The intersection of the human world and the natural world is endlessly fascinating. This is especially true in the wine business, where we encounter the human world in great complexity (not to mention pomposity) and we also encounter the natural world in its full - and sometimes frustrating - complexity. So far this vintage, Mother Nature and the human world happen to be in sympathy - they are both all messed up. Fannie Mae and Freddie Mac have been bleeding. The dollar, up recently, is still anemic. Banks are afraid to lend. Consumers are afraid to spend. Oil prices are shockingly high and interest rates are surprisingly low. Mother Nature is equally confused. Torrential rains, followed by drought. The hardest frost in 35 years, followed by extraordinary heat. Long cool spells, with lots of smoke in the air from thousands of fires. Amazingly, in the messed up human world, wine sales have shifted around but are nevertheless holding up pretty well. Most folks think sales will continue to grow. Amazingly, in the natural world, crop size has been hard to gauge but in many areas it is looking fairly normal and many people think that, despite all the difficulties, it will come in close to average. The hot spell during the first week of September, however, may result in low berry size and thus a smaller crop.

Grape and bulk wine sales continue lurching forward through all of this. Prices are up. But sellers still are not happy because costs are also up. Buyers are very concerned about economic conditions and about their ability to pass on increased costs. But they keep buying. It is a grumbling, disjointed, worry-and-complaint-filled market. But it is still the best market we've seen in over seven years and we've helped a record amount of grapes and wines in bulk to change hands. If the wine business is holding together this well in the middle of an economic slowdown, I cannot help but wonder what will happen when the economy finally turns around. It may take six months, or 12 months or 24 months, but sooner or later the economy will pick up again. And you had better have your grapes in a row by then, because the California wine business is going to soar.

See Grapes & Wines in Bulk below for more market details.

## The Grape Market

**Chardonnay:** In the North Coast the sparkling harvest has been down, with the first-to-ripen vineyards off as much as 20% from recent estimates. Later vineyards have been closer to normal but

the total harvest could still be down as much as 20% from average, due to frost damage and lighter-than-normal clusters. Napa and Sonoma Chardonnay is pretty much all committed and prices rose as harvest approached. Some Chardonnay tonnage from Mendocino, Lake and Suisun is still available. Quality looks good.

Due to frost and other problems, the **Central Coast** Chardonnay crop is significantly below average and demand has been strong. Monterey County Chardonnay tons per acre appear similar to last year's relatively light crop. There is still tonnage available. Paso Robles Chardonnay that struggled to find a home last year at \$500 per ton has pretty well sold out this year in the \$900 per ton range. Multiple buyers are purchasing Santa Barbara Chardonnay in the \$1,200 to \$1,400 per ton range but demand softens significantly at price points higher than that. In the **interior regions**, Chardonnay crop levels generally look healthy except for Clarksburg and a few other localized areas hurt by the frost. There is still a small amount of tonnage available as harvest moves into full swing.

**Cabernet Sauvignon:** The **Napa Valley** Cabernet crop size is below average and it is mostly sold out. Prices have started out in the \$4,100 range, about twice last year's starting price. Napa Valley prices, of course, go up - sometimes way up - from there. While Alexander Valley Cabernet Sauvignon is mostly sold, there is still some tonnage available from other parts of **Sonoma County**. The crop level in Sonoma County as a whole is probably 15% below normal. Buyers are still active. **Mendocino, Lake and Suisun** have some Cabernet Sauvignon still available.

Poor set has reduced the Cabernet Sauvignon crop in the **Central Coast**. In Paso Robles the crop could be down from early estimates by as much as 40%. Demand has increased in the face of shortage and almost no fruit is currently left unsold. Prices climbed over the last few months as the shortage has become increasingly apparent. Cabernet is also light and demand strong in **Lodi**. The **Southern Interior** has an average or slightly above average Cabernet Sauvignon crop.

**Merlot:** Although the **North Coast** crop is below average due to shatter and smaller berries, Merlot is still available throughout the region and buying activity is slow. **Central Coast** Merlot yields are not down as much as Cabernet Sauvignon but they are down and demand is up. Paso Robles Merlot tonnages that sold last year at clean-up prices of \$200 per ton have sold this year at \$500 to \$950 per ton. **Lodi** Merlot is also light and demand is up. By contrast, the yield per acre is average or above in the **Southern Interior** but vineyard removals will probably keep the total tonnage down. Demand is strong.

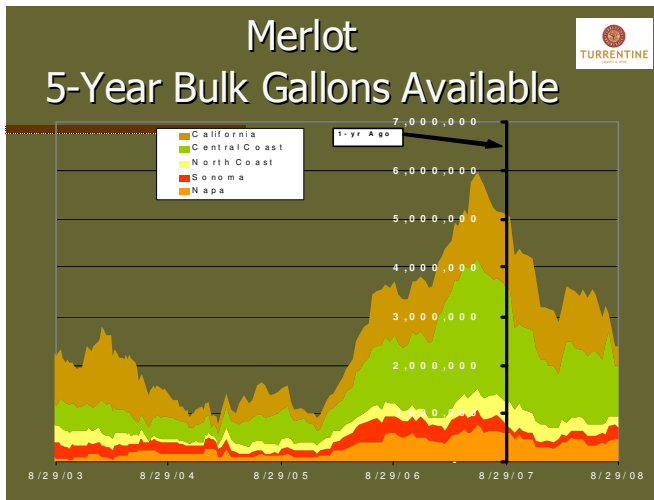
**Pinot Noir:** Although some early fields picked for sparkling wine were down an alarming 30% below average, later fields have been closer to projection, down about 10-15%. Although some brands have felt a slowdown in sales, particularly sales in high-end restaurants, demand for North Coast Pinot Noir grapes remains significantly greater than supply. **Central Coast** Pinot Noir from Santa Barbara County and Edna Valley in San Luis Obispo County is well above the light 2007 crop level. Some vineyards have come in 30 to 40% above earlier estimates. Very little of this bonus fruit, however, has made it onto the open market. In most cases, the contracted buyers have been more than happy to absorb any excess. Monterey Pinot Noir is also up from 2007 but shatter has reduced the amount of increase. In the **Interior Regions**, Delta Pinot Noir has come in light so far, but Lodi and the Central and Southern Interior regions have been at or above expectations.

**Sauvignon Blanc:** Sauvignon Blanc yields around the state appear to be average or below average, but demand has been soft.

## Wines in Bulk

The bulk wine market often takes a well-deserved rest during harvest, when there are more pressing matters afoot, so to speak. There is no rest for the wicked, however, and this year that seemed to

include not only those interested in **Pinot Noir** but even those needing **Cabernet Sauvignon**, which has been active all year as the market emerges from many years of excess into the beginnings of a shortage. The demand for Cabernet Sauvignon has also spilled over to good **red blenders** such as Petite Sirah and Syrah. **Pinot Grigio** demand is still strong but is already focused on 2008 juice and wine.



**Chardonnay and Merlot**, in contrast, have mostly settled down - after a busy year - for a good harvest nap. Russian River remains the strongest appellation for Chardonnay on the bulk market. Chardonnay from Monterey County and its sub-appellations has been active all year with wine still available. Santa Barbara County, Paso Robles, and Mendocino County Chardonnay have also strengthened but demand has continued to lag behind supply. Supply and demand from Lodi and the Interior regions have been relatively balanced. Merlot finally awoke from a coma this year, as the accompanying inventory graph shows.

**Sauvignon Blanc and Zinfandel** have been sleepy all year. We have 2006 and 2007 Zinfandel from most appellations still available. Early season demand for top quality Zinfandel was pretty much limited to Dry Creek. Even 2006 and 2007 Zinfandel bargains offered by motivated sellers to empty tanks for harvest stimulated little interest. Sauvignon Blanc also slumbered throughout the year, except for a few, small Russian River lots. Much of the 2007 Sauvignon Blanc finally found a home in the last few weeks, but at deeply discounted prices.

**Processing:**

Reduced bulk wine inventories and lower tonnage estimates have reduced the need for outside processing this year. The recent high temperatures during harvest, however, have hastened ripening and many varieties are becoming ripe at the same time. This has created some exploratory interest in processing.

Give us a call if you might need - or could supply - processing services. Also let us know if you have grape or wine needs, or grapes or wine for sale. The sooner you let us know, the better job we can do for you. Happy Harvest 2008!