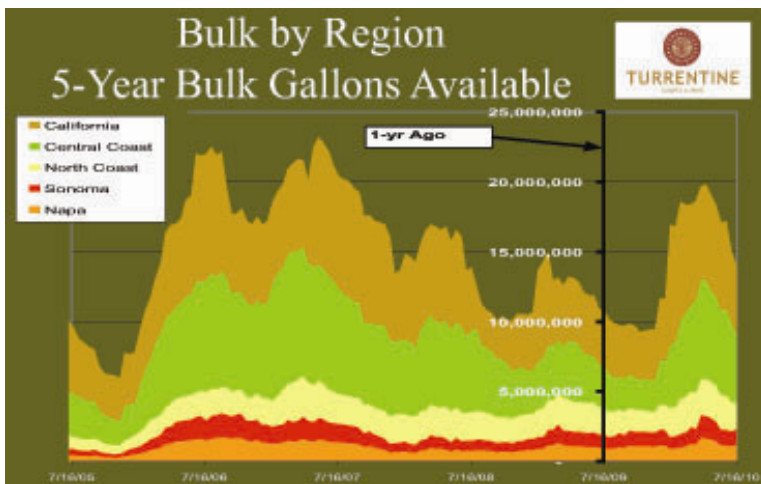




A Compelling Narrative

In a recent *New Yorker* cartoon, the psychiatrist tells the patient that happiness is out of the question, but that he can at least give him a compelling narrative for his misery. The 2010 harvest is rather like that for many areas and varieties. It is hard to promise happiness, especially at the high end, but at least we can supply a compelling narrative - and perhaps some hope for the future. Many different kinds of businesses across the country have been slowly and cautiously rebuilding inventories over the past several months, fueling a weak recovery. But wine grape growers and wineries have less control over inventories than most businesses. The 2008 harvest was blessedly light and the resulting reduction in inventories kept many wineries in balance with a slowing casegood market. But high-end sales in general - and restaurant sales in particular - remained slow and discount-dependent as the 2009 harvest came in at higher levels and pushed up inventories just as lenders and investors were increasing the pressure to reduce inventories. The relative volume of wine listed for sale in bulk is the best proxy available for variations in total industry inventories, bulk and bottled. As the chart below shows, wine listed for sale in bulk has swelled from about 11 million gallons last year at this time to about 14.5 million gallons now. It is important to remember, however, that that is still almost 40% less than the all-time high of May 2007 - and casegood sales have grown significantly since 2007.



Close to three and a half million gallons of that excess is Chardonnay, which makes it the variety in the most pain. Almost 50% of the excess Chardonnay comes from the Central Coast. Cabernet Sauvignon checks in with about two and half million gallons of excess and Cabernet has a significantly smaller base of casegood sales than Chardonnay. On the other hand, total Cabernet Sauvignon sales are still growing at a healthy clip. Cabernet, furthermore, is typically aged longer than Chardonnay and therefore requires an inventory of multiple

vintages. While high-end Cabernet is somewhat oversupplied because of consumers trading down, inexpensive Cabernet seems in balance both in California and internationally. Merlot clocks in with about two million gallons, perhaps not out of balance with total casegood volumes and demand, although there is more coastal Merlot than demand at sustainable prices. There is currently about 800,000 gallons of Pinot Noir on the bulk market, up from just 200,000 gallons last year and almost nothing the year before that. There is probably enough demand to swallow all the Pinot Noir on the market but at prices way below cost for most coastal producers. There are a few islands of hope. Muscat is hot, with demand exceeding supply both domestically and internationally. In a typical recession pattern, the least expensive items are relatively strong, including dry red and dry white wines and, at the very bottom of the bulk market, wine for distillation.

Bulk Market Review

After several slow months, our bulk wine team put in some long hours in July, and sold over 2,539,000 gallons of wine. It's a tough market - but it is better than no market at all. Experienced buyers have known that the approach of crush 2010 would put downward pressure on prices, and it has. And yet striking at the right moment requires a keen sense of timing. Those who wait too long run the risk of being stuck either with the bulk market dregs or being forced to bid against other tardy buyers for the remaining good quality lots whose owners have held out for higher prices.

Last minute purchases are more problematic in the grape market than in the bulk wine market because growers with grapes that do not have a home do not always continue to invest in the inputs necessary for the best quality. Buyers nevertheless are moving with glacial speed and the slow, chilly market seems to have influenced Mother Nature as well. At some point we expect to see both the market and the summer temperatures heat up and a vast quantity of grapes will get sold, delivered and crushed in a nanosecond or two. This is very tough on growers. It is also tough on winemakers. Not that anyone cares that much - after all, it is our job - but it's tough on brokers too. We just keep repeating to ourselves that a tough market is better than no market at all.

Chardonnay: Chardonnay continues to be a weak market and supply exceeds demand at all price points. We have moved some volumes recently at bargain prices, but there is still a substantial excess.

Cabernet Sauvignon: The value end of the market has been active all year and prices continue to be stable in \$5.25 to \$6.00 range for both Interior region and some Central Coast Cabernet Sauvignon. The 2008 vintage is mostly long gone in this price range and activity is focused on 2009. At higher price points, the few buyers are still mostly looking for high quality Napa Valley wines from the short 2008 vintage, which remain hard to find. There is an abundance of 2009 Cabernet Sauvignon from all premium regions.

Pinot Noir: Just 18 months ago, we would typically sell a new lot of Pinot Noir the same day we received the samples. There have now, however, been some lots of Pinot Noir on the market since December that have received no offers. There is still demand for Pinot Noir but the demand comes from bargain brands. With many lots from which to choose, quality standards are up and prices are down. We have made recent sales of Interior appellation Pinot Noir at less than \$5.50 per gallon. We moved some lots of Central Coast Pinot Noir in the low teens, but there is still a substantial volume available from the coast and recent offers have been at lower prices.

Merlot: In the last few weeks we have moved good volumes of California and Central Coast Merlot inventory at the lower end and inventories have decreased as a result. Higher priced inventory, however, is very slow.

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