

TURRENTINE



Market Update
April 22, 2019 | Telephone: 415.209.9463

2018 CRUSH REPORT TOP 5 TAKEAWAYS

April 10th came and went, and we can now close the book on the 2018 vintage... or can we? The total California winegrape crop proved to be a record 4.282 million tons, but in typical Turrentine fashion, we feel it is important to take a deeper dive into these numbers for more in-depth analysis.

	Tons Crushed 2018	Tons Crushed 2017	Net Gain/Loss	Equivalent Gallons	Percent	Percent Change vs. 5-Year Avg.
North Coast	612,833	482,509	130,324	21,503,000	27%	20%
Central Coast	578,453	540,727	37,725	6,225,000	7%	12%
Northern Interior	1,107,542	976,217	131,325	21,669,000	13%	17%
Southern Interior	1,953,992	1,978,607	(24,616)	(4,062,000)	-1%	-1%

ONE

AS EXPECTED, RECORD CROP (Especially for Cabernet Sauvignon and Pinot Noir)

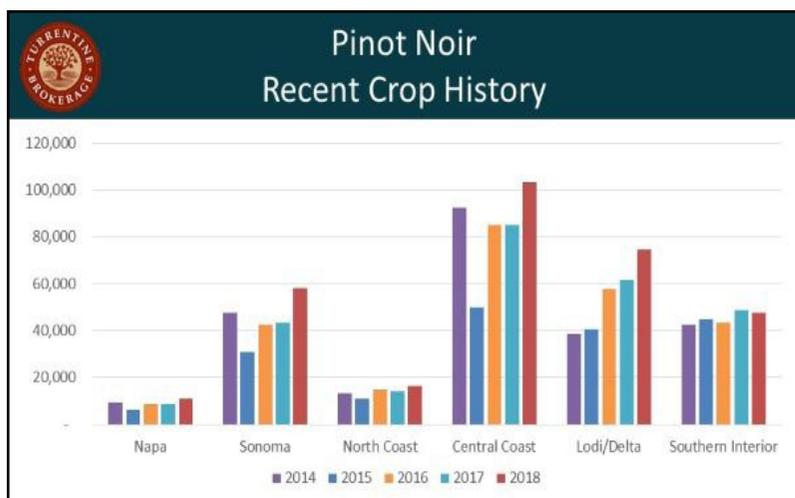
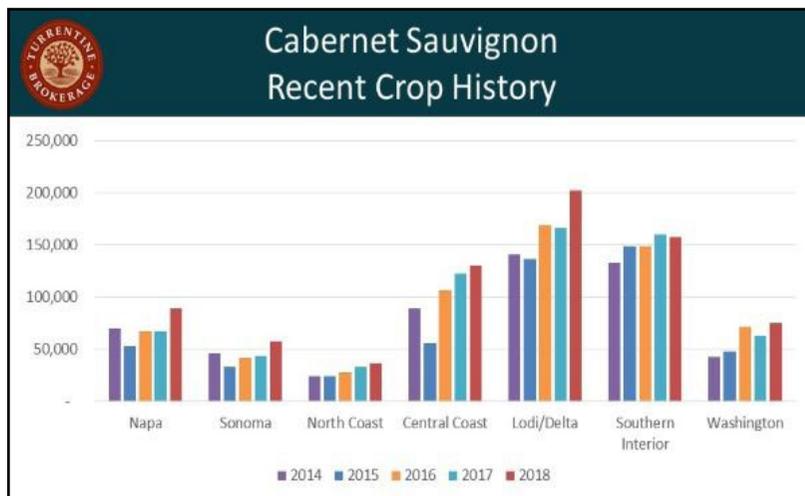
The 2018 crop size edged out 2013 by just 37,000 tons following a tremendous 2018 growing season. To put this in perspective, that is the equivalent to California's Chenin Blanc harvest last year, or Burger from a decade ago. So why does this feel so much larger than it did in 2013?

Articles and industry presentations over the last several months have outlined the issue of slowing retail sales growth and higher inventory levels of wineries, so we won't dwell on that here. The second primary contributor is the planting wave that began in earnest in 2012 and began to slow in 2017 throughout coastal regions and the northern interior. The two varieties planted the most? Cabernet Sauvignon and Pinot Noir. The last main contributor was the excellent growing season in 2018 which spurred high yields per acre.

A new tons crushed record was set in nearly every major Cabernet Sauvignon growing region last year including Lodi, south of Lodi in District 12, Napa Valley, Sonoma County, Paso Robles, Lake County and Mendocino County. In an article written in May of 2018, we wrote:

"The desire for wineries to grow and develop Cabernet Sauvignon brands between \$9.00 and \$20.00 per bottle has created a fierce environment... In California the total bearing acres of Cabernet Sauvignon have increased nearly 40%. If one analyzes the primary regions that are used to source a \$9.00 to \$20.00 per bottle brand in California, namely Lodi, Paso Robles, Lake County, Mendocino County, as well as adding the additional acreage in Washington State, the increase is an astounding 54%, or 8.6 million cases of wine that needs to be consumed annually."

For Napa Valley, in particular, there was an assumption by some that the region was fully planted and that could equate to a cap on production of Cabernet Sauvignon. In reality, new Cabernet acres were developed, older acres were redeveloped, and additional acres were transitioned from less profitable varieties. These acres have been planted to higher densities with better rootstocks, clones and trellises resulting in a greater yields per acre and now a larger total potential supply each year for at least the next few years.



Similar to Cabernet Sauvignon, Pinot Noir produced record tonnages in Sonoma County, Monterey County (a near record in Santa Barbara/San Luis Obispo), and throughout Lodi and the Delta as a result of new acres and better yields per acre. In previous years, perhaps one or two regions would be large, but it is quite rare to have such a bountiful harvest from all major growing regions across the state.

So why does this harvest seem to be so much larger than the 2013 harvest? One reason was that the crop was significantly larger for the most in demand varieties, which has slowed bulk wine and grape markets in 2019. Another reason, the growth rate of the California crop size over the last five years is 2.4%. The issue that we are facing now lies with the growth rate over the same time period for casegood shipments. California wine to the US market has grown at 2.0% over this time, but exports have dropped 11.1% which brings the total shipment growth from California to just 1.3%.

So are we able to close the book on 2018? Not yet. The growth from new acres and great yields per acre in 2018 mean quite a large amount of wine will need to make its way into a shopping cart for Cabernet Sauvignon, Pinot Noir and a number of other varieties, and inventories are already backed up. If they haven't yet already, wineries will need to look beyond selling in bulk to balance inventory as described in quadrants two and three of the Turrentine Wheel for excess supply. Historically, this has meant innovation and discounting price and we expect the same this time through the cycle.

	CA Winegrape Crop Size	Shipments of CA Wine to US Market (9L Cases)	Export Shipments of CA Wine (9L Cases)	Total Shipments of CA Wine (9L Cases)
2014	3,894,397	376,500,000	24,664,300	401,164,300
2015	3,705,320	387,700,000	24,594,000	412,294,000
2016	4,031,571	397,500,000	21,317,300	418,817,300
2017	4,015,792	403,300,000	17,836,900	421,136,900
2018	4,281,684	407,200,000	15,376,700	422,576,700
CAGR 2014-2018	2.4%	2.0%	-11.1%	1.3%

Source: NASS Grape Crush Report and The Gomberg Fredrikson Report

TWO

CHARDONNAY - RELATIVELY LARGE HARVEST ON EXISTING ACRES

Of the most popular varietals, Chardonnay was among the few, in recent vintages, to not be planted in considerable quantities. On the contrary, total bearing acres of Chardonnay continue to slowly increase just above replacement levels for most regions of California.

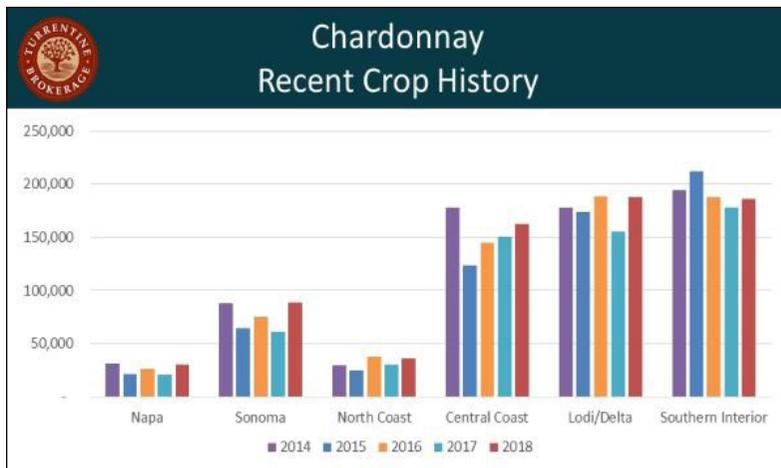
There was a sizeable increase in 2018 over the 2017 harvest in a few key areas of the state

including Sonoma County, Lodi, the Delta, and to a lesser extent, Monterey County. In many cases, the 2018 tons crushed were not in groundbreaking territory. Chardonnay supply is still somewhat abundant, but the surplus is not structural due to the very modest levels of planting.

Throughout most of the world, value Chardonnay is in balance. The 2019 crop in Australia, Chile and South Africa are below the long-term average. As a result of the shorter crop there is more interest from the value-end wine producers in current and past vintage bulk wine from both California and Washington.

Chardonnay supply currently is more dependent on crop size than the other major varietals. There is also more vintage release flexibility than other whites which can moderate demand for any single vintage.

Looking forward, Chardonnay supply seems to be more in-balance, especially when compared to Cabernet Sauvignon and Pinot Noir. There will still be an additional challenge for 2018 wines due to the larger harvest, similar to 2015 following the three large harvests between 2012 and 2014 in many of the primary regions to grow Chardonnay.

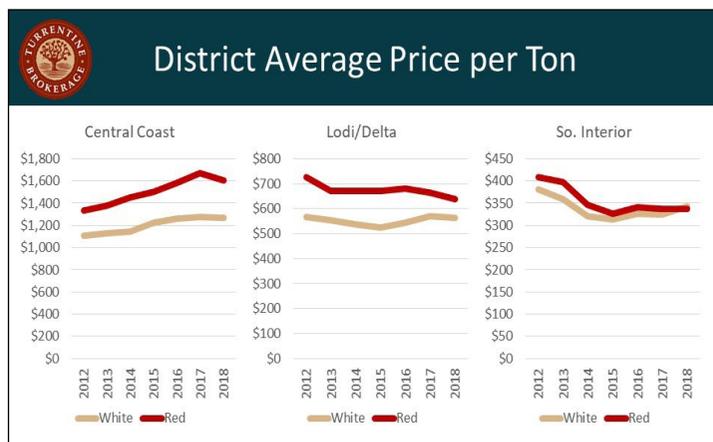
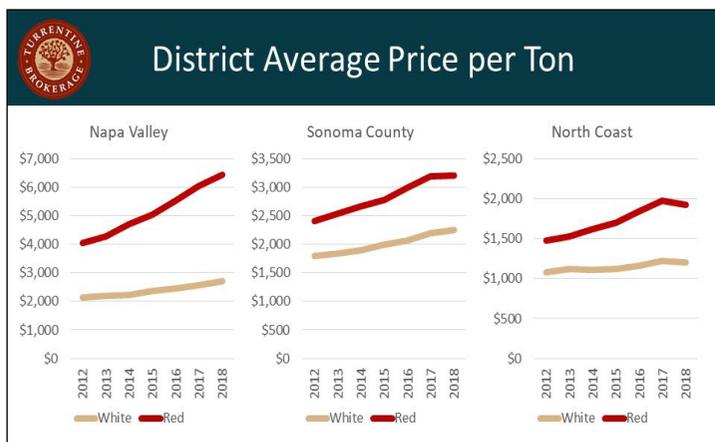


Source: NASS Grape Crush Report

THREE

PRICE DEACCELERATION

We have advised, presented, and written about transitional markets for two years now. In general, both spot market and district average prices have come off their upward trajectory and, in some cases, decreased, as seen in the district average price per ton graph.



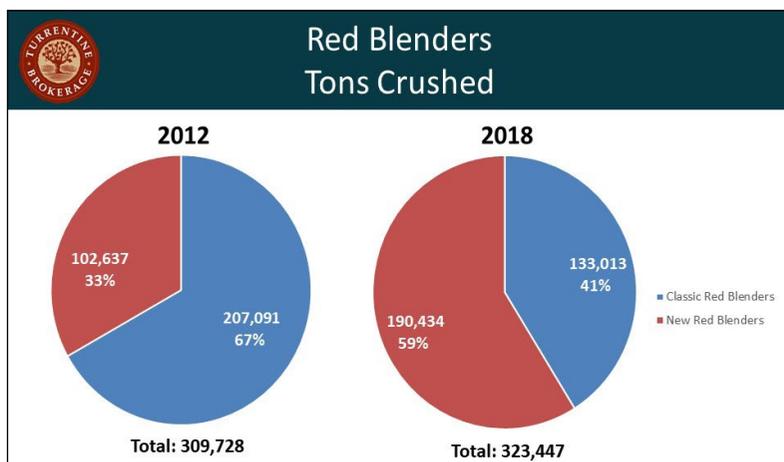
Source: NASS Grape Crush Report

Napa Valley supply and pricing is heavily weighted towards Cabernet Sauvignon which increased another 5% in 2018 to \$7,844 per ton. District average prices, while being an effective indicator for cost of goods, can be a misleading barometer for the market in that season. These district average prices are comprised of many multi-year contracts, some of which are indexed to the previous year's district average price, which inherently makes it slow to react to spot market fluctuations. Often-times, the Turrentine Spot Market Prices are more reflective of a given market, and while the district average price suggests that prices are continuing to escalate, it became clear in 2018 that demand had softened and spot market prices actually began to drop. To intensify the challenge of escalating price, over 40% of the Napa Valley Cabernet Sauvignon tons sold last year were for over \$8,000 per ton. With a record harvest in 2018, this creates a further increase in the volume of luxury wine that must be sold at a price that can still provide a profit margin to the winery. It is going to be a challenge for spot market grape prices to continue to escalate until global retail sales of Napa Valley Cabernet Sauvignon grow to the point that grapes become short again.

Since the 2018 California statewide crop was, in large part, a function of increased acreage, prices are less likely to increase in the near future. For prices to again begin to increase substantially, sales of high-end bottled wine will need to continue to grow to surpass the production brought on by the increased acreage, and/or the state will need a lighter harvest in 2019, and even then, it may not be enough to stimulate additional short-term demand depending on the severity of a diminished crop size. Vineyards throughout the state that are unable to meet quality standards in terms of yield, financial return, or the confidence from wineries that the grapes will ripen are starting to be redeveloped, especially in Paso Robles and Zinfandel vineyards in Lodi.

FOUR CHANGING OF THE GUARD FOR RED BLENDERS

In 2012, we released an article acknowledging the growing segment of premium red blends. At that time, we classified classic red blenders as Barbera, Carignane, Grenache and Ruby Cabernet. Leading the charge for the young, rowdy, and bold new premium red blenders were Petite Sirah, Petit Verdot, and Malbec. More recently, Teroldego has joined the party.



Source: NASS Grape Crush Report

Six years ago, two-thirds of the total tons from these varieties were the old-timers. Today, tons crushed weighs more heavily for the new premium red blenders at nearly 60%. Meanwhile, total tons crushed for all of these varieties has increased from 310k in 2012 to nearly 355k in 2018. What this means is that there is plenty of supply to fuel growth of red blends and to use as a blender for Cabernet Sauvignon or other varieties as a quality enhancer. This has placed downward pressure on other varieties including Zinfandel, Merlot, and the aforementioned classic red blenders. Lower prices have stimulated some additional interest. On the positive side for value red blenders, there has been winery demand for wines between \$2.00 to \$3.50 per gallon for a year or more, showing some balance to that market and that perhaps enough acres have been removed. There will still be the challenge for a sustainable financial return for the grower at those prices though.

FIVE

ABOVE \$10 PER BOTTLE

Following the 2015 California Grape Crush Report, we wrote:

“Virtually all attention from the industry has been in growing existing brands or developing new brands above \$10.00 per bottle. Rightly so, consumer sales are promising in that category. The increased focus of wineries to create brands at higher price points should be met with cautious optimism moving forward as the consumer will have plenty of choices to satisfy their palate.”

Three years later, it is safe to say that the industry should be more cautious in their sales growth plans now that consumers have a variety of choices on the retail shelves. In the last few years, we have highlighted the effects of better vineyard and winemaking technology which has led to wines from a larger area that are able to meet the increased standards of consumers above \$10.00 per bottle. A large number of the recent acres were planted with these above \$10.00 per bottle intentions. According to Nielsen Total US xAOC+Conv+Military+Liquor Plus as of January 26th 2019, just 22% of wines sold over the last year are above \$11.00 per bottle. If we can make the assumption that all coastal regions and roughly half of the northern interior is suitable for \$11.00 per bottle and above, that equates to 41% of California tons crushed in 2018 that can make wines for this price point. There are bound to be winners and losers as the industry moves wine to the consumer. The looming challenge will be to sell wine in a timely fashion at the intended price point. Wineries that are able to do this without discounting will flex their position of strength, but many may need to discount in order undercut competition.

The 2018 harvest was a record in Napa, Sonoma,

the North Coast regions of Lake and Mendocino County, and the Lodi/Delta. The southern interior didn't have a particularly large harvest to speak of, and there were unsold tons that weren't crushed in the Central Coast and North Coast due supply exceeding demand and/or quality concerns. It is difficult to estimate with any certainty what the crop size could have been had everything been crushed, but this is a sign of the times changing.

The wine business is constantly moving through the supply cycles, sometimes slowly and other times quickly. History has a way of repeating itself even if consumer preferences and economic factors are different. We have moved past market balance and are now looking at an emerging excess. It is valuable to have the most current market information from our brokers on your individual position in the market and possible opportunities. During this time of the cycle, we can expect shorter-term supply contracts and prices to remain lower than just a year or two ago. Additional plantings will continue to slow, and the consumer will see an expanding selection of wine at bargain prices. Wineries will also see an expanded selection of grapes and bulk wine, and with increased options come higher quality standards. Grapes from vineyards not in the sought-after areas or from older blocks where a buyer has less confidence in the grapes meeting current standards are likely to be available and may see offers at lower prices. Bulk wine with flaws or that needs a lot of additional work to correct color or oak profile will have less interest and sell for lower prices. We have already witnessed many of these indicators over the last year or two, but the intensity of each is likely to increase for some time until retail casegood growth again outpaces the growth in supply. This current market is one of opportunity. Call your broker early for a more personalized market update and we can work together towards your success in 2019.

For more information on the Turrentine Wine Business Wheel of Fortune, please visit our website at <http://www.turrentinebrokerage.com/wine-wheel/>. This has proven to be a valuable tool over the last 23 years which can assist, with the help of our brokers, in forecasting changes and utilizing the market correctly.

Turrentine on the Road

VIINEYARD ECONOMIC SYMPOSIUM MAY 8

Napa

Daniel Tugaw will be attending this premier conference covering vineyard economic and financial issues.



BULK WINE market opportunities

AVAILABLE

- +2018 North Coast Sauvignon Blanc: 16 lots, 115,000 gallons
- +2018 Sonoma County Sauvignon Blanc: 23 lots, 187,000 gallons
- +2018 Sonoma County Chardonnay: 53 lots, 634,000 gallons
- +2017 California Cabernet Sauvignon: 36 lots, 734,000 gallons
- +Napa Valley Cabernet Sauvignon: 158 lots, 774,000 gallons
- +2018 Sonoma County Pinot Noir: 36 lots, 477,000 gallons
- +Central Coast Pinot Noir: 74 lots, various sizes, appellations & vintages
- +Central Coast Chardonnay: 62 lots, various sizes, appellations & vintages
- +Dark Red Blenders: many options from all areas
- +Whiskey & Brandy, High Proof

GRAPE market opportunities

AVAILABLE

+Napa Valley Cabernet Sauvignon: truckload quantities

+Russian River Pinot Noir: truckload quantities

+Westside Paso Robles Cabernet Sauvignon: truckload quantities

+Westside Paso Robles Syrah: small lots

+Westside Paso Robles Zinfandel

+Westside Paso Robles Grenache

+Monterey County Chardonnay

+Contra Costa Hillside Mourvedre

+Contra Costa Hillside small quantities of Obscure Whites

+Lodi Old Vine Zinfandel

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