

October 2018 Cabernet Sauvignon in Focus

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Wine Sales +3%

IRI-Off Premise -1%

DIC Shipments +14%

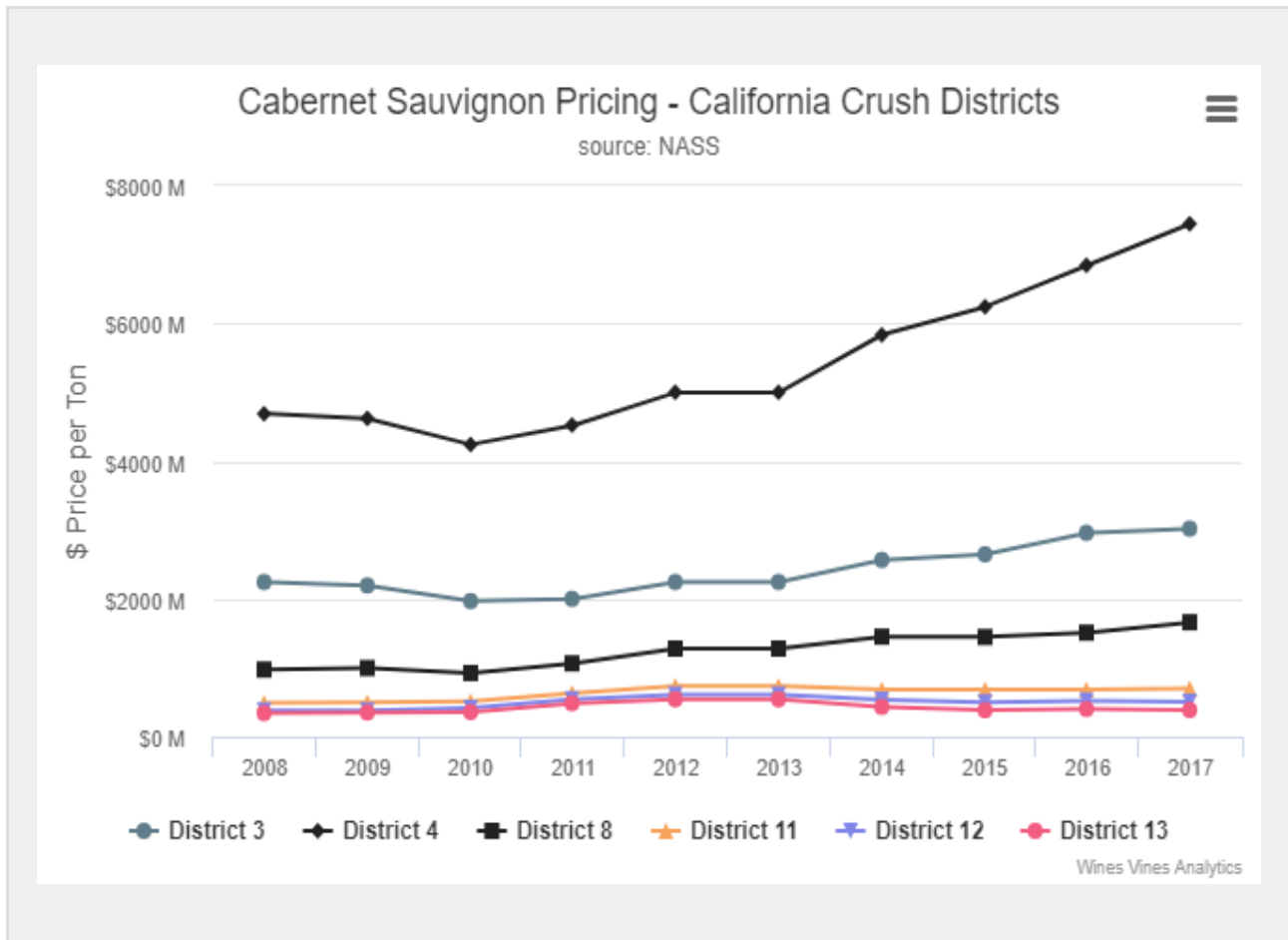
Winery Jobs +1%

Cabernet Sauvignon continues to fetch the highest prices in the grape market, and the varietal is a strong performer in off-premise and direct-to-consumer wine sales. Expectations of many more years of strong sales led to a surge in new vineyard acreage in California, and the red grape is soon expected to overtake Chardonnay as California's most planted variety. Yet the 2018 harvest brought changes to the wine and grape market that could mean even Cabernet may face challenges in the near term.

Cabernet Remains at the Top

In 2008, the average per ton price for Napa County Cabernet Sauvignon was \$4,689 and at that point Napa's average was already about twice as much as Sonoma County, the home of California's next highest priced Cabernet.

After a small dip following the Recession, Napa County's Cabernet prices continued to increase to nearly \$7,500, which is more than double the average for Sonoma County Cabernet grapes. The rise in grape prices has been largely fueled by the ongoing trend of premiumization in which U.S. wine consumers have been purchasing more expensive wines. Napa County Cabernet is also a leader in the direct-to-consumer (DtC) channel where Napa accounts for \$1.3 billion worth of shipments and Cabernet represents the lion's share of those shipments.



According to some of the latest Wine Industry Metrics by Wines Vines Analytics, Cabernet Sauvignon is the most valuable varietal shipped DtC in the last 12 months at \$809 million on a volume of 984,046 cases. The varietal also enjoyed a robust 9% increase in DtC shipment value and that's on top of the largest share of all shipments. In off-premise sales, Chardonnay remains the overall leader but Cabernet is a close second at \$1.8 billion in the 52 weeks ending July 2018. Cabernet's sales growth rate of 5% well surpassed Chardonnay's 1% sales growth.

"It's kinda been the best of both worlds, prices have been increasing and shipments have been increasing," said Jeff Bitter, president of Fresno, Calif.-based Allied Grape Growers that represents more than 600 growers throughout California.

He said much of California's Cabernet crop is contracted and those agreements — put together when demand was strong and supply limited, especially in the North Coast — have buoyed Cabernet prices. "Those contracts, which I think are pretty common out there in those areas will keep prices up," he said.

With prices up, demand has shifted to other areas in California, but Bitter said that shift hasn't delivered significant price increases to those areas. "I don't think that's served to raise prices in other areas of the state," Bitter said. "The supply has been available and the pricing is lower."

As that sourcing shifted, new Cabernet acreage in places such as Lake County and Paso Robles has come online to meet that demand and that has also held prices in check.

If there's one segment of the market where even Cabernet struggles, it's at the lowest tier of the market. "We're not selling \$5 Cabernet," Bitter said.

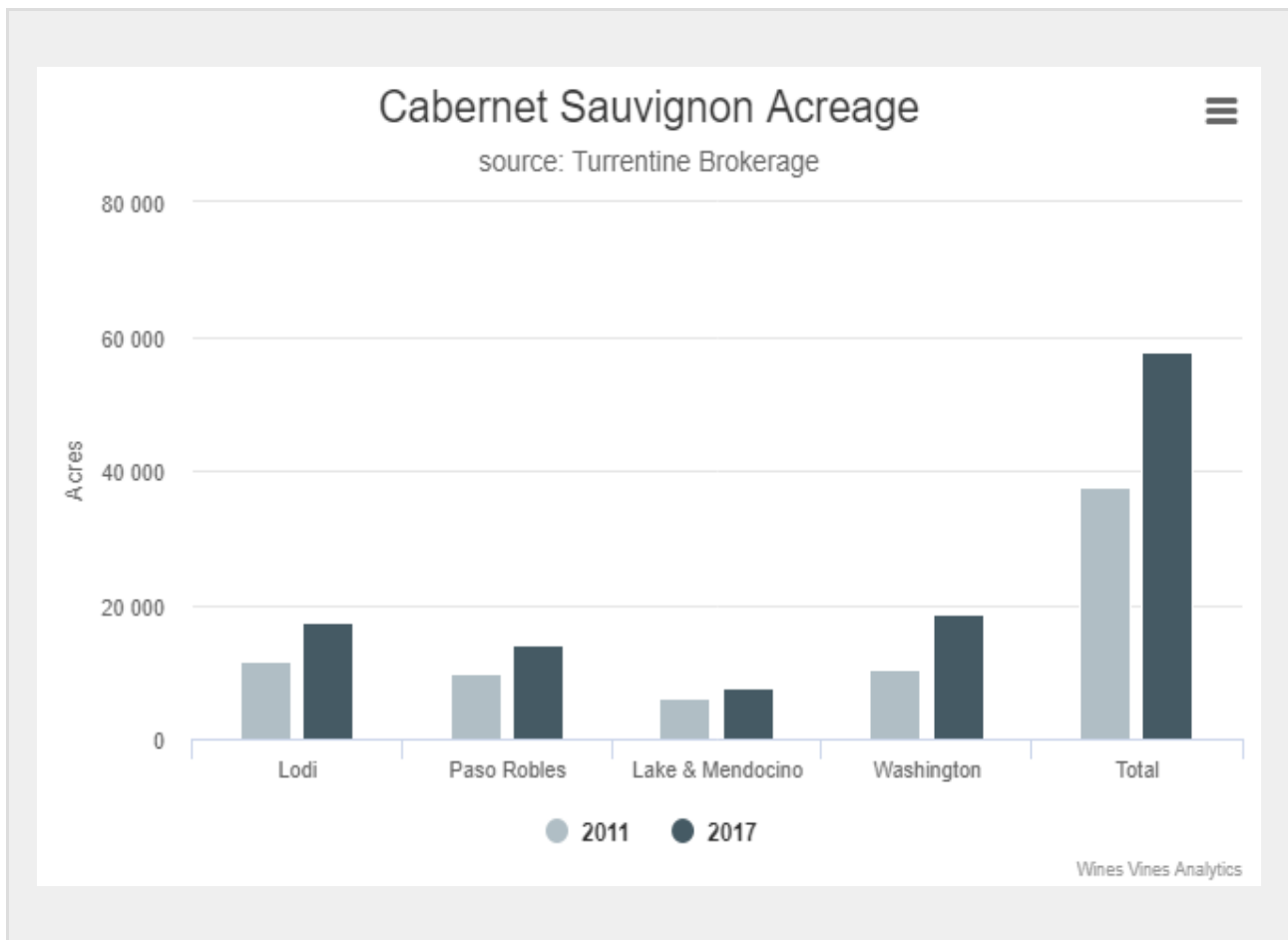
Vineyards that had supplied budget-priced bottled wine continue to be pulled out of the ground in California's interior valleys as growers there see much better prospects with nuts or dark color blender varieties such as Teroldego.

Despite reduced Cabernet acreage there, Bitter sees the variety soon outpacing Chardonnay as California's top planted wine grape overall. Cabernet nearly overcame Chardonnay in the 2017 vintage as the Chardonnay crop had run slightly smaller than average. With Cabernet being the most planted variety for the past five to six years it should exceed Chardonnay relatively soon. "In the midst of all of this what we do see is buyers that are still bullish on Cab as a variety," Bitter said. "They're looking for areas to control cost, move appellation or blend in different regions."

Planting to Ride the Cabernet Wave

Throughout the coastal regions of California and in some of the interior valleys, growers have continued to plant more Cabernet Sauvignon or switch over vineyards to avoid the opportunity cost of not growing Cabernet. According to Novato, Calif.-based wine and grape brokerage Turrentine, new Cabernet acreage in the Lodi and Paso Robles AVAs, Lake and Mendocino counties and Washington state totals nearly 60,000 acres since 2011.

Much of this new acreage is expected to support wineries and brands that have had to seek new sources of supply for Cabernet as the average prices in Napa, Sonoma and other premium areas of the North Coast of California have steadily marched upward. While new acres have been developed and brands have had to migrate to other appellations, those trends are not readily apparent in average prices for Cabernet.



Opportunities and challenges in Lodi

The Lodi AVA is one region where growers had hoped to take advantage of wineries developing California appellation Cabs at higher price points. Yet while the average price per ton for Sonoma County Cabernet has increased by about \$1,000 from 2011 to 2017, the average price for Lodi Cabernet remained relatively flat at \$700 during the same period.

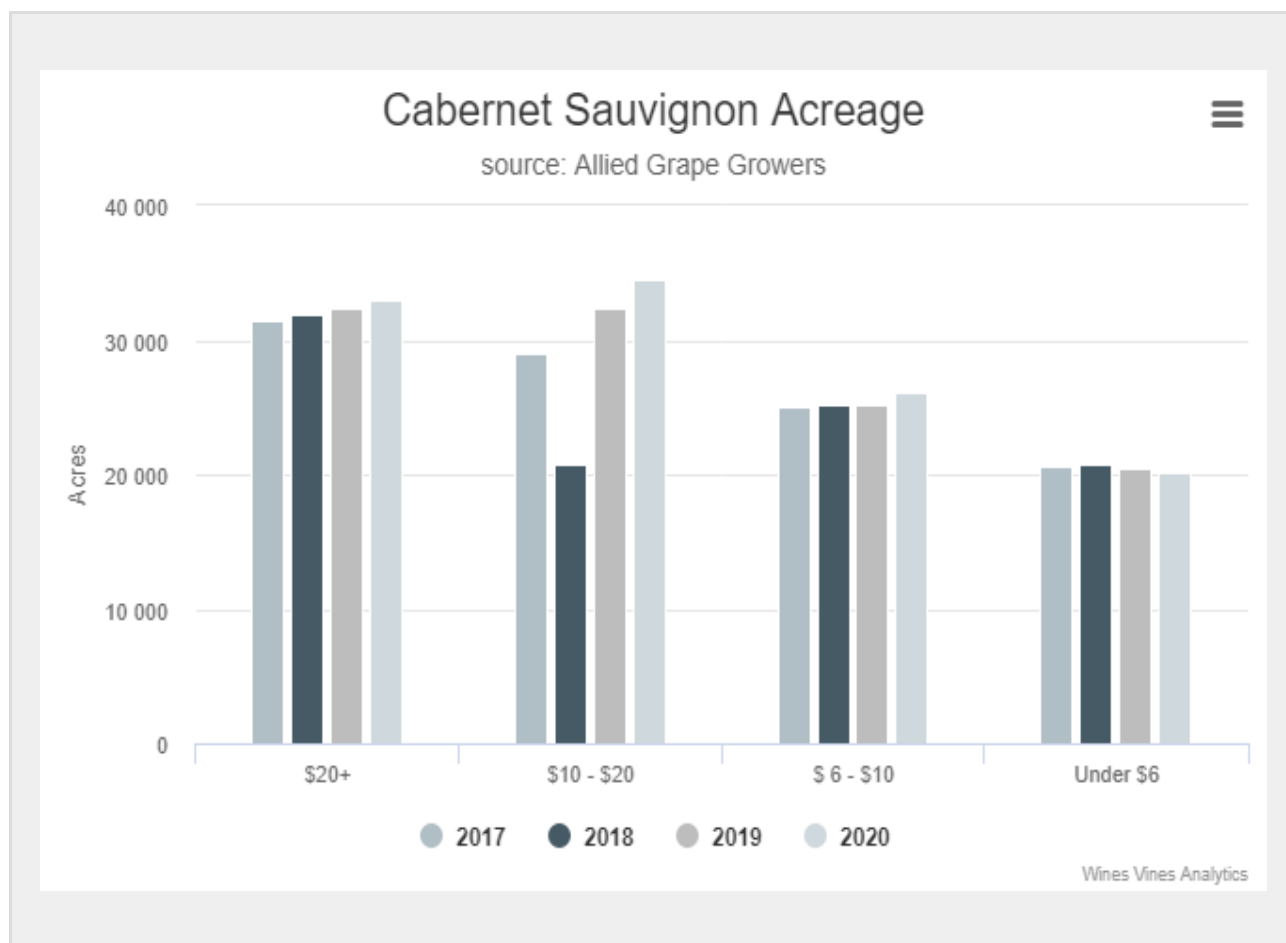
That average isn't reflective of the entire Lodi market, said Stuart Spencer, executive director of the Lodi Winegrape Commission who noted there's been significant new Cabernet acres planted in the area in the last five to six years. Lodi growers still rely heavily on purchases by the largest wine companies that are buying tons in such volume that growers can accept prices closer to the district's average. "We are seeing that and the challenge for Lodi, as for a lot of places large wine companies buy a lot of grapes, it influences the average," he said.

But he said the spread in prices paid for Lodi Cabernet has widened as some growers have been able to find customers looking to produce wines in the \$18 to \$20 range and will pay a higher per ton price to support a higher quality product. Those types of clients likely aren't buying in as much volume and expect more work on the part of the grower to ensure the grapes meet the expected quality parameters.

"The other thing we see is the increase in pricing for Cabernet on the coast opening up opportunities for Lodi," Spencer said. This could also include California AVA products as well

as Lodi AVA brands, which have enjoyed some sales growth in the wider U.S. retail market and is the “most exciting” development for the Lodi industry. The large volume buyer, however, will continue to remain a key pillar of support for growers for the foreseeable future. “It absolutely is going to be a factor, with the volume of grapes we grow in Lodi you can’t ignore the production side of the business.”

Spencer said higher prices are available if growers are willing to take the time and make the investment. Farming costs in general have to be maintained in light of rising labor and other costs while every grower has to carefully consider redevelopment and how to be best positioned three to five years from now in what, Spencer said, feels to many growers like a changing market heading toward excess supply.



In Paso, A Warning of Oversupply?

In Paso Robles and the rest of the Central Coast, the market appears to have already shifted. Speaking to the Insider in late September, Turrentine’s Central Coast broker Audra Cooper said 2018 appears to be another large harvest and is hitting with significant new acreage coming online.

The result has been a drop in the demand and prices for any grapes on the open market in 2018. She said some of the drop in demand has been from wineries that have not seen sales match projections and lowered expectations and grape needs through 2020. “That said

Cabernet sales haven't slowed entirely," and the variety is still a leader in Paso Robles where the average price of \$1,660 was behind only Sonoma and Napa. Cooper said niche or high quality Cabernet was still fetching strong prices but it was very dependent on quality.

Paso and the Central Coast have been sources for North Coast wineries and other major producers selling California Cab brands for several years, and Cooper said higher prices in the North Coast regions haven't been a force in the market most recently.

Bitter said Paso Robles is different than other premium Cab regions in that it has more uncontracted grapes, possibly as much as 10% or higher, that account for its total crop. That means the region is more affected by the dynamics of the spot market, which has not been in Paso's favor this year.

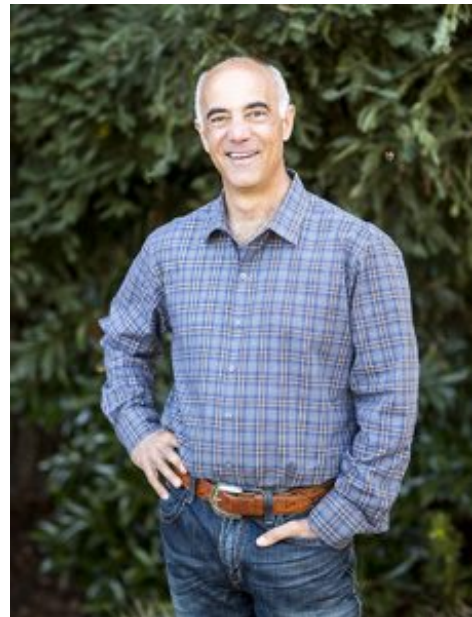
Many of the new Cabernet vineyards in Paso, particularly the region's Eastside, have been backed by large institutional investors that leverage the deep resources of entities such as the endowments of major universities. Grapes from such vineyards may struggle to find good prices this year, but that could change over the long term. "Maybe we got ahead of ourselves a little bit but maybe longer term that's the right strategy," Bitter said.

Executive Q&A: Alex Ryan, president and CEO Duckhorn Wine Co.

Duckhorn Wine Co. of St. Helena is a believer in Cabernet Sauvignon. It has produced the varietal every year but one since 1978, and now farms 200 acres of the grape in Napa and Sonoma county as well as Red Mountain in Washington state. Tonnage has increased more than 300% in the past five years, supporting the growth of 15 offerings that retail for between \$25 and \$135 a bottle. These include the entry-level Decoy brand from Sonoma (about 210,000 cases), Canvasback from Washington (10,000-plus cases), three Paraduxx blends and nine estate bottlings from Duckhorn (50,000 cases). Duckhorn president and CEO Alex Ryan shares his thoughts on the variety's future.

Q: Tell me about your current offerings of Cabernet Sauvignon and how the portfolio has evolved since Duckhorn first produced the varietal in 1978.

Ryan: We've moved into a series of smaller, vineyard-designated estate bottlings of Cabernet over the years, giving our DtC (direct-to-consumer) customers something special and unique. Decoy has been a fascinating, lower-end luxury-tier success for us at \$25 a bottle. We've now



Alex Ryan is the president and CEO of Duckhorn Wine Co.

moved into the Red Mountain area of Washington with Canvasback, and it's exciting. Washington will ultimately be a huge competitor to Napa Valley, and defined as a great producer of Cabernet Sauvignon.

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Q: Which channels are most important for distribution and sales?

Ryan: The general distribution blend for our company across all channels is roughly 85% wholesale and about 15% direct to consumer. Of that 15%, roughly 40% is purchased by our club members, about 40% is purchased at our individual tasting rooms, and then about 20% is generally an online purchase. Decoy might be more 90-10, weighted to wholesale, while the smaller, vineyard-designate bottlings, are probably almost 100% DtC. Canvasback is still relatively small, but we'd like to see it be accepted on a national basis so it's probably more in line with our general winery distribution of 85% distribution and 15% direct to consumer."

Q: Canvasback's broad availability at retail initially surprised me. What was the thinking around making a relatively limited production wine so widely available in a competitive market?

Ryan: We fell in love with Washington state because they make a unique style of Cabernet, and we wanted our portfolio to be part of it. The data indicates there's a lot of opportunity for Washington-driven, high-end luxury-tier Cabernet in the U.S. domestic market. There are a lot of great ones out there, but they're small and they're probably largely DtC and probably haven't permeated the entire country, let alone the world. That's a huge opportunity for the varietal Cabernet and Washington, and we want to be at the forefront. So we're putting Canvasback in a wider distribution net than we might otherwise for, say, a California-branded Cabernet.

Q: What, then, are the opportunities in today's market for Cabernet from California?

Ryan: Cabernet is still king, and we feel there's a lot of room for growth. A lot of other regions are really trying to hone themselves in – Napa and Sonoma (kinda obvious), a number of other regions in California, Washington State (as we've discussed).

The question is, how are these people going to access it? The rest of the world wants to taste Cabernet and they're going to have to figure out how they can find it. We just have to be honest: you're asked to pay a lot of money for a great Cabernet, and so you've got to really believe in the wine or the brand, and I think there's a certain population that enjoys that, is willing to do that. But for the next group, how do we get them to be Cab devotees? DtC data confirms that people are seeking out Cabernet, and we feel it will ultimately become a function of price and access.

We're trying to own the mid-tier luxury price point. Decoy, a named brand from a named appellation at \$25 which over-delivers, has been really, really successful for us. The next move is Canvasback at a \$40 retail price but something less than a \$100 wine list price. Wine lists

are starting to see a little hole built between \$85 and \$100 for a named brand, high-quality, over-delivering Cabernet. We think there's a lot of opportunity there and Canvasback is going to be a natural fit.

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Our goal is to work them up the price channel, and we've done that, I think, successfully. The marketing between Decoy, through Canvasback, through Duckhorn is a natural migration up the price scale to more fun wines, interesting wines, wines of more specific terroir. We've given them a roadmap and it's worked out really well. You've got to over-deliver in the style and the quality. That's ultimately the hook for the consumer.

Q: How are grape prices influencing retail prices, especially in a market where consumers are willing to trade up but not necessarily willing to break the bank?

Ryan: Prices are more moderate in places like Washington and throughout California, including places like Sonoma. Cabernet in Napa beats to the sound of its own drum. There's a lot of high-quality brands in the world, so our ability to make it up in the retail market is very difficult. We have to pick our price point carefully, put a lot of marketing behind and sell one bottle at a time. It's difficult for us to raise prices significantly, especially on more commercially generated wines, so we're careful about that. It's put some pressure on us, and that's not unlike anyone else in the market.

The thrust of change from a multi-varietal county called Napa to really a Cab-dominated market is going to be interesting. People have been radically replanting and we're seeing a large crop in the current vintage. How that plays out will be very interesting, because it's been a runaway train for the last five years on price and popularity.

I think if you asked most Napa people, they're still betting on Cabernet but there's quite a bit of it around, so it could be a boon for the consumer. It might raise a lot of boats of interest in Napa Cabernet and make a little more availability, and that could be a good thing on a long-term basis. We're going to hold our course.

Latest Metrics: Wine Sales Led by Value Increases

San Rafael, Calif.—September saw 3% growth in the value of U.S. wine sales, as consumers traded up in value while paring back on volume. The trend appeared across multiple channels, underscoring the strength of the economy.

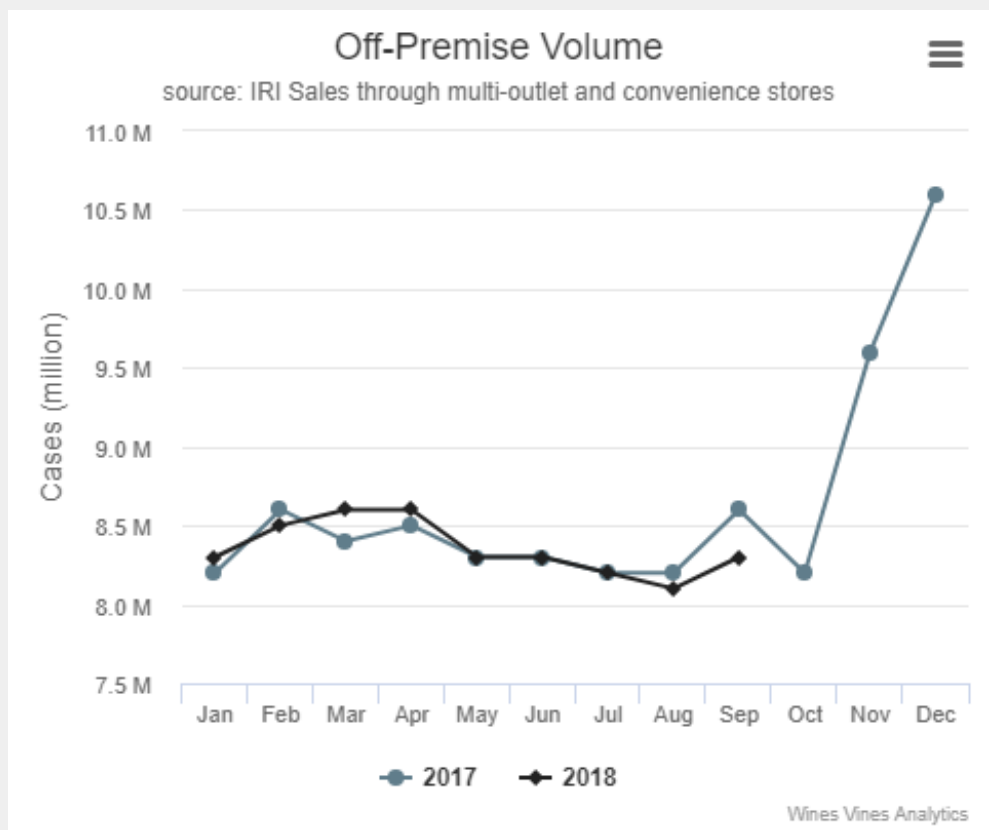
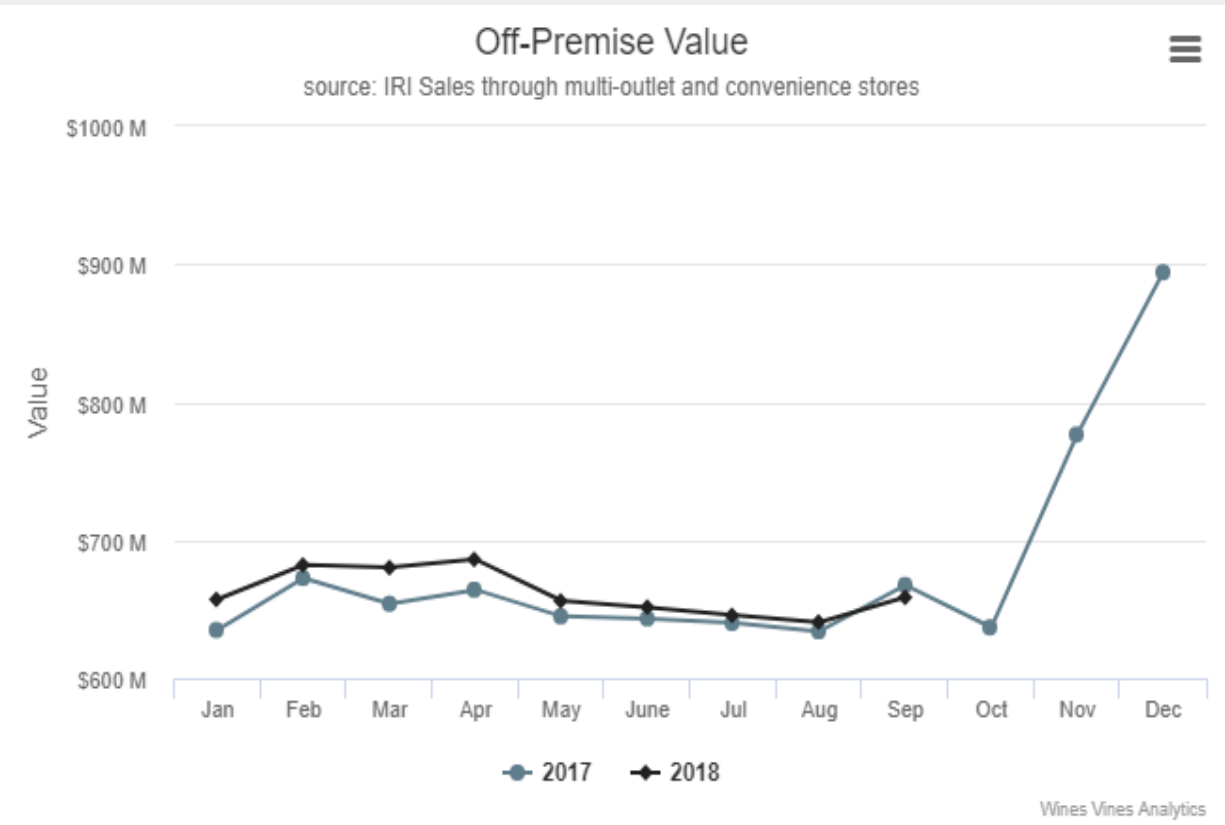
Direct-to-consumer (DtC) shipments posted the strongest growth in September, driven by the arrival of the cooler weather that invites shipping. Wines Vines Analytics/ShipCompliant by Sovos reported that shipment value rose 14% from a year earlier to \$252 million, while

volumes increased just 9% in the period to 537,446 cases. The faster growth in value versus volume pointed to the movement of more consumers to more expensive wines; indeed, the average bottle price increased 5% from a year ago to \$39.12.



Bearing out the trend were inroads by the regions producing some of the country’s most expensive wines, Napa County and Oregon. The most expensive DtC shipments flow from Napa, where the average bottle shipped is worth \$65; in Oregon, the average bottle shipped is \$39, on par with the national average. The latest 12 months saw Oregon post the strongest DtC growth of any region at 28%, to \$178 million. Napa, while logging the smallest growth at 7%, did so off a commanding lead over every other region, with total shipments worth \$1.3 billion.

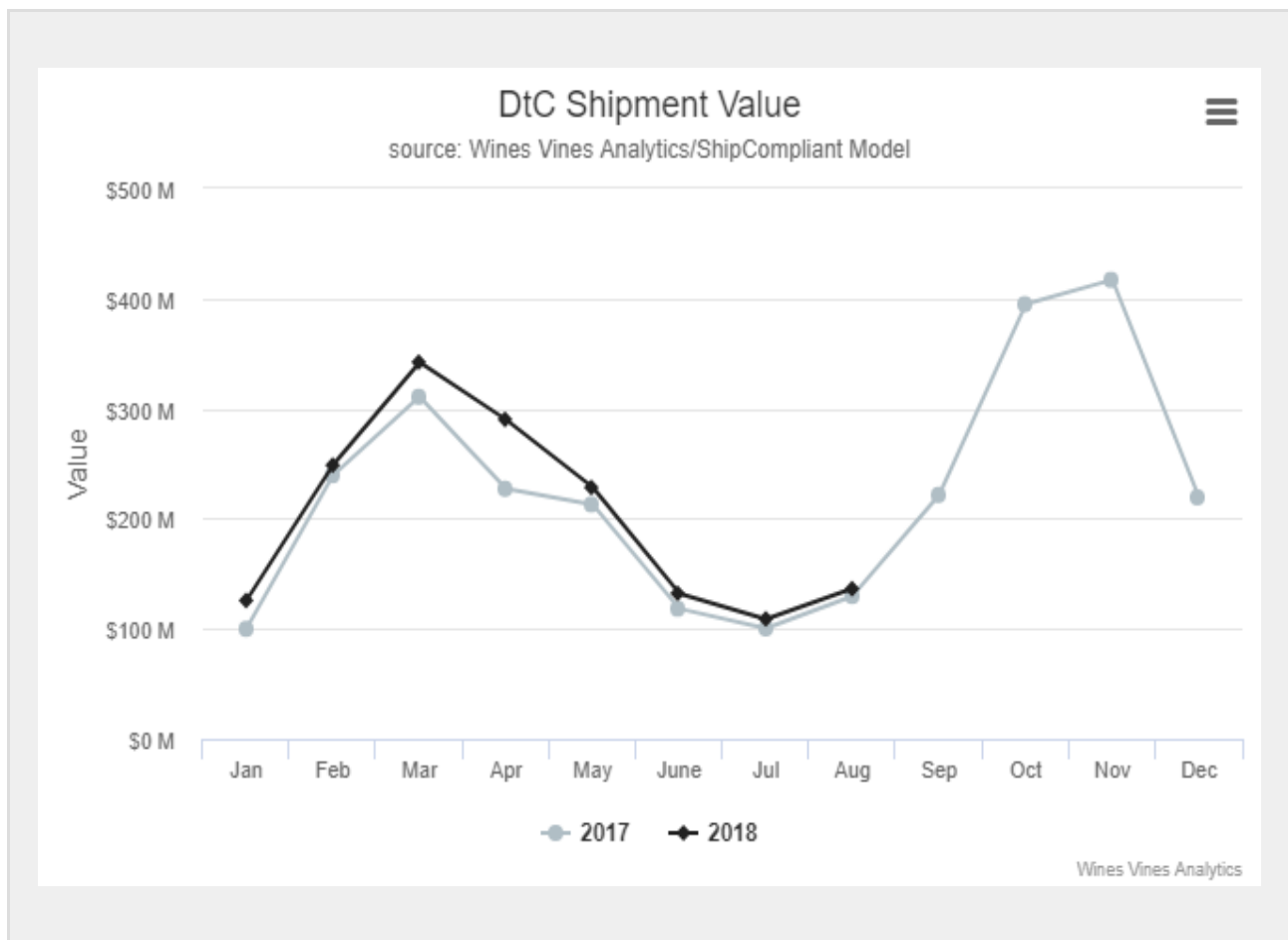
The exception was Sonoma County, the one region in the latest 12 months to see case volumes grow faster than shipment value. Sonoma wineries led the channel with shipments increasing 27% to 1,776,913 cases, pushing Napa into second place with a case volume of 1,726,309. Sonoma’s rise accelerated this year, manifesting first in January before becoming firmly established over the summer. Sonoma wineries shipped bottles worth an average of \$29 apiece, down just 3% from last year, for total shipment value of \$622 million. This represents 21% of the channel, up a percentage point from last year and ranking second only to Napa, which claims a 46% share of the channel.

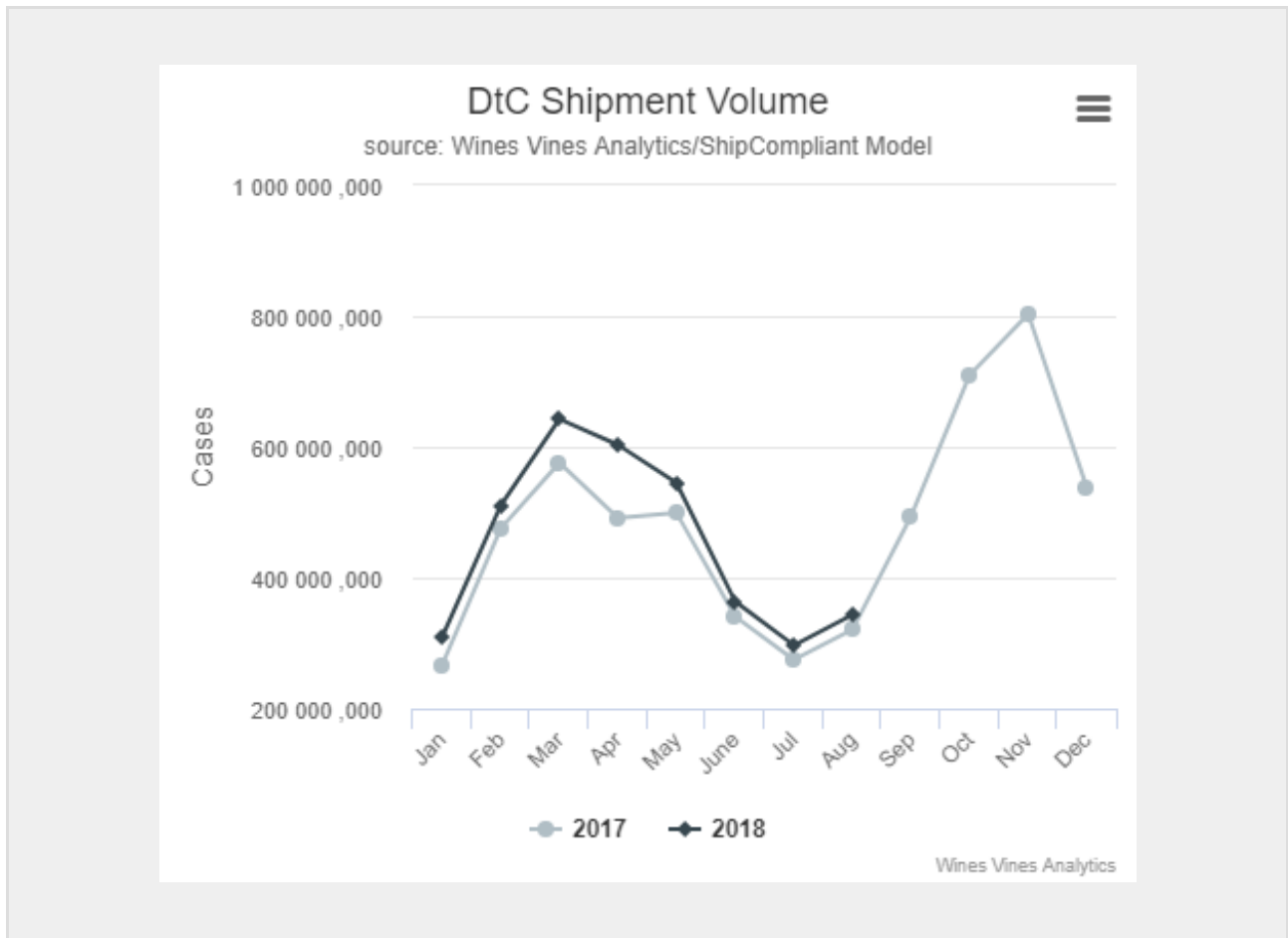


Total wine sales in the U.S. rose 6% in the latest 12 months to \$70.5 billion. The latest 12 months saw domestic wine sales rise 5% to \$47 billion, led by 4% growth in table wines and 3% growth among sparkling wines. Packaged imports increased 8% in the period to \$23.5 billion, adding \$1.8 billion in sales, but this was topped by an additional \$1.9 billion in sales of domestic table wines.

Growth in bulk imports, a component of domestic wine sales, was muted. The segment increased 12% in the latest 12 months, representing 6% of value, but rose just 3% in the latest month, when it accounted for a scant 1% of value.

With the phrase “inventory management” cropping up in conversations with sources during this year’s harvest, which is expected to be one for the record books all along the West Coast, lower demand for imported bulk wine isn’t surprising.

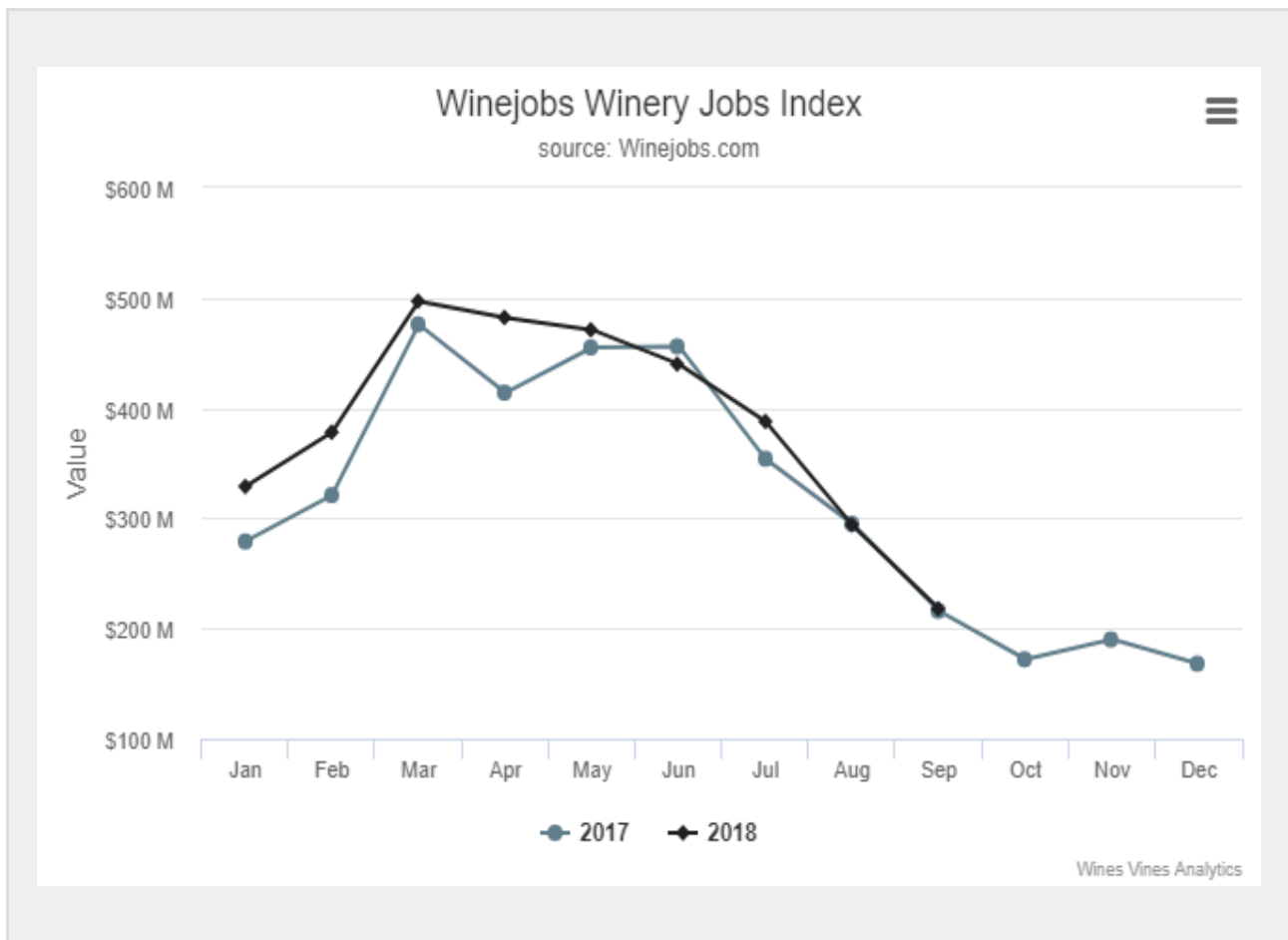




Similar to DtC shipments, sales through multiple-outlet and convenience stores tracked by market research firm IRI in the four weeks ended Sept. 9 saw their average value increase. Sales in the period totaled \$659 million, down 1% from a year ago and volume declined 3% to 8.3 million cases. Consumers may have been buying less, but they chose pricier wines than last year. The shift favored domestic wines, with sales at \$25 and up increasing 11%, and those at \$20-\$24.99 rising 10%. Close behind were sales at \$15-\$19.99 a bottle, which rose 9%.

While sales of imports also increased, the biggest growth was seen in price segments below \$25. The \$15-\$19.99 price segment led with 17% growth, followed by 11% growth in both the \$11-\$14.99 and \$20-\$24.99 price segments.

Trading up among consumers helped lift U.S. wine sales 3% to \$3.8 billion in September, part of a better set of trends noticed by market research firm bw166. Both table and sparkling wines increased 3% in the month versus a year earlier, rising to \$3.6 billion and \$194 million, respectively.



Nor is the demand for winemaking positions, with Winejobs.com’s Winery Job Index reporting a 57% increase in demand for production staff in September. The sub-index for the category rose to 161 in the period, and represented the strongest single area of demand.

General administration and other positions gained 44% to an index reading of 390, the highest of any subcategory. Direct-to-consumer positions posted the greatest decline, with demand falling 21% to an index level of 343. Sales and marketing positions also fell, declining 14% to an index level of 148.

Dispatch: Wine Industry Financial Symposium

Napa, Calif.—Two of the wine buyers for grocery store chains in California reported demand for Cabernet Sauvignon wines remains as strong as ever, but customers are willing to try new brands if faced with price increases.

Curtis Mann, wine buyer for Raley’s, said Cabernet retains plenty of cachet with his customers but they have balked at some well-known Napa Valley brands after those wineries raised their prices. Mann said he’s had to discontinue about half a dozen of such brands. “It doesn’t make sense any more to keep carrying those items,” he said.

Still needing to fill his customers’ thirst for the varietal, Mann added new brands from the Paso Robles AVA or Washington state that offer competitive quality and prices.

Mike Taylor, buyer for the Nugget chain, said he still sees demand for the big-name labels out of Napa Valley but the sales volume for such brands is small compared to his overall sales. In general, Mike said Cabernet is the leader and he doesn't see demand slowing any time soon.

The buyers' comments came during a panel discussion at the 2018 Wine Industry Financial Symposium that included a "lightening round" of questions for members of the trade, Napa Valley grower Andy Beckstoffer and winery executives.

When asked by moderator and the San Francisco Chronicle's wine critic Ester Mobley if Napa Valley Cabernet prices are going to keep on increasing, Beckstoffer said when wine prices increase so do grape prices.

He said bifurcation of Napa County grapes is going to increase, with more tons selling for more than \$20,000 and fewer grapes selling for less than \$5,000. Wineries and growers who want to continue to produce Napa Cabernet will have to decide which half of the business they want to be in.

In a separate session at the symposium, Steve Fredricks, president of Novato, Calif.-based Turrentine Brokerage, noted in 2011 about 35% of the purchases for Napa County grapes were at \$5,000 per ton or more. In 2017, \$5,000 per ton or more was the price in 90% of grape purchases.

Fredricks and the company's North Coast grape broker, Mike Needham, delivered a presentation on the grape and wine market.

Some of the key trends the two noted as indicating a changing market were case sales slowing, traditional buyers have become sellers and bulk wine volumes have been building.

"We're moving into a transition in the market," Fredricks said, referencing the company's "Wine Business Wheel of Fortune" that appears to be shifting toward a long market. Napa County Cabernet bulk wine prices may have reached its tipping point as prices have dropped about \$10 per gallon since last year to around \$35.

Barring any extreme weather, the 2018 harvest should bring significant Cabernet tonnage as since 2011 bearing acreage in Lodi, Paso Robles, Lake and Mendocino counties and Washington state has increased by 50% to 60,000 acres in those regions.

Plentiful Cabernet and lower prices should provide additional opportunities in the market as Fredricks said many private label companies, negociants and wineries looking to develop new brands will have more options in terms of supply and prices. "It's always been a great market of opportunity," Fredricks said of an excess market. "There's not all bad news but good news too."

Spot prices for North Coast Cabernet grapes neared \$2,500 in 2017, and that is more than double where they were in 2005. The difference in prices between North Coast and Lodi AVA grapes in 2005 was about \$500, according to Turrentine. By 2017 that gap had widened to \$1,500 as North Coast prices grew steeply while Lodi prices have remained essentially flat.

Prices for Paso Robles Cabernet took a significant fall between 2016 when they fetched a little more than \$1,500 and 2017 when prices fell to about \$1,000 per ton.

As prices for Paso and Lodi Cabernet grapes fell, production is expected to increase. The Central Coast and the Lodi AVA account for a growing share of California's Cabernet grape crop and in 2018 are projected to yield more than 250,000 tons

Industry News

Vintage acquires Qupé

Santa Rosa, Calif.—Vintage Wine Estates (VWE) purchased Qupé, which was founded in 1982 by Bob Lindquist. The purchase includes the brand and inventory. Lindquist will stay on as consulting winemaker and the tasting room, located in Arroyo Grande, Calif., will remain open. Qupé produces around 35,000 cases per year of Rhône variety wines and had been owned by Terroir Selections, which acquired it in 2013 and formed a sales and marketing partnership with V2 Wine Group in 2018.

Constellation Brands names next CEO

Victor, N.Y.—Constellation Brands, Inc. named Bill Newlands as the company's new president and chief executive officer, succeeding current CEO Rob Sands, effective March 1, 2019. Sands will then assume the role of executive chair. Newlands joined Constellation Brands in 2015 as executive vice president and chief growth officer. Prior to joining Constellation Brands, Newlands held several senior leadership roles in the beverage alcohol industry spanning more than 30 years. Also effective March 1, 2019, Richard Sands, who is currently serving in the role of executive chair, will assume the role of executive vice chair.

Cakebread names new CEO

Napa, Calif.—Cakebread Cellars hired Mike Jaeger as its new president and chief executive officer. Current president and CEO, Bruce Cakebread, will remain on the winery's board of directors, along with his brother Dennis Cakebread, who will continue as chairman. Jaeger has 20 years of experience leading numerous wine businesses, including both family-owned and public companies. Most recently, Jaeger was CEO at C. Mondavi & Family and also served as chairman at Clos du Val Winery.

New CFO at Cooper's Hawk

Chicago—Cooper's Hawk Winery & Restaurants announced the appointment of Michael Coyne as chief financial officer, effective Oct. 1. Most recently, Coyne served as chief financial officer at sandwich chain Potbelly Corporation, which included a period as interim chief executive officer. Prior to joining Potbelly, he served as senior vice president, at CNA Financial Corporation. He also spent seven years at Sears Holdings Corporation, culminating as vice

president and treasurer. Coyne will report directly to the Chicago-based company's founder and CEO Tim McEnery, and will oversee the company's finance, accounting, financial planning and analysis, internal audit, tax and treasury areas of the business.