Post-Harvest Report

Fall 2016

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Allied Grape Growers is a winegrape marketing cooperative with 500 grower members from major winegrape regions of California.

The association exists for the purpose of efficient and competitive marketing of its members' grapes as well as offering marketing services for non-members. Direct lines of communication are maintained year-round with growers and vintners for better understanding of market conditions and opportunities.

ALLIED GRAPE GROWERS

POST-HARVEST REPORT

An "Allied Press" Newsletter Publication

Written for the growers and customers of Allied Grape Growers

Editor: Jeff Bitter

Reviewing the 2016 crush ...

Over or Under 3.9?

Last year following harvest, quite a few people were taking bets on whether the winegrape crush was over or under 3.7 million tons. Those that just couldn't decide turned out to be right, since it ended up landing almost smack-dab on 3.7 million tons. This year, that over/under line seems like it could be a little closer to 3.9 million tons. For whatever it is worth, the State of California has estimated the 2016 winegrape crush at 3.9 million tons, and we don't hear many people crying foul about it in the industry. Generally speaking, we agree with the state's number, going all the way back to July when AGG made public statements that we estimated the crop at 3.8 to 4.0 million tons.

Prior to the 2016 crush, initial projections of crop size by onlookers were generally vague, but most said it would be above last year's 3.7 and lower than 4.0 million tons. As harvest initiated and grapes began to be delivered from the Central and South Valley, yields were coming in light, and many onlookers made quick assumptions that the statewide crop would be way off again and be challenged to exceed last year's level. However, as harvest progressed and the grapes began coming across the scales in the Coastal areas in late August and into September, it became apparent that the Coast wasn't going to easily succumb to another

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State Estimated Crush at 3.9

Crop Year	Winegrape Tons Crushed or Estimated	AGG Est'd Winegrape Bearing Acres	Estimated Winegrape Avg. Yield
2012	4,018,237	525,000	7.65
2013	4,244,891	540,000	7.86
2014	3,894,397	550,000	7.08
2015	3,704,571	555,000	6.67
2016*	***3,842,000***	***565,000***	***6.80***
2017*	4,139,750	571,000	7.25
2018*	4,197,500	575,000	7.30

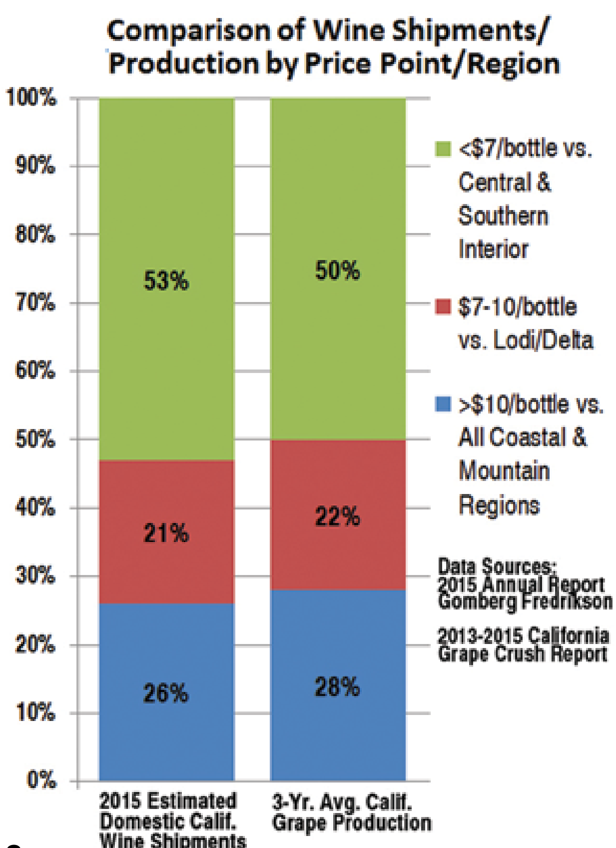
**2016-2018 – Assume approximately 1% Coastal and 6% Interior attrition rates*

extremely light harvest year. In addition, Northern Interior yields (besides maybe Chardonnay) seemed to be stronger than expected earlier in the season, as those grapes began coming off the vine in September.

Fields in Lodi and the Delta picked out well – not huge, but well. In fact, one of the tell-tale signs that this year's crop wasn't large across the board was the general lack of contract overage floating around in the marketplace.

Contract overage is the result of wineries that safeguard themselves against processing challenges in large crop years by setting contractual tonnage limits on growers' deliveries. In large crop years, there are many growers that exceed these tonnage limits and end up having to sell their "excess" tonnage on the spot market at harvest.

This year was not one of those years. It wasn't exactly to the contrary either, where wineries were so short that they were actively trying to back-fill tonnage based on the delivery shortages of growers. So overall you might say, "Just sounds like an average crop." Well, not exactly.



We still believe the crop to be below average overall. Based on our historical statewide yields and our estimated bearing winegrape acreage, an "average" state crush would easily top four million tons. So why weren't many buyers actively pursuing spot market grapes in light of an assumed short crop? There were a few reasons. One main reason was that they couldn't create any more fermenter space internally to handle the additional processing required. Even though the crop wasn't large, it did seem to be ripe and ready simultaneously (especially across red varieties).

There were about 4 to 6 solid weeks when most buyers simply stated they were running at capacity – just waiting for fermenters to turn over in order to bring in the next "batch." When presented with purchase opportunities during this time, their common response was, "Talk to us in a couple of weeks, if the grapes are still available."

Other factors that influenced buying decisions were the availability of wine (both foreign and domestic – high end and low end) as well as current internal inventory levels. These issues seemed to be associated more with Interior wineries than Coastal wineries, as Interior grape buyers seemed to have more robust inventory and supply purchase options than Coastal wineries did coming into 2016. Essentially, the crop wasn't far enough off average (maybe only about 5 percent) to produce big waves in the marketplace when buyers had other options and issues to consider.

The great thing about this crop, however, was that from a supply standpoint, it really seemed to match current demand. The Central and Southern Interior being on the shorter side was probably a blessing, since consumer demand is waning at price points supplied by this region. The Northern Interior and Coastal areas (mid and upper segments of the market) experienced decent production for a segment of the market that continues stable and growing. From a supply balance perspective, we couldn't have asked for more in 2016. Well, we take that back, specifically we could have had more coastal Pinot Noir and Cabernet Sauvignon….

The graph included at left shows that, when domestic shipments are broken down by price point, they very clearly match up with the average regional supply, as defined by three major geographic designations. As demand continues changing among these price points over time, supply will need to adjust. Even small percentage drops in wine shipments below $10 can have a significant effect on winegrape demand when considering that

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Pricing the 2016 Crop

As we moved into the 2016 harvest season, the market for winegrapes had been mostly robust – at least more so than the previous two years from the January thru June time periods. This was particularly true of the Coastal regions, but also applied in general to the Interior market, as many grapes were moved (contracted) during the first six months of the year. Some of this had to do with the fact that wineries were experiencing expiring term contracts (mostly three- to five-year deals that were written between 2011 and 2013) and weren't as committed contractually during the winter as they had been in previous years. But some of it had to do with expanding market opportunities at the mid and high end, as well as vineyard removals and lessening supply on the lower end. As term contracts expire and supplies/needs change, buyers/growers have a bit of an opportunity to play buyer/grower musical chairs if either party thinks it is better off somewhere else.

With the Coastal regions coming off an extremely short crop in 2015, and consumer demand continuing to expand for Coastal wines, the grape market in the cooler regions seemed unstoppable. Buyers were interested in nearly every variety in Coastal regions. Of exception were Merlot and Zinfandel outside of high-end AVAs. Particularly strong in the market were Chardonnay, Sauvignon Blanc, Cabernet Sauvignon and Pinot Noir. We expect to see more increases in the reported average prices of all of these varieties in every Coastal district in 2016 over 2015 when the crush report is published early next year.

Most Coastal Cabernet Sauvignon of average or better quality was selling in the $1,800 to $2,200 range with AVA specific Cab moving at much higher prices. Sauvignon Blanc and Chardonnay pricing held strong and experienced increases anywhere from 5 to 10 percent or better in most Coastal regions, while Pinot Noir saw significant upward movement in prices, particularly in Monterey and Sonoma County, as the anticipated crop was not enough to fill supply needs. Pricing on all the above varieties was at least at previous year's average, but mostly with some premium attached.

In the Northern Interior, Lodi and the Delta experienced much more action early on, with regard to Pinot Grigio, Sauvignon Blanc, Chardonnay and Cabernet Sauvignon, than in the years previous. Spot Chardonnay pricing in particular was notably improved, but in many cases in Lodi, still short of what we consider sustainable, given the yields in 2016. Most Lodi Chardonnay traded in the $450 to $500 range with an occasional $500-plus sale. In the Delta, pricing was about $100 - $200 per ton more. Pinot Grigio and Sauvignon Blanc held last year's average and even better in most cases for both areas, and Cabernet Sauvignon in Lodi traded mostly from $600 on up, with bonuses for sugar and quality – basically near previous year's average. Zinfandel was a mixed bag in Lodi, as premium Zin on wire or head-trained fetched decent pricing ($600 - $900 per ton), but the market was very thin if you were a seller, with few buyers out there that had lots of choices. In the end, some Zinfandel hung on the vine in Lodi, as the crop proved to be larger than the market needed. Merlot was a tough sell as well, with pricing at unsustainable levels, if a buyer could be found at all.

Moving south into Crush Districts 12 thru 14, the market was very soft on pricing on most varieties. However, as mentioned earlier, there was quite an increase in market activity over the previous two years.

Of particular note as a market disaster was White Zinfandel. The demand for White Zinfandel continues to shrink, and once again, the market dropped to give-away prices of $100 per ton for the final tons that were harvested in 2016. But whereas other

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nearly 75 percent of all grapes grown are in the Interior regions supporting those price points. Small percentage changes equate to large volume differences. The inverse is true about wines above $10 per bottle. It is important to note that the lion's share of California wines sold domestically (and abroad) continues to be priced at $10 and below.

President's Message:

As we finish the 2016 harvest and look around the state, we thank the good Lord for a season that resulted in a better crop than 2015 in both production and prices in most areas of the state. After many years of drought, we had a winter and spring that brought California just enough moisture to have sufficient water supplies to make our 2016 crop and not have a detrimental effect on the 2017 crop. Let me make a clarification in that, if vines are stressed during the growing season, it may have an effect on next year's crop, regardless of the amount of rain over the winter. But all agree, there wasn't really enough rainfall to do anything other than get us through the year. We are still experiencing a drought.

Mother Nature was good to us this year with a stable harvest season with a couple of heat waves that may have affected the overall production but not quality. The year is being proclaimed as a quality year by winemakers around the state, based on fruit composition and early wine evaluation. There were a few wild fires being watched, but wind patterns were such that we may not see any significant smoke taint in 2016.

When asked by the media recently what the most significant pest pressure was this year, I answered, "Those persistent pests coming at us from Sacramento!" With the onslaught of new regulations and legislation, from higher minimum wage and new piece-rate rules during non-productive time to the new overtime rules, it makes farming any commodity in California more challenging. But there were other normal disease pressures as well, such as powdery mildew on Chardonnay and other susceptible varieties – a season-long battle throughout the state. Yes, I said season long. Even beyond the traditional time of veraison, we saw mildew continue to develop this year. We did have some success with the declaration of the eradication of European Grape Vine Moth as the result of a great partnership between the California PD/GWSS program and the various County Ag Commissioners, especially in Napa.

We discuss the market in more detail in other parts of this newsletter, but overall the North Coast experienced great demand in 2016. There was competition from multiple wineries for Cabernet Sauvignon, Chardonnay and Pinot Noir, but lack-luster demand for Zinfandel. The Central Coast saw much of the same demand for the same varieties, with Zinfandel again seeing the most challenge. There was some demand for quality Zin, but supply in all regions seemed to outpace the demand.

In Lodi and the Delta we saw good demand for most varietals. Pricing was good, but not as strong as we had expected with the demand for wine at $10 and above increasing. Perhaps the larger than expected Coastal crop caused some buyers to shy away from buying Northern Interior fruit. In the Central San Joaquin Valley, demand was mixed, depending on variety and quality. The spot market was mostly improved from last year, but still could be categorized as weak overall, especially for White Zinfandel.

The crush demand for Thompson Seedless has fluctuated based on juice concentrate demand over the last few years. This year we once again experienced low demand from processors. Most Thompsons made their way into either the crush market (for sparkling wine or concentrate), dehydrator (for golden raisin production), or raisins. But regardless of the outlet, once again the Thompson Seedless grower is not seeing profit in any of these areas.

I know it may sound hard to finish on a positive note after that, but I do believe, overall, the wine industry in the Interior has seen the bottom of the cycle, with Lodi/Delta positioned well for the future, while the Central Valley still may have some supply balancing issues with which to deal. The North Coast is experiencing a stronger market, much ahead of the rest of the state, and as long as upper end wine sales continue strong, the Central Coast should be in a solid position as well. How much better 2017 and 2018 may be will likely be influenced by import pressure, the strength of the U.S. dollar and the U.S. economy.

Wine Shipments Disappoint & Impress at the Same Time

Once again, our summary of wine shipments reported by industry authorities points to ups and downs simultaneously in the marketplace. At the expense of sounding like a broken record, wine shipments continue to stagnate at less than $9/bottle while simultaneously thriving at greater than $9/bottle. A recent report from the Nielsen Company indicated that, for the 52-week period ending in early September, wine shipments below $9/bottle were off by just under 1 percent. For that same time period, wine shipments over $9/bottle were up by almost 9 percent from the previous year.

This doesn't really come as any major surprise considering that this trend has been one that has existed for quite a few years now. Our challenge is to continue to adjust our domestic supply to accommodate this trend. Fortunately, the regional yields for the 2016 crop we discussed earlier in this newsletter pointed to generally higher yields in Lodi and Coastal areas, and mostly lower yields in the Central and Southern Interior of California. The current year's production reality fits well into the market's needs for more of the premium-priced supply and less of the affordably priced product. While the Nielsen data doesn't capture 100 percent of all wine sales nationally, it does provide a good compass for the direction of the market.

Another resource we often use to gauge the performance of the wine market is the Gomberg-Fredrikson Report (GFR). The most recent GFR report shows that, through July 2016, total California wine shipments were up by only about 1 percent. Unfortunately, the sector of the market that is growing the most (generally above $9/bottle) represents less than a third of the volume of the market, so it takes quite a bit of growth in that sector to offset the volume losses by a simple 1 to 2 percent decline at the lower end.

Additionally, the GFR indicated that, while California wine exports have declined in 2016 as compared to 2015, imports for the year have been almost right on par as compared to last year. Of course, the stronger U.S. dollar is the main culprit here; something about which we can do little, if anything.

As far as specific varietals are concerned, the Nielsen data shows very clearly that whatever is experienced in the retail marketplace directly translates into the winegrape market, as wineries continue to seek varieties that are in demand, while shying away from those that are not. For that same 52-week period noted above, Nielsen reported the varietal performance inserted here.

Chardonnay	+0.9%
Moscato	+3.0%
Pinot Grigio	+5.6%
Sauvignon Blanc	+9.9%
Cabernet Sauvignon	+4.6%
Merlot	-4.7%
Pinot Noir	+6.4%
Syrah	-12.3%
Zinfandel (Red)	-4.9%
White Zinfandel	-6.4%

It's no coincidence that the same varieties performing poorly with consumers are a tough sell to the wineries by growers. From a non-varietal position, of notable performance, is the rosé category. Although not shown in the table, it increased by 54 percent in volume (albeit on a small base). It is non-varietal categories like these that help consume varietal surpluses, as they allow more flexibility in using multiple varieties in their production (hopefully some that are in surplus). This especially holds true for the "Red Blend" category, also not shown in the table above, but enjoying a 10.4 percent increase in Nielsen volume as compared to a year ago.

Over the last 19 months, monthly wine shipments (as compared to the same month the previous year) have been up 11 times – but down 8 times – which signifies the competitiveness of the global marketplace and explains why overall shipments continue to grow at meager rates of only 1 to 2 percent. The real change is occurring "within" the industry, not "to" the industry.

As our overall volume remains relatively constant (growing slightly), our varietal, regional and categorical mixes are adjusting with great speed – at least as speedy as can be expected, considering the time it takes to get from soil to shelf.

Upcoming Industry Events

Tuesday, November 8, 2016 -
"Rootstock" Symposium - Napa Expo Fairgrounds
Napa Valley Grape Growers Association

Friday, November 11, 2016 -
Central Coast Grape Expo - Paso Robles Fairgrounds
Malcolm Media

Wednesday, November 16, 2016 -
Grape, Nut and Tree Fruit Expo - Big Fresno Fairgrounds
Malcolm Media

Wednesday & Thursday, November 30 & December 1, 2016 -
2016 Wine and Grape Industry Forum -
Fermin Campos Farms Facility, Fresno
San Joaquin Valley Winegrower's Association

Tuesday - Thursday, January 24 - 26, 2017 -
Unified Wine & Grape Symposium -
Sacramento Convention Center
CAWG & ASEV

Allied Grape Growers

Pricing the Crop

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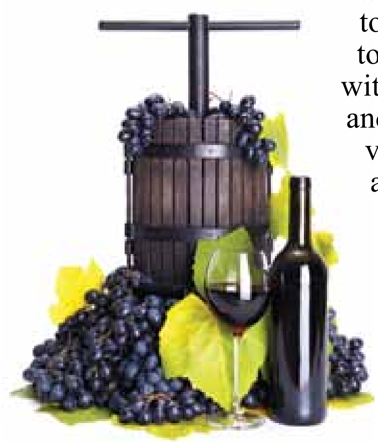
varieties also experienced $100 spot prices in 2015, there were virtually no such deals in 2016. Even unwanted generic reds, such as Syrah and Ruby Cabernet, were able to fetch respectable, albeit not sustainable, prices starting with a "2."

Muscat of Alexander and most florals found homes at "okay" prices, as the market cleared itself through harvest. Many Central Valley spot market grapes going into, and even during, the 2016 harvest were traded between $250 to $350 per ton with an occasional sale of high quality Cabernet Sauvignon, Sauvignon Blanc or Pinot Grigio at prices of $400 to $500 per ton and better.

Rubired, a grape commonly used for the production of red concentrate, as well as a coloring agent for many blended wines, experienced strong demand in light of the extremely small crop of that variety. Even with a major buyer of that variety willing to release growers of their obligation to deliver, the market stayed healthy, with pricing anywhere between $275 and $300 per ton on the high production variety, assuming color and sugar were achieved.



The one area of strength in the market in the Interior was for organically grown varieties. With only a handful of sellers of such grapes, the few buyers that are out there are generally hungry to purchase – sometimes at premiums of 50 to 100 percent over the conventional price. The problem is that the market is so thin that, if many growers began converting to organic production, the premium in prices that currently exists and actually provides for sustainable production would immediately disappear. We have seen this scenario play out many times over the past two decades with regard to organically grown grapes. Any expansion of organic production should be done strictly in cooperation with a buyer, and with a contract.

Lastly, in reference to the Thompson Seedless market, a slightly strengthening white concentrate market and a tardy buyer run at available supply helped bolster the spot price to $200 per ton versus last year's $150 per ton. Once again, the lion's share of Thompsons will end up in the raisin market as dried fruit, since winery demand was not announced until after most growers had made their decision to make raisins, much to the chagrin of most of those involved in the raisin industry. Even the golden raisin market, which is commonly seen as "healthy," was depressed this year by the underlying weakness of the traditional raisin market and growers' willingness to sell cheap on-the-vine to dehydrators (golden raisin producers) as opposed to making natural sun-dried (purple) raisins. The Thompson crop turned out to be quite a bit shorter than in 2015, with most growers reporting yields at 15 to 20 percent off of last year. With a higher-than-desired carry-in of 2015 raisins, the short crop was welcomed by all.

Overall, grower returns in the Interior are such that any grower without a contract that has a challenged or aging vineyard should strongly consider removing it. Only those growers with favorable varieties and/or healthy producing vineyards that provide above average yields with average or better quality can justify keeping winegrape vineyards in the San Joaquin Valley in the ground. On the other hand, we could have used a few more Coastal grapes this year. But based on planting trends that we have observed over the recent years – they are coming. We continue to insist, there is no shortage of winegrape acreage or winegrape supply in California in the immediate future – in any area of the state other than within some of the highest end AVAs.