

# INDUSTRY UPDATE

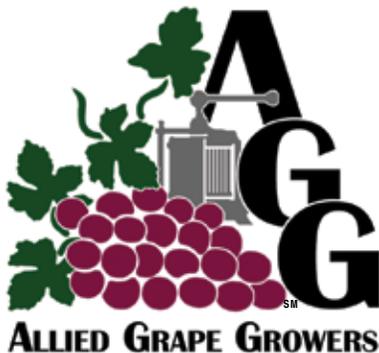
# Winter 2018

Allied Grape Growers:  
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Fresno, CA 93711

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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.*



## INDUSTRY UPDATE

### An "Allied Press" Newsletter Publication

Written for the growers and customers of  
Allied Grape Growers

Editor: Jeff Bitter

## Building the Industry Puzzle

With every new year, wine industry folks find themselves recalibrating and repositioning. Ultimately, they are adjusting to inventory. Inventory, in its most basic description, is the product of supply AND demand. Because the clear majority of California wineries produce truly (and only) California wines, they are immediately subject to (and directly impacted by) what is available to them annually via the California grape crush.

The exception to this would be wineries with a preponderance of brands that can readily substitute California with alternative sources from around the world, or perhaps even nimble wine negociants that are constantly changing their product offerings based on global wine supply. But even then, they have annual supply limitations and opportunities. It's just on a much broader scale.

Demand is a very complex side of the business as well, with lots of moving parts, but much like the supply side, it mostly moves in "trends." Both sides of the business can be easily and suddenly upset by extraneous variables such as 9-11 (demand side) or raging wildfires (supply side). As with all things in life, nothing is ever for certain or guaranteed.

So all involved are constantly evaluating inventory to ascertain their positions. It's not just the production or sales and marketing folks that are impacted. Even folks in finance and accounting, information technology, hospitality and other peripheral fields will find themselves ultimately subject to the reality that everything about this business comes down to product in, product out.

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# A Look at Some Pieces of the Puzzle

This practice of inventory evaluation and manipulation involves lots of puzzle pieces that need to be put in the right places in order to see the big picture. It's not just about building a puzzle to see the past; it's about building a puzzle that reveals the future. It sure would be nice if the industry was like one of those four-piece puzzles you put together as a toddler – nice and easy. You can see the parts on the floor in front of you and immediately know how they assemble to reveal the whole. But this is nowhere near that.

Our industry is affected by so many different variables and factors that are constantly in flux that it feels more like a thousand-piece forest picture puzzle, where all the pieces look very similar in color and tone and are very difficult to put in place in relation to each other. So what do we do? We build the puzzle like most people. We start with the outer frame of pieces (you know, the ones with the flat sides) and eventually begin to fill in the middle.

As we progress, we focus on the few distinct parts within the puzzle that can easily be tied together, and we build them in sections in the interior. Lastly, we attempt (often in futility) to power through the remaining 500-plus pieces that make up the homogeneous “fill-in” parts. At AGG, we are all about helping folks with the outer frame and the distinct inner sections of the industry puzzle. Filling in the homogenous middle is up to the individuals in their distinct businesses. So, considering we are in a new year, let's walk through some trends and factors to help define and clarify the industry puzzle.

## Some Pieces of the Puzzle



In order to establish a bit of a supply foundation, we first look to California's 2017 crop. Most in the industry agree it was a “lighter than normal” crop. Internally, we reviewed our year-on-year production (yield) numbers at AGG, and the table below shows what we found in regard to the state's major varieties in major regions.

In observing our internal numbers, there are clear indications, as compared to last year's yields, that the North Valley crop appeared to be on the lighter side overall; the Central Valley crop appeared to be on the heavier side; and the Coastal crop appeared to be about the same, with mostly single digit ups and downs, depending on variety.

What could this mean in terms of totals? Since almost half of the state's winegrape tonnage comes from south of Lodi, the stronger crop in the Central Valley may actually bolster the total tons crushed more than industry folks have previously assumed. The flip side is that this is also the region of the state where the most pullouts have occurred since the previous harvest, thus reducing bearing acreage. We estimate about 8,000 acres were removed between the 2016 and 2017 crops. This would have an offsetting effect on the higher yields, and may mean a very similar Central Valley crush size between the two years.

In the North Valley, on the other hand, bearing winegrape acreage continues to expand. But that expansion could have been slightly thwarted with the lower yields this year – the exact opposite phenomenon as when compared to the Central Valley. Once again, the question becomes the degree of interaction between the two issues – yield and actual bearing acreage.

Lastly, the coast seemed to provide a mixed bag of production, with some ups and some downs, but our numbers indicated relatively stable tonnage overall. It should be noted that Coastal bearing winegrape acreage is on the rise, and it will continue to be in the near future as planting has been the norm there since 2013.

This said, the range of industry estimates for the 2017 crush generally span 3.8 to 4.0 million

## AGG Yield Change from 2016 to 2017 (Same Vineyards Only)

	Central Valley	North Valley	Coastal
Chardonnay	0%	-15%	-3%
French Colombard	** 7% to 20%	N/A	N/A
Pinot Grigio	20%	-20%	-3%
Sauvignon Blanc	N/A	-1%	6%
Florals (Muscat)	** 6% to 49%	N/A	N/A
Cabernet Sauvignon	20%	-4%	9%
Merlot	2%	4%	-11%
Petite Sirah	N/A	-24%	1%
Pinot Noir	N/A	8%	3%
Rubired	** -9% to 1%	N/A	N/A
Zinfandel	-10%	-15%	-6%

\*\* Denotes a range % change based on vineyard age where “older” is compared to those planted from 2010 and beyond. New plantings experienced greater “positive” changes in yield than older vineyards.

tons. We believe the actual number will be toward the upper end of that range. That is based on the stronger-than-anticipated production we experienced internally, and the knowledge that we added at least 10,000 *net* new bearing acres last year due to newly bearing plantings. We should still fall short of what we consider an average (normal) crop, which, based on our work on acreage and yields, would produce 4.2 million tons on today's bearing acreage.

Looking out into the future, we continue to see expanded development of vineyard acreage in the premium growing regions of the state, which is associated with the current and past demand for premium wines (wines above \$10 per bottle). The Central Interior of the state is continuing to retract in vineyard acreage, although the rate of pullouts has slowed considerably the last two years.

Two years ago, following the 2015 crop, AGG went on record explaining that, based on categorical sales trends, growers needed to remove 36,000 acres of interior winegrapes to balance supply with waning demand. As of the 2017 harvest only about two-thirds of that number had been removed. Simultaneously, we have experienced no improvement in wine sales below \$10 per bottle. So we still need to see at least 12,000 more acres come out.

Our proprietary data gathered in the months following the 2017 harvest shows that, of the 11,000 grape acres that have been removed from the Central Valley since harvest 2017, approximately a third to a half are winegrapes.

Although these totals put us closer to that original target number, we need the diggers to keep digging. Obviously, this doesn't apply to all Central Valley winegrape growers. If you are wondering whether it applies to you, ask your

accountant. He/she will certainly tell you.

We know we didn't have a huge crop in California in 2017, but at least we didn't see the disastrous crop sizes experienced in some places around the world last year. Many major

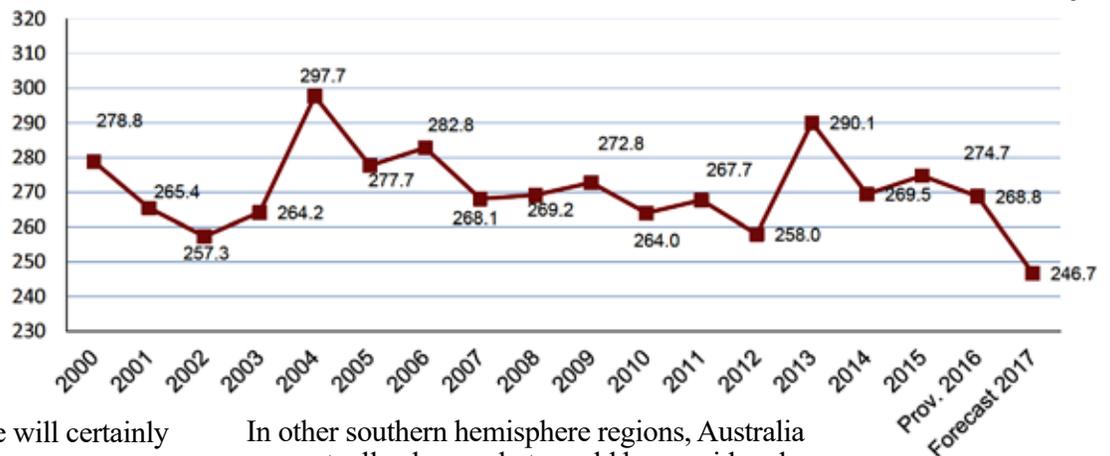
winegrowing regions of the world experienced significantly short crops.

The "big three" wine producing countries in Europe – Italy, France and Spain – form the collective giant of worldwide wine production. But they are estimated to have been down, in total, by 15 to 20 percent in 2017, coming in at somewhere just shy of 17 million tons collectively. Since, combined, they generally constitute about half (or more) of the world's wine supply, it is a pretty big deal when they experience double digit changes in production.

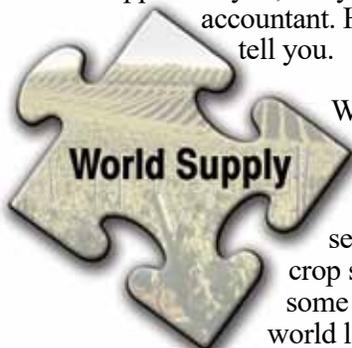
Germany and Portugal, although notably smaller in production than their neighbors, experienced variations in crop size as well, with Germany seeing at least a 10 percent reduction in 2017, while Portugal actually may have eclipsed 2016's crop size by just a bit.

The 2017 South American crop (inclusive of Chile and Argentina) was also very disappointing, especially considering that they had really short crops in 2016. While neither Chile nor Argentina was significantly lighter in 2017 than in 2016, collectively they were almost 40 percent off their "normal" production as measured between 2012 and 2015.

## Trends in World Wine Production in mhl (Excluding Juice & Musts)



In other southern hemisphere regions, Australia was actually above what would be considered "normal" for them, while South Africa came in near their five-year average. According to the International Organization of Vine & Wine (OIV), the total global wine production likely didn't achieve 247 million hectoliters (see graph here for relativity) – a marked decrease from recent years. In fact, globally, 2017 brought the shortest wine production seen in decades, according to the OIV.



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# Trends and the Puzzle Pieces

Much can be forecasted regarding the measurably shorter global wine supply coming out of 2017, and most industry onlookers view this deficit in tonnage/gallonage as an opportunity for the lower end of the market to work closer to equilibrium.

As far as we are concerned in California, the lighter global crop was welcomed. Reports from wine brokers indicate that stability and firming of lower-end bulk wine prices has occurred throughout 2017 in relation to the shorter production. It is our opinion this should help establish some stability in an otherwise struggling segment of the business.

In recent years, the industry has really hung its hat on the premium side of the business.

The word premiumization has been used by many, including AGG, to characterize wine industry trends. Many businesses have made investments in “moving up” on the quality and price ladder in order to capture more margin and maybe a little market share to go with it. This has all been positive and has afforded many opportunities. Even at AGG, our focus has been on developing premium business with growers capable of delivering premium product and expanding our operations in regions most equipped to provide those opportunities.

The latest industry sales data continues to show great market health within the premium side of the business (wines at more than \$10 per bottle). However, it is being more widely reported that this segment of the business, which has virtually been on fire the last few years, is starting to cool just a bit. Recent headlines from reputable and notable industry analysts/publications have stated, “Disturbing Sales Growth Trends” and “U.S. Wine Sales Growing – But Not As Quickly. We’ve Seen a Deceleration.” Although it certainly isn’t cause

for panic, it is most certainly something to pay attention to.

At AGG, we tend to be fairly focused on the big supply picture. After all, that’s what we do – production. So part of that is being aware of the overall prospects for balance in the marketplace. Reporting in recent years on market performance has consisted of lamenting about wine sales below \$10 per bottle while simultaneously rejoicing about wine sales above \$10 per bottle, always pointing out that, in the end, wine shipments are still increasing modestly overall.

Unfortunately, if we were to experience a slowing growth rate in the premium segment of the business in the future, it will be more challenging to see overall volume growth in the market. We need continued large shipment growth rates in the smaller premium segment of the business to make up for the trend of small annual shipment losses in the larger volume, lower-end segment. A recent estimate from Silicon Valley Bank (chart at bottom left) pegged 2017 premium winery growth at only 4 percent, when previous years (2011-2016) were mostly in the 8 to 12 percent range.

This estimate has been backed up by similar conclusions from other industry data providers and analysts, such as Nielsen Company and the Gomberg Fredrikson Report, who both have shown alternative data sets indicating sales growth rates for wines above \$10 per bottle have slowed in 2017 as compared to recent years. Where we previously had seen premium segment growth rates at or above 10 percent annually, all indications are that this growth rate for 2017 is below 10 percent.

What this means for the industry is that folks might be much less apt to “take chances” based on the momentum of the business. If there is any doubt about growth potential, we will see wine producers take a more cautious approach to grape buying, grape pricing and unproven program development.

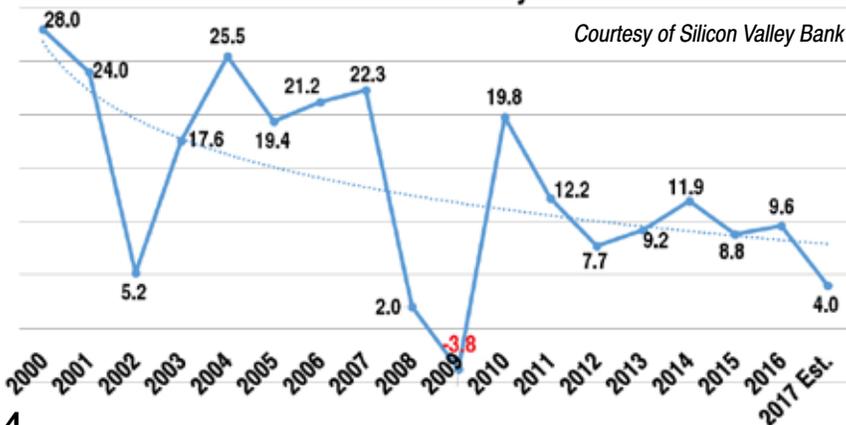
There are other implications too, as it relates to supply and demand for cascading regions of the state, but it’s not necessary to discuss that unless we actually find ourselves in a position of market stagnation or decline. And that certainly is not what anyone is forecasting at this point.

In fact, based on all indications, 2017 will be the first year the nation’s wine consumption will top 400 million cases – another all-time



SVB Data - Premium Winery Sales Growth

Courtesy of Silicon Valley Bank



# Two Industry Issues Brewing

## Produce Safety Rule:

CAWG has been working very hard to obtain an exemption for winegrapes from FDA's Produce Safety Rule, since winegrapes are not consumed raw by consumers. A lengthy written argument was made to FDA administrators recently detailing the fact that winegrape varieties in California are almost invariably grown, harvested and sold for processing into wine. Therefore, they should be exempt from the written notification requirements regarding microbial hazards that are associated with fresh fruit for human consumption.

FDA has not granted the exemption requested and is now requiring an exchange of disclosure and assurance notifications between growers and wineries. With each load of winegrapes shipped, growers must provide notice (disclosure) to the winery that the grapes "have not been processed to eliminate microbial hazards of public health significance." These records must be kept for a period of two years and are required beginning with the 2018 grape harvest.

Efforts are still being made to meet with FDA officials to discuss the absurdity of this requirement. CAWG succeeded in including language in the USDA/FDA House and Senate appropriations bills directing FDA to address the problem. But until a long term appropriations bill to fund the remainder of the fiscal year is passed, it won't be acknowledged. Work is also being done with the House appropriations staff to persuade FDA to resolve this issue.

## TTB Notice of Proposed Rulemaking 160 and 160B:

The Tax and Trade Bureau (TTB) has proposed eliminating a wine labeling exemption that currently allows out-of-state winemakers to make American Viticultural Area (AVA) claims on wines they make from fresh California grapes, as long as they sell the wine within their state. (AVA label regulation requires wines to be made in the state of their AVA.)

This exemption from federal oversight and label approval creates a situation where the wine is then subject to only state regulation that may not be consistent with the production standards developed as a precursor to using the AVA in the first place. Proponents of the exemption elimination look to preserve these production standards in any wine that uses an approved AVA in order to maintain the integrity of the AVA.

While this sounds like a good idea on the surface, the reality is that there are numerous California AVAs that are widely recognized by wineries and winemakers from other states. Many AVA associations have worked tirelessly over the years to develop out-of-state markets for their grapes and gain notoriety among out-of-state wine producers. Interest in these AVA designated grapes are predicated on the AVA in the first place, so eliminating the out-of-state grape buyer's ability to make AVA claims on their labels, simply because the grapes were fermented outside of California, would take away the incentive to purchase them at all.

AGG sells many fresh grapes throughout California into these markets and thus desires to maintain the exemption until an alternative solution to the issue is proposed. At the same time, AGG recognizes the concerns of those in well-recognized AVAs that do not want their investment in developing their geographic brand to be abused (and therefore devalued) in the marketplace by having "exempted" labels carrying their AVA. AGG's stance is in opposition of the Proposed Rulemaking only as long as it fails to offer a fix for those that depend on these out-of-state markets that they have developed in conjunction with their AVA.

The core reason AGG opposes TTB 160/160B is because we are certain that harm will be done to many of the industry's growers (including many of our own) that have developed markets based on their AVA. On the contrary, we are not certain, nor is there any proof, that the exemption that has always existed has actually caused devaluation or damage to any AVA based on the "misrepresentation" of wine with AVA claims.

The most recent comment period on the issue closed earlier this month, so a decision is anticipated by TTB soon. To see a full description of the issue and all associated comment letters, both pro and con, please see <https://www.ttb.gov/wine/wine-rulemaking.shtml>.



*Many AVA associations have worked tirelessly over the years to develop out-of-state markets....*

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# President's Message:

*Jack be Nimble, Jack be Quick, Jack Jump over the Candle Stick!*

Did I get your attention? I hope so, because I believe 2018 is a year that should get everyone's attention. Winegrape growers, wineries, farm workers, suppliers, harvesters/haulers and other associated businesses and personnel will be affected by what's going to happen by the things we can control, the things we can't control, and the things over which we can have some influence.

**Things we can control:** As you look into 2018, first look toward Allied Grape Growers to get you the best and most credible information regarding pricing and negotiations for your grapes. We are on the cutting edge of the market. No one knows your market potential better than us. Working together assures you better potential. We can also better assure your profitability by looking at some of the costs that you must evaluate for economic sustainability. As cost of labor, crop protection materials and fuel increase, so does your overall cost of production. You may look to adapt to some form of mechanical operations, plan less passes through the field, or use softer, less expensive crop protection products.

**Things we can't control:** We can't control the minimum wage nor the new overtime pay requirements. We can't really control the price of fuel unless you've figured out how to control OPEC. I didn't even mention California's fuel tax. We really haven't figured out how to control the strength of the dollar, which has a major impact on wines imported into the United States as well as competition abroad for our exported wines.

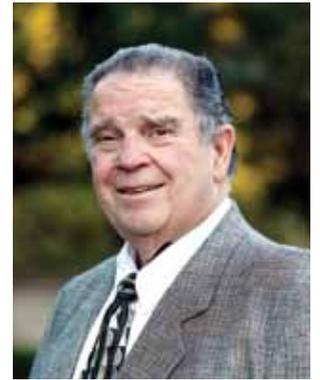
**Things we can influence:** We can influence at what price and on what terms we eventually say *yes* when selling our 2018 California winegrapes! Allied Grape Growers believes 2018 will be a strong year for wineries and growers alike. We are comfortable in saying that we believe the 2017 crop was lighter than normal. We do not know what the 2018 crop looks like, but the 2017 growing season was not ideal for 2018 fruit wood development. It is still early, but we have not had signs of a wet 2018 winter yet. So we hope 2018 brings us a normal crop year, which the industry could use, but is going to require gains in wine sales.

Growers should be able to sell their crop at good, fair prices in 2018. Obviously, various varieties and AVAs will be different, but knowing and understanding where you are and what market you are serving is important, so you can maximize your potential. We at AGG are here to help. Sales are still doing well at the higher price points, but growth rates are slowing. Below \$10 per bottle still represents a large part of the market, but is decreasing overall.

California wines still represent the largest share of the American wine industry. The United States is still the largest wine consuming country in the world, but that title is being challenged by China. We need to do our best to work with Wine Institute (WI) and California Association of Winegrape Growers (CAWG) to promote legislation and regulations that would benefit California winegrape growers and vintners. Some of the challenges facing us are trade issues, such as the status of the TPP and NAFTA, which obviously bring too many issues to discuss in this newsletter.

CAWG and WI have been working together for close to 15 years in the area of sustainable winegrape growing. Allied Grape Growers has been active from the very beginning, with board and workgroup participation in the California Sustainable Winegrowing Alliance (CSWA). CSWA has matured from being a self-assessment program, which is still available and promoted, to having a certificated sustainability program for those who want to take that next step. With some retailers and wineries requesting a certification program, it was a natural evolution of the program. Those wineries that are certified and buy certified grapes may now put a certified label on the bottle. It is our hope that wineries will compensate growers for any additional expenses associated with the program.

We need your help on additional things we can control, or at least influence. This includes reaching out to other growers, wineries and industry associates to get involved in the political process.



# Jeff Osterman Joins AGG Team

AGG is excited and proud to announce the newest addition to our employee family, Jeff Osterman. Some of you reading this are probably thinking, "Osterman, why does that name sound familiar?" It may not take long to put two and two together and realize that we already have an "Osterman" on our staff. Jeff's father, Joe Osterman, has been our Northern Interior Grower Relations Representative for over 30 years, so Jeff literally grew up around AGG.

Before you draw any conclusions regarding Joe, we have not hired Jeff to replace Joe, but rather to work with Joe in the Northern Interior to expand AGG's influence. Jeff will hold a newly created position within AGG as part of our ongoing effort to expand our operations in the premium side of the business. His title is Manager of North Valley Operations. Although his role will include a strong grower relations component, his main emphasis will be on marketing our members' North Valley grapes to numerous buyers throughout the state.

Jeff will be administering contract negotiations, seeking involvement in local industry associations and expanding our operations throughout the various northern interior crush districts, including 6, 9, 10, 11, 12 and 17. Joe will continue as our Northern Interior Grower Relations Representative, and together they will provide a fabulous grower-serving team.

Growing up, Jeff helped his family on its Central Valley raisin and winegrape operation in Madera

## President's Message

*(continued)*

Talk to your legislators about how policy or regulation has had a negative effect on you and your business. You can get involved with your local trade associations in various ways, including legislative field trips to the capital and visits with legislators in their offices.

The other way individuals can help is by donating funds to any one of many agricultural PACS that help tell the ag story or winegrape story. We all gain knowledge at the local coffee shop and share it with our friends and family, but unless we act on it, it does no good for anyone.

Remember: ***Jack be Nimble, Jack be Quick, Jack Jump over the Candle Stick!***

County. As he worked alongside his family, he developed a passion for grape growing, which turned into a deep interest in winemaking and viticulture. This passion led him to enter the Enology Department at California State University, Fresno, where he obtained his winemaking degree in the fall of 2008.

Once Jeff earned his degree at Fresno State, he relocated to the southern hemisphere to work one vintage at New Zealand's most awarded winery, Villa Maria Estate Winery. With a solid education and a little foreign work experience under his belt, he returned to California to begin his career. Jeff first went to work in winemaking at Landmark Vineyards in Kenwood, and then as an Assistant Winemaker at Harmony Cellars on the Central Coast. Following his exposure on the smaller, premium side of the business, Jeff was hired as an Assistant Winemaker at Bronco Wine Company.

Although Jeff's training and initial passion were in winemaking, he eventually came to the realization that he really missed the vineyard and viticulture, where all good wine begins. He began seeking opportunities to become involved in viticulture and ended up accepting a position with Constellation Brands. There he served as a grape buyer and landed in Lodi as a Grower Relations Manager. From Constellation Brands, Jeff moved on to Treasury Wine Estates as a buyer of grapes for their premium wine programs, sourcing from California's northern interior including the Bay Area, Lodi and Delta.

Jeff's diverse background and experience in the business (not to mention a decent bloodline) make him a perfect addition to our staff, and one who will help us accomplish our goals of continually evolving to survive and thrive in an ever-changing industry.



# Grower Profile:

# J & J Farms

Fresno County, Calif.

Our grower profile for this edition features a relatively new AGG member that has spent the last few years diversifying its farming operation, adding its first field of winegrapes in 2013.



J & J Farms is located just outside Firebaugh, straddling the Firebaugh Canal and Westlands Water Districts in Fresno County. Founded in 1949 as an acala cotton and grain operation, J & J has spent the last 10 years expanding into permanent crops, such as pomegranates, almonds, pistachios and winegrapes, on over 3,000 irrigated acres.

The history of J & J Farms began when CW "Bill" Jones and Cornelia Visman Jones met at UC Davis around the time of World War II. CW and Cornelia married and raised their three children, Sue, Bill and Ron, on a farm in Fresno County. Son Bill ended up taking an interest in government and served as an assemblyman for California's 27th district. Later he was elected Secretary of State, and he became the founding chairman of Pacific Ethanol. But Bill loved farming and wished to return to work with his brother Ron back at the ranch.



As part of diversifying their farm, the Jones brothers were looking for ways to do more with less water. As they expanded their interest in crops conducive to drip irrigation, winegrapes were identified as having serious potential for the farm. So with the help of Allied Grape Growers, J & J Farms secured contracts for the first planting of winegrapes on the family's ranch. Seventy-five acres each of Rubired, Chardonnay and Pinot Grigio were planted.

According to Bill, "The learning curve has been steep, but we appreciate the help and guidance of AGG. It's tough to get an old cotton farmer to give up chasing a four-bale yield, but we've been thrilled with the yield from the selected varieties."



Today, Bill and Ron work with their nephew, Darcy Villere, to continue developing their business into the future. "It's an exciting time," said Darcy, "The development into permanent crops and drip irrigation has really opened up a whole new world for us."

AGG is excited to be working with J & J Farms, proving success can come in all areas of the state with the right mix of varieties, quality and yield.

## AGG's upcoming calendar items Asterisk denoting the events at which AGG staff will speak

**Unified Wine & Grape Symposium\***  
Sacramento, CA January 23-25  
<https://www.unifiedsymposium.org>

**Lodi Grape Day**  
Lodi, CA February 7  
<http://cesanjoaquin.ucanr.edu>

**Livermore Valley Winegrowers Meeting\***  
Livermore, CA March 1  
<https://www.lvwine.org>

**Central Coast Insights**  
Paso Robles, CA March 20  
<http://centralcoastinsights.com>

**WiVi Central Coast**  
Paso Robles, CA March 21  
<http://www.wivicentralcoast.com>

**ASFMR Outlook Conference\***  
Visalia, CA March 22  
<http://community.asfmra.org>

**CAWG Day at the Capitol**  
Sacramento, CA April 4



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new consumption record. This includes imports, which happen to be performing very well, but it also points to the underlying reality that more wine is continually being consumed in this nation year after year. Our challenge has been, and will continue to be, competing with a quality product that brings great value to consumers. We think California is up for the challenge.

There are so many other industry puzzle pieces that we look to put in place throughout the year, and so many more we wish there was time to discuss. Hopefully the message is received that 2018 should bring another exciting year in the wine business, full of opportunities and challenges and hopefully full of bountiful production coupled with bountiful sales. Cheers to a successful 2018!