

INDUSTRY UPDATE

Winter 2019

Allied Grape Growers:
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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

Estimations & Prognostications

As with the end of any period and the beginning of another, we tend to reflect on and evaluate the past and prognosticate the future. With 2018 behind us and 2019 upon us, we once again find ourselves seeking direction and attempting to position for success.

There is strong evidence that the 2018 winegrape crop will go down as a record on the production side. While the Central Valley probably experienced an average-sized crop overall, the northern interior and coastal regions of California burgeoned with supply. This growth in production was due to two things: increased yields and increased bearing acreage in those regions. AGG is estimating that up to 4.4 million tons of California winegrapes may have been crushed in 2018.

On top of California's ample winegrape crop, recent reports by the International Office of Vine and Wine (OIV) conclude that global 2018 wine production will be near the largest in the last two decades, estimated to be up a whopping 14 percent from 2017. Evaluating the situation on the surface, it may seem we have entered into a period of market imbalance, with excess supply.

Coupled with this growth in supply is a flattening of demand and wine shipments, discussed elsewhere in this newsletter. So the question has to

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QUALITY INTEGRITY STABILITY

Estimations & Prognostications *continued from Page 1*

be asked, “Do we have a supply problem or do we actually have a demand problem?”

Our production in recent years has been very flat, even considering the fluctuations experienced via annual yields. We have crushed right at four million tons of winegrapes per year, since 2012. Spinning this into a positive, we can say that this contributes to the very slowdown in shipment growth about which we are concerned. Isn't it impossible to ship more wine over time if we aren't producing more grapes?

Additionally, we should be tempted to recognize that a supply imbalance can be easily corrected with a short crop, particularly when there is no evidence that bearing acreage will increase in the future. But on the demand side there are longer-term demographic and cohort issues that we need to understand, not only to properly forecast the behavior of, but also appeal to, the next generation of consumers (the millennial generation).

How do these dynamics establish the setting for the 2019 crop? Certainly, we have areas of ample supply in the wine industry. And the reality that global supply is large doesn't help the situation. Structurally, we have grown premium supply (via vineyard plantings) in accordance with a growing market since 2010 and have decreased

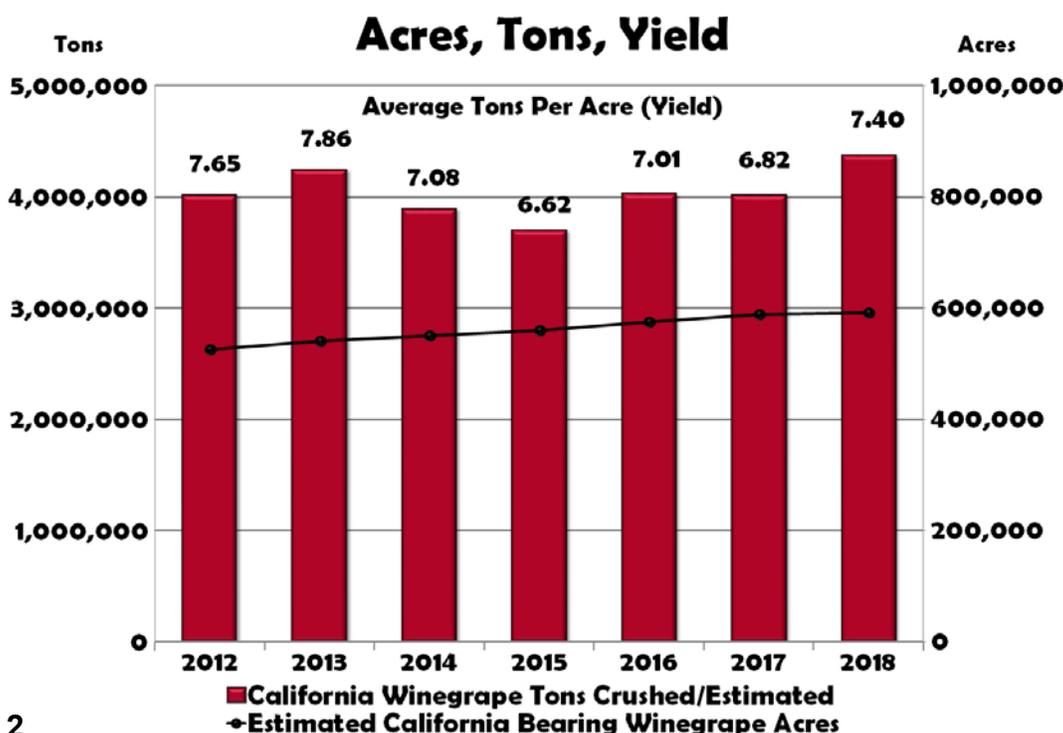
supply in the value segments in accordance with shifting demand. We really aren't all that far from “balance,” although anytime you are out of balance, it feels uncomfortable.

One thing that we will say for certain, and hopefully with convincing passion, is that struggling vineyards have no place in the future of this highly competitive business. A struggling vineyard is one that is production-challenged in areas where production is necessary for survival (i.e. the interior). It is also a vineyard that is challenged to achieve proper color (for red grapes) and/or brix requirements to produce quality wine. There are many virus-affected vineyards statewide that fall into this category and need to be seriously evaluated for their ongoing sustainability. Lastly, a struggling vineyard may be one that is overly dependent upon hand labor for its survival, like non-trellised vines in lower value regions.

The plea with which we want to leave folks in the industry, is to not panic amidst some slightly changing supply/demand dynamics. Things could be much worse than having a flat shipment period or slightly elevated inventories. Those things have a tendency to correct themselves rather automatically with increased vineyard removals and sudden changes in crop size. Again, this is especially true since we forecast no real growth in bearing California winegrape acreage.

The longer-term issues should be of greater concern. What are we doing to appeal to the next-generation consumer? What are we doing to assure long-term viability and sustainability of California agriculture? What are we doing to understand (via research) how we can maintain a competitive advantage in production and winemaking, assuming we have one?

Maybe we don't get hung up on one large crop or a flat shipment market, but rather look to what opportunities we have to control our own destiny through appealing to the next-generation consumer and continually adjusting our supply base to best match demand of the future.



Smoke Exposure - An Industry Issue

The 2017 and 2018 harvest seasons brought extreme challenges for growers in the North Coast, as wildfires ravaged hillsides and forest lands in the region. Not to discount or minimize the loss of life and property, but a real issue also facing winegrape growers includes the after-effects of smoke exposure on grapes. In some cases, it can make their annually grown crops completely valueless, following the investment of thousands of dollars per acre. This jeopardizes their very existence as growers.

For many years, the industry has been aware that exposure to smoke, at some level, has a negative impact on wine quality. In California, we first experienced this in a major way as a result of the 2008 Mendocino County wildfires. But we have since experienced issues with wildfires and resulting smoke exposure in many other regions of the state throughout the Central Coast and North Coast.

Following two years of back-to-back wildfire devastation in the North Coast, the industry is now grappling with just how to handle the issue, as it is common to hear those in the industry calling wildfires “the new norm.” This grappling is mainly a result of wineries and growers trying to define “smoke taint.” There’s absolutely a distinction between “smoke taint” and “smoke exposure.” As an industry, we need to make sure we are using the correct verbiage and understand that smoke-exposed grapes are not necessarily tainted to the point of being unmerchantable.

It can be said that growers and wineries are simply at odds with each other about what to do or how to respond to smoke exposure, but that doesn’t paint the complete picture of the situation. The real issue is that nobody really knows how to quantify when exposure actually becomes taint. There are certainly tests that exist and compounds that we all know are involved in contributing to smoke taint, but the reality is that there are an extreme amount of variables and unknowns when it comes to defining levels of exposure and, potentially, taint.

As an industry, we need to fast-track research regarding smoke exposure. There are already some academics and others performing trials and replicating situations to learn more about smoke exposure, but we have a long way

to go before we can definitively quantify the potential for taint in wines simply by testing grapes, and even more challenging may be defining taint by variety or including consideration of various winemaking processes.

It is very well documented that different varieties respond differently to smoke exposure. Additionally, certain winemaking processes may add to (or detract from) the severity

of smoke influence in wines. There are also questions with regard to the type of exposure to smoke (blowing through or hanging around, high level or low level, etc.) and the duration of any of this exposure. There’s so much we simply don’t know.

As a community of grape buyers and sellers, our immediate response should be to communicate with each other regarding ways we can work together to address smoke exposure concerns. While it is simply not appropriate for buyers to cast a wide “taint” net over entire regions after a wildfire occurrence and exposure to smoke, it is also not appropriate for producers to insist that nothing is wrong, and winemaking and wine distribution should go on, “business as usual.”

Pending a more in-depth understanding and quantification of exposure versus taint, there are a few things we can do to avoid disagreements regarding the condition of smoke-exposed grapes, or to mitigate the impact of disagreements on grape quality. The first is to negotiate grape contracts that have specific resolutions defined in the event of smoke exposure. Many grape contracts that are currently in force have no specific verbiage regarding smoke exposure, so it leaves buyers stretching to incorporate alternative clauses in the agreement to address exposure and taint issues. Some of the best clauses we have seen incorporate



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Smoke Exposure vs. Smoke Taint

a spirit of cooperation and a willingness to evaluate wines, post-fermentation, not only subjectively, but objectively.

The inclusion of such clauses for smoke exposure becomes a negotiating point, just like clauses regarding any other grape standard, like brix, MOG, and defects such as mildew or rot. Although smoke exposure is currently not measured by third-party state inspection, like other standards can be under statute, there are measurements and quantifications that can be done by third party labs to protect both parties of the contract. These measurements can be taken pre-harvest and post-fermentation.



The next question has to do with exactly what we are measuring, specifically, which compounds or set of compounds. Growers and winemakers alike should do their best to understand that which we already know is

available about contributing compounds of smoke taint. This knowledge can be gained by reading current research and discussing smoke exposure testing with certified labs. There are a few variations on exactly what can be



tested by third party labs (specifically which compounds and in what forms). It's important to understand this for the purpose of negotiating smoke exposure clauses in grape purchase agreements.

Ultimately, there should not be a single threshold (or level) for smoke taint that is accepted by the industry for all varieties in all situations, regardless of what compound(s) we are measuring. Creating such would be the equivalent of creating a specific brix at which level all grapes should be harvested, to achieve the best wine. That simply isn't practical, given the inherent diversity of wines and wine styles. Until we know more about smoke exposure and contributing compounds and conditions, negotiating these points will be that much more indistinct.

Finally, as growers, in these relatively uncertain times with regard to wildfires and quantifying smoke exposure in grapes, it is certainly a wise idea to explore the relevance of crop insurance. Smoke taint is a covered peril under the federal crop insurance program. Understanding the specifics of crop insurance and acting on purchasing a policy can be the single largest risk mitigation effort you can make.

As part of this, it is important for growers to understand ahead of time what crop insurance underwriters will require to substantiate a claim for loss due to exposure. Growers should make sure to compare what their underwriter may require with that which the buyer may use to reject (or reduce the price of) grapes. Be careful not to get caught in the middle of a rejection by a buyer and a refusal to pay an indemnity by an underwriter.

Ultimately, the "silver bullet" regarding smoke exposure for the industry would be to find a way to clean the contributing undesirable compounds out of wines completely, after processing, so that grapes could be accepted without worry after smoke exposure. Current methods do exist to clean up smoke tainted wines, but there is much uncertainty as to the side effects (like stripping a wine of desired characteristics) and the comprehensiveness of compound removal, particularly as wines age.

AGG will be involved in supporting industry efforts to better define smoke exposure versus smoke taint, and will work with the grower community to mitigate the risks associated with growing grapes under perilous conditions with uncertain consequences.

Grape Concentrate: Dead or Alive?

It's nearly impossible to talk about the winegrape market in California without providing some "honorable mention" regarding the grape concentrate market. After all, grapes crushed for concentrate constitute about 10 percent of the overall grape crush each year. When grapes for concentrate are discussed, there is usually a focus on Thompson Seedless and other various grapes (for white concentrate) and Rubired (for red concentrate).

In past years, the concentrate market constituted about 20 percent of the grape crush annually, but as the wine industry has grown and foreign competition has stymied the production of domestic concentrate (specifically white concentrate), it's percentage of the overall crush has become less. There are a few out there asking if it is back, though, considering last year's jump in the value of Thompson Seedless in the marketplace (up about 30 percent from 2017). And more importantly, many question whether last year's market can be sustained, given the history of price fluctuations and the reality of a global marketplace for a commodity such as white grape concentrate.

Essentially, white concentrate producers are buying grapes "from" other markets, because California's white concentrate is produced primarily from Thompson Seedless, excess table grapes and excess winegrapes. None of these grapes are grown primarily for the white concentrate market. Winegrapes are grown for wine; table grapes are grown for the fresh market; and Thompson Seedless is a raisin variety. This provides for a completely different (and much more variable/volatile) grape market than if these, or other grapes, were grown specifically for white concentrate production.

In years where the raisin, table and/or wine markets are long, the concentrate producers can be the beneficiaries. In years where those markets are tight,

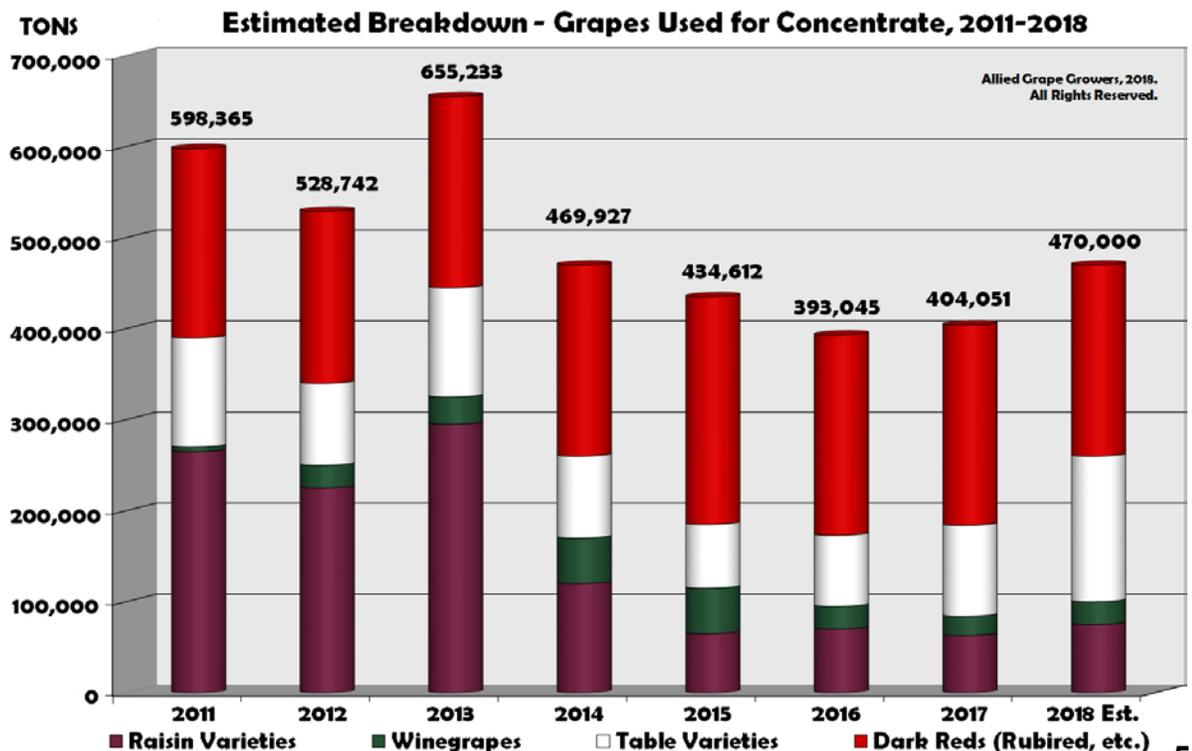
concentrate producers have to make a decision on whether to invest more dollars into grape purchases or forego production altogether. In 2018, they chose to invest the money.

As you can imagine, this variability in supply need makes the challenge of addressing overhead in those operations a bit trickier than it would be otherwise. It also provides a specific challenge to Thompson Seedless growers who like to sell "green" for crush, but don't enjoy the relative market stability that is inherent within other ag markets, where products grown are almost always destined for the same market outlet.

In addition to variable market dynamics within the wine, table and raisin industries annually, the fact that there is formidable foreign competition (primarily from Argentina) in the white concentrate arena, exacerbates the difficulty in stabilizing the market. With an opposite (southern hemisphere) Argentinian harvest season, there are variable amounts of product in the marketplace during our off-season, and it becomes a major factor in setting the stage annually for California demand.

The 2018 marketing year was very strong for white concentrate. Pricing of white concentrate remained stable throughout the year, resulting in attractive grape pricing for Thompson Seedless grapes. This worked well

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Grape Concentrate Assessment

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and in conjunction with the tightening raisin market, which is really what drove higher pricing. However, the unknown at the beginning of harvest was the condition of the table grape market (and to a much lesser extent the winegrape market), which both ended up being in long positions, with surplus grapes widely available by harvest-end.

Because of the commodity aspect of the white grape concentrate market, it is extremely premature to forecast demand for this year, but these are the factors to consider as we enter into the first half of 2019: Argentine production, raisin shipment trends, and grape crop size. These three primary factors will influence the direction of the white concentrate market for 2019. We are exiting 2018 with ample supply (only because of excess table grapes), but we also have many months to pass and many factors to consider prior to making any significant estimates of 2019 demand.

When evaluating the red (or high color) concentrate market, it is fairly easy to track and forecast production, as nearly 100 percent of the product is made from Rubired grapes. Rubired may also be used in winemaking, but the practice of fermenting Rubired grapes for wine is certainly subordinate to the practice of using the color generated from concentration of Rubired to color-up wines. This color can be “extracted” with or without sugar, depending on the process, so the food and beverage industries have numerous options with regard to utilizing the product of grape as an additive to all kinds of products.

California is the primary supplier of grape color in the world, and specifically to the United States. Although other countries produce red grape concentrate, the amount and quality of such are much less. Red concentrate is evaluated in the market place based on the depth of color and can also be categorized based on hue – i.e. more red or more purple. The deeper the color, the more valuable the product.

For this reason, grape buyers are immediately concerned with color in regard to buying Rubired grapes. Much work has been done by grape buyers over the years to evaluate the color of specific vineyards over time. Many have experimented with various viticultural practices, as well as soil and foliar amendments, to enhance color (and sugar) production. For these reasons, what we see in the marketplace is a natural gravitation toward those vineyards that have a proven color history. Buyers are often willing to pay a premium to purchase grapes from vineyards with higher color, and conversely, they quickly shy away from lower color/sugar vineyards.

The market for Rubired remains stable as we enter 2019. The only real instability, if there is any, is centered around vineyards with low (or poor) color and/or sugar history. Our annual grapevine nursery survey has confirmed that no material amount of Rubired has been planted in recent years, so there is no anticipation of increased production capacity.

The basic market challenge for growers in this segment is that there are very few buyers. Whereas there are literally thousands of wineries in the state and dozens that buy grapes from the Central Valley, there are only a handful that actually process Rubired for concentrate.

This makes the transaction arena very transparent. There are few secrets in this segment of the business.

Our forecast for 2019, with it being way too early to have any knowledge of crop size, is that the market should remain stable. Even though the acreage base of Rubired is not increasing, the market isn’t necessarily growing either, as buyers are discovering

additional methods of extracting color from the grapes. In short, they are doing more with less, which is thwarting the need for significant additional plantings.

Besides requiring color, to be successful as a Rubired grower, it is absolutely imperative to be able to achieve high yields. Growing grapes for concentrate is in the commodity arena, where volume counts. With pricing over the years of +/- \$300 per ton, it is certainly a game of yields in order to survive, regardless if you are growing grapes for red or white concentrate production.

California is the primary supplier of grape color in the world & specifically the U. S.

Addressing Wine Shipment Trends

Tracking the specifics of wine sales and shipments can be encouraging and disappointing all at the same time. Depending on which reports or market channels you follow, mixed messages can abound. While we regularly tend to look at the market from a macro-level of overall shipments of wine, we can certainly find strengths and weaknesses in relevant segments and channels that point to longer-term trends, issues and opportunities.

Here are just a few trends we're currently seeing in the wine market:

- Imports have continued to expand their presence in the U.S. market, gaining about 1 percent market share in each of the last three years.
- Direct-to-consumer channels for U.S. wineries continue to expand, as wineries look for margin over volume.
- Wine shipments for bottles above \$9 per bottle continue to grow, while those below \$9 per bottle continue to retract.
- While certain varietals may not do particularly well in the mainstream market, they sometimes explode in popularity in specialty markets as "cult wines," like Red Zinfandel for example.

As has been discussed numerous times over the last year or so, wine shipment growth is slowing, and wine shipments may even be entering a declining period. The graph shows wine shipment performance for the last few years, and it is clear to see times are changing. Although 2018 wasn't looking that strong with regard to the data through September, the year was on track to actually end stronger than it started. We are hoping when all the numbers are tallied we don't experience a second year in a row of declining shipments.

Being able to "track" consumer behavior and preferences will be key to having the right wine in the right place at the right time in the future. The next-generation wine drinker behaves much differently than that of preceding generations. Prognostications by wine industry analyst Rob McMillan, from Silicon Valley Bank, point to the fact that the new-generation wine drinker may not be as loyal to wine as generations before. Substitute products are available to them that generations before have not necessarily had, like craft beer and legal cannabis.

Another important point of recent research is that the next generation is doing "life-things" later than previous generations (like moving out

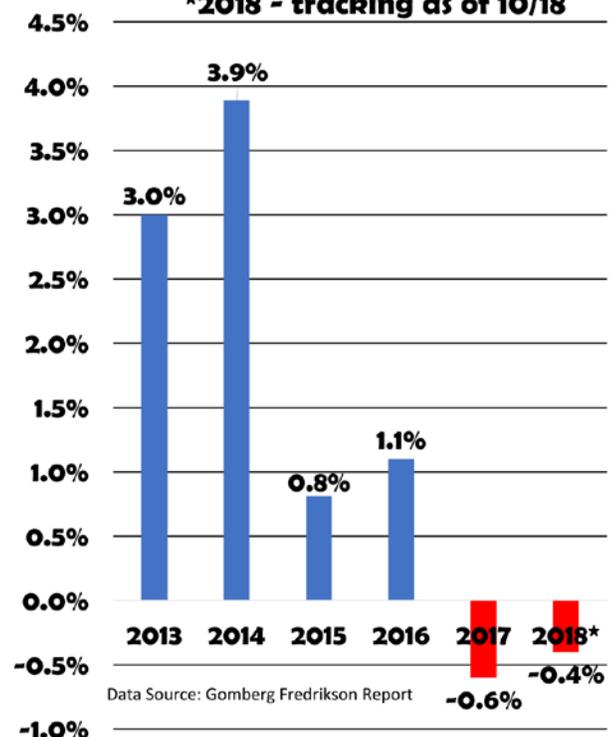
of the house, getting married, having children, etc.). This means that embracing wine as part of the "maturation" process may also be delayed. As Rob McMillan points out, this means we can't necessarily count on them to embrace wine at the same age as preceding generations, which could be exactly what is contributing to the slowing of shipment growth currently.

While there is no specific concern that millennials won't have the money to gravitate more toward wine as they mature, the question becomes, will we have effectively attracted them in that direction, as an industry? What appeals to them? How do we bring the product to them versus putting it out there and expecting them to come to us? How do we differentiate our product in a meaningful manner?

As grape and wine producers, we feel one of the many tools that we have in our toolbox is our competitive advantage with regard to sustainability. The California wine industry is a leader in implementing sustainable practices and documenting such, much more so than competing beverage categories and foreign wine producers. We absolutely should be tying this benefit to our appeal to the millennial generation. Millennials have been raised to be environmentally and socially conscious, and tapping on that one important point may resonate with them in a very meaningful way.

One thing for sure is that we won't know exactly what the next generation of wine consumers is thinking or what drives their purchase decisions unless we carefully gather data. We need to continue doing this as an industry, and purposefully implement strategy to appeal to their wants and desires with regard to beverage alcohol.

**California Wine Shipments
Change From Previous Year
*2018 - tracking as of 10/18**



Grower Profile: *The Capp Brothers*

Farming is definitely in the blood of this edition's featured AGG growers, Brian and Rob Capp. The Capp brothers have been farming all of their lives and, like their father before them, are members of Allied Grape Growers. In addition to farming their own grapes in both Solano's Suisun Valley and Napa's Gordon Valley, the brothers provide vineyard management services for several AGG members within Suisun Valley. They also offer mechanical harvesting and grape hauling services.

The Capp family's relationship with AGG began with their father, Lanny Capp. Lanny farmed the family ranch in Napa's Gordon Valley, growing Zinfandel and Petite Sirah. Sons Rob and Brian have carried on the family tradition, preserving the Zinfandel vineyard that Lanny planted in 1969, while adding Petite Sirah and Sauvignon Blanc to their estate holdings, for a total of about 35 acres under vine in Gordon Valley.



About two miles down the road from the Capp Estate Ranch, just over the Napa County line into Solano County, the Capp brothers are farming the 40-acre Inn Ranch. The Capps have been farming sustainably for years, and at the Inn Ranch they get a little help with the weed control from the native wildlife. Wild pigs are often nocturnal visitors, mowing through any weeds that pop up in the vine rows or under the vines. Soil aeration is another nice side effect of these visits.

The Inn Ranch consists mostly of Sauvignon Blanc, along with 7 acres of Cabernet Sauvignon, and about 3 acres each of Verdelho and Malvasia Bianca. These last two uncommon grape varieties have proven to be popular with some of the smaller Napa and Sonoma wineries, and the resulting wines have been lauded in the press. Their 2015 vineyard designated Malvasia Bianca is pictured here.



Getting deeper into Solano's Suisun Valley, the Capps are also farming the Chavez Ranch, consisting of about 30 acres of Chardonnay and 8 acres of Cabernet Sauvignon, as well as the SVR Ranch, which is about 10 acres consisting of Cabernet Sauvignon, Merlot and Syrah.

Brian Capp (pictured on the left) is one of the newest members of the AGG board of directors, being elected to the board in 2017. He and fellow board member Tim Norgard (Mendocino County), represent District Four, which comprises all the North Coast counties—Napa, Sonoma, Mendocino, Lake, and Solano.

The Capp brothers are both married and have children. They are hopeful that the next generation will be involved in the vineyards. Recently, Jacob Capp, when not fighting fires as part of the Gordon Valley Fire Department, has been learning the business from his dad, Rob, and uncle, Brian. This past year, Jacob was the primary operator of the Capp's new mechanical harvester.

AGG's Upcoming Calendar Items

Unified Wine & Grape Symposium
Sacramento, CA January 29-31
www.unifiedsymposium.org

Lodi Grape Day & Lodi Farm Safety
Lodi, CA February 5 & March 7
www.lodichamber.com/grape-farm-safety-days

UC Cooperative Extension & San Joaquin Valley Winegrowers' Mechanical Pruning Field Demo
Fresno, CA February 19
www.idrinkwine.net/event/

San Joaquin Valley Winegrowers' Annual Tailgate Meeting & Field Day
Madera, CA March 6
www.idrinkwine.net/event/

Central Coast Insights & WiVi Program
Paso Robles, CA March 12 & 13
www.wbmevents.com

CAWG's Day at the Capitol
Sacramento, CA April 10
www.cawg.org

AGG's District Membership Meetings:
Election District 1, Central Valley
2 meetings: Selma & Fresno - April 16
Election Districts 2 & 3, North Valley/Lodi/Delta - Stockton - April 17
Election District 4, North Coast
Napa & Santa Rosa - April 23 & 24

Vineyard Economics Symposium
Napa, CA May 8
www.wbmevents.com

CAWG's Summer Conference
Sonoma, CA June 25
www.cawg.org

Lodi Wine Economics Symposium
Lodi, CA June 26
www.wbmevents.com

Allied Grape Growers' Annual Meetings
Fresno - July 9 & Santa Rosa - July 11

Sponsored in part by Rain & Hail Insurance.



Invitations and additional details for the AGG-specific events will be sent ahead of the events for members, sponsors & affiliates.

Outside of farming, the Capps are avid hunters and fishermen. Post-harvest, they can often be found either at their cabin in the Sierras or off on a hunting trip somewhere. The Capps represent the epitome of a true family farming operation, an increasingly rare find these days. Keep up the good work guys!