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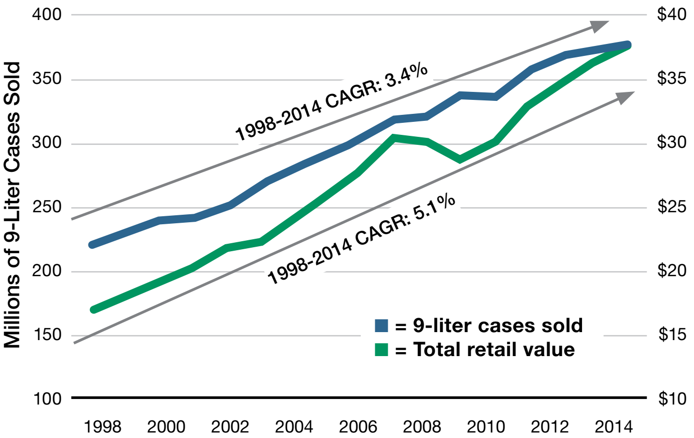
Predicting Mergers and Acquisitions in 2016

The stage for 2016 is set: The U.S. economy continues to expand; capital markets are relatively strong; U.S. wine consumption continues to rise, and consumers' purchase patterns increasingly favor more expensive wines. Wine sales have increased during the past 16 years at an average of 3.4% per year, reaching 375 million cases (or approximately 2.8 gallons per capita in 2014). As of 2013, the U.S. became the largest wine market in the world, with plenty of room for continued growth in per-capita consumption.

U.S. WINE SALES, 1998-2014



The ongoing growth and attractiveness of the U.S. wine industry has created a fertile environment for merger and acquisition (M&A) activity. Established players as well as new entrants are likely to continue using acquisitions to stake out or strengthen their competitive positions.

2015 retrospective

Looking at 2015 through the rearview mirror, it was a year of noteworthy transactions involving major wine players. High-profile deals included Treasury Wine Estates' $600 million purchase of the majority of Diageo's wine portfolio, Constellation Brands' $315 million purchase of Meiomi, and E. & J. Gallo Winery's acquisition of J Vineyards, Talbott Vineyards and The Ranch Winery. There were many other notable M&A transactions in 2015 and, as with any other year, M&A transactions in process that were delayed or otherwise have not yet come to fruition.

We owe the elevated level of transaction activity to a number of key long-term drivers shaping the wine industry. These include three closely related trends: premiumization, portfolio rebalancing and geographic diversification. In addition, the relentless consolidation occurring in the distribution channels continues to be a strong motivator to increase scale through acquisitions. Barring major economic dislocation, these trends are likely to continue their influence into 2016, portending another year of significant transaction activity. However, there are also factors that could temper the level of deal activity, and we would not be surprised to see a decline in the total dollar value of M&A transactions in 2016 compared to 2015.

Premiumization: industry continues to move up market

In conjunction with increased consumption, consumers are shifting to more expensive wine. This premiumization trend, which is also occurring in the spirits and beer sectors, has become very apparent in recent years, as demonstrated by the chart showing California winery revenue by price segment in 2011 and 2014. Wine above $7 per bottle increased from 66% of total revenue in 2011 to 71% of revenue in 2014, while the share of wine below $7 wine shrank proportionately during the same period.

The premiumization trend continued into 2015. Nielsen data show that the largest increases for the 52 weeks ending Nov. 7, 2015, were for bottles above $9, and the $12-$14.99 price category led other price categories with more than 10% growth.

Premiumization was the primary driver for many of the major transactions occurring in 2015. The table M&A Acquisitions: 2005 vs. 2015 contrasts the low retail price points of key acquisitions made in 2005 and 2006 by Constellation Brands, E. & J. Gallo Winery and The Wine Group with their acquisitions in 2015 of brands positioned in the ultra premium and luxury categories.

A quick review of historical M&A transactions shows that premiumization-driven acquisitions are often also focused on strengthening the acquirer's position in a rapidly growing grape varietal and tapping into premium vineyard sources in specific AVAs to feed the acquired brand. As recent examples, Meiomi, Siduri, J Vineyards and Talbott Vineyards were all strong ultra-premium or luxury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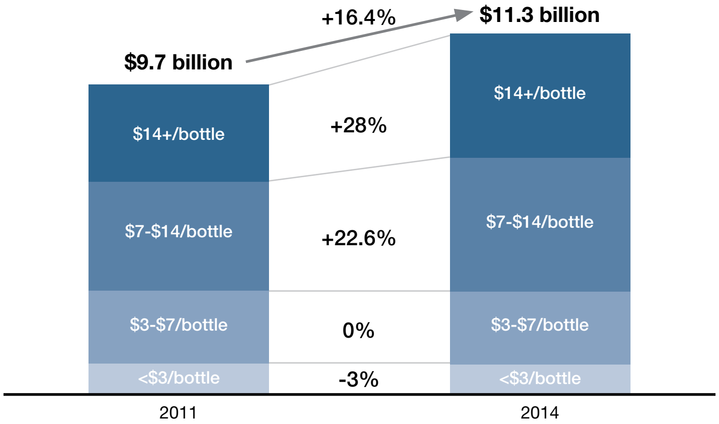
CALIFORNIA WINERY REVENUE BY PRICE SEGMENT



Source: Gomberg, Fredrikson & Associates

growth brands with significant Pinot Noir sales. In the case of J Vineyards and Talbott, Gallo also acquired significant North Coast and Central Coast vineyards in the transactions, while the Meiomi and Siduri acquisitions gave Constellation Brands and Jackson Family Wines access to new supplier relationships to support the acquired brands.

Portfolio rebalancing

The overall growth of the industry can sometimes obscure the reality that wine brands—like other consumer product brands—have life cycles, and that once-vital brands can lose their luster and enter a period of stagnation or decline. For example, of the top 100 wine brands in the U.S. market as measured in 2014, 48 of those brands were stagnant or lost volume since 2010. The declining brands' total loss of 21.1 million cases since 2010 was offset by growth in the other 52 brands totaling 37.4 million cases, for a net gain of 16.6 million cases between 2010 and 2014.

As a result of this natural "churning" of brands in the market, suppliers with multi-brand portfolios inevitably find themselves with some brands that are no longer performing and are dragging down the overall growth of the portfolio. In addition, these brands may not be positioned in premium price categories. Revitalizing a troubled brand can be a long and unpredictable undertaking, as is starting a new brand from scratch. Often it is faster and more practical to ignore or divest the problem brands and acquire new growth brands that have already achieved traction in the marketplace. We expect the need for brand portfolio rebalancing to continue to be a strong catalyst for acquisitions in 2016 and beyond.

Geographic diversification

Premium wine growing regions outside California's North Coast continue to gain awareness and credibility with consumers. Washington and Oregon wines are increasingly recognized not only for their high absolute quality, but also for their compelling price to quality ratios. Similarly, San Luis Obispo and Santa Barbara counties are witnessing increased recognition for ultrapremium and luxury wines from specific subappellations including Paso Robles and Santa Rita Hills. At one time, the majority of grapes grown in the Paso Robles region were used in California appellation or other regional AVA wines. Over the past

M&A ACQUISITIONS: 2005 VS. 2015

Acquirer	2005: Targets $10 and under retail	2015: Targets $18+ retail
Constellation Brands	Rex-Goliath ($7-$9)	Meiomi ($18-$25)
E. & J. Gallo Winery	Barefoot Wine ($5-$7)	J Vineyards ($20 and up)
The Wine Group	Big House ($10)	Benziger Family Winery ($15-$25)

decade, wine brands using the Paso Robles appellation have proliferated, and at the high end, we have witnessed the ascendancy of a number of cult luxury brands producing Rhone or Bordeaux varietals under the Paso Robles appellation.

Wine producers are following the consumer to these regions. For example, Jackson Family Wines has become a significant vineyard holder in Oregon over the past several years, and Gallo now sources a substantial amount of fruit from Washington. Vineyard acreage in the Pacific Northwest is less expensive to develop and comes with fewer regulatory constraints than in California, enabling the creation of scalable brands at $15 to $25 per bottle retail price points. In California, North Coast producers are increasingly looking to build a presence in the Central Coast, particularly Paso Robles. As a result, we expect to see increased acquisition activity in the Pacific Northwest and California's Central Coast over the next few years.

Distribution channel consolidation

Channel consolidation continues to occur at both the distributor and retailer levels. Notable recent examples in the distributor tier include the announced merger of Charmer Sunbelt and Wirtz Beverage, creating a combined entity with $6 billion in annual sales in 2016 covering 16 U.S. markets. Examples of increased concentration in the retail channel include the announced acquisiton of Rite Aid by Walgreens and the continued growth and market share gains of the Total Wine chain as it expands across the country from its East Coast base. At the same time, the number of wineries and wine brands is growing rapidly, creating a fundamental mismatch with the available distribution channels.

As a result, the minimum size at which a wine producer is considered "relevant" to the shrinking number of distributors continues to rise. We believe that channel consolidation will continue to motivate wine producers to achieve increased scale through acquisition in 2016 and beyond.

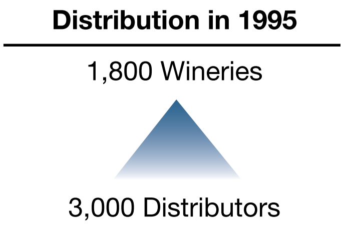
Expectations for 2016

Public companies: Following the economic recession and until mid-2014, the major publicly traded companies stayed on the sidelines, making few major wine acquisitions. This changed with the purchase of Kenwood Vineyards by Pernod Ricard, followed by the aforementioned acquisitions of Meiomi by Constellation Brands

2014 WEST COAST VINEYARD PRODUCTION AND PRICING

Region	2014 Bearing Acres	2014 Total Tons	Average Price per Ton
Washington	48,000	227,000	$1,100
Oregon	25,000	78,000	$2,100
CA District 1 – Mendocino	16,000	60,000	$1,500
CA District 3 – Sonoma	60,000	250,000	$2,300
CA District 4 – Napa	45,000	175,000	$4,000
CA District 8 – Santa Barbara/ San Luis Obispo	45,000	210,000	$1,500

Source: USDA Grape Acreage Reports and Grape Crush Reports; information rounded.



Source: The Wine Institute, V2 Wine Group

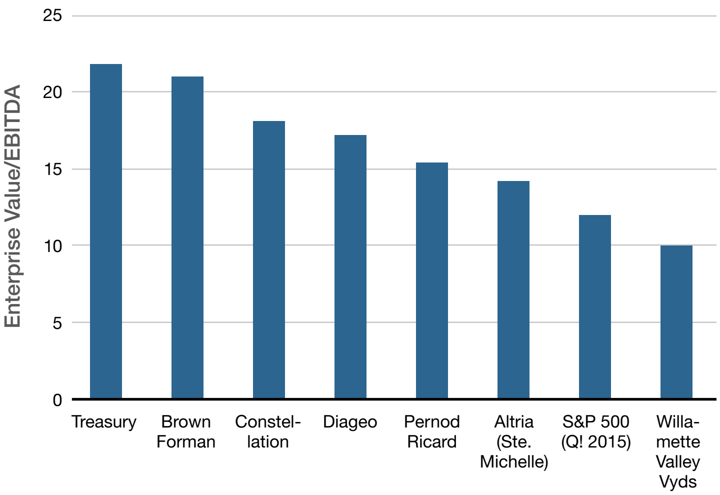
and the Diageo wine business by Treasury Wine Estates. Valuations of publicly traded wine companies are currently quite strong (as measured by the ratio of total enterprise value to EBITDA), giving them access to capital and a strong currency for making acquisitions.

In general, public companies can be expected to continue their focus on acquiring brands rather than assets, with a selective preference for larger brands that can immediately contribute to sales and earnings. While Diageo has exited the U.S. wine business, Constellation Brands remains an active acquirer and Treasury Wine Estates, through the Diageo acquisition, has clearly signaled a commitment to growing its brand portfolio rather than entertaining buyout offers. Although Ste. Michelle Wine Estates has not made a major brand acquisition since 2007, it has access to significant capital resources through parent Altria and continues to actively evaluate available acquisition opportunities.

Private companies: Major privately owned wine producers are likely to continue to be active acquirers in 2016, each with differing acquisition interests depending on their corporate goals and strategies. For example, E&J Gallo is likely to continue to bolster its presence in the above $20 per bottle retail price segment with a preference for integrated brands with vineyards. Jackson Family Wines is focused on acquiring brands that can leverage their extensive premium vineyard assets in California and Oregon. Vintage Wine Estates, which acquired the $10 to $20 per bottle B.R. Cohn brand in 2015, can be expected to seek additional brand acquisitions in similar premium price categories as the company builds critical mass in anticipation of a possible IPO.

Foreign investors: While some international buyers may be hampered by the strength of the U.S. dollar, the U.S. remains a very

PUBLIC WINE-RELATED COMPANIES VALUATION MULTIPLES



Source: Capital IQ, Yahoo Finance, 11/29/15 attractive growth market for international wine producers, and owning a U.S. brand can provide significant credibility within the sales channels. Potential acquirers going forward will include companies such as Pernod Ricard and Concha Y Toro, which already own U.S. brands and may wish to increase their presence in the market, as well as other Western European, South American or Chinese companies who would be seeking to strengthen their foothold in the U.S. market by acquiring a domestic brand and sales team. Although somewhat unpredictable, Chinese buyers continue to express interest in U.S. wine investments involving vineyards and real estate to diversify their holdings outside China.

Private equity: It is no secret that the wine industry, with its long investment horizons, high working capital requirements and complex distribution structure, has not been a good fit for traditional private equity funds. In addition, purely financial investors are ill equipped to compete for acquisitions with strategic acquirers, who can typically pay higher valuations based on the synergies they bring to the transaction. However, there is growing evidence that certain individual investors, funds and family offices may have found an appropriate niche in acquiring smaller, luxury-priced boutique brands. These brands can be efficiently managed to maximize margins and profitability, often predominately through the direct-to-consumer channel. Recent examples include the acquisition of Kosta Browne by J.W. Childs and the purchase of Brewer-Clifton by a private investor group. We expect to see more of these acquisitions as insightful investors explore whether it makes sense to own several of these brands with the potential to share back-office functions and direct-marketing expertise.

Factors potentially inhibiting acquisitions

Impact of craft spirits and beer: Craft spirits and craft beer are growing rapidly and receiving significant attention, particularly from younger consumers. Craft is synonymous with experimentation, and there has been noticeable erosion of wine's share in the on-premise markets as consumers choose to sample new cocktails and craft beers. Particularly in the case of larger, diversified beverage suppliers such as Constellation Brands, the craft sector threatens to divert acquisition dollars and attention away from the wine industry.

Valuation as a balancing act: M&A activity historically is the strongest when buyers expect sales and profits to continue and sellers still have reasonable price expectations. The wine industry has experienced a period of growth since 2012, with many industry insiders of the mindset that sales will continue to be strong into the foreseeable future. This tends to increase valuations as both buyers and sellers believe significant growth can be achieved at relatively low risk levels. Based on past experience, buyers may begin to associate more risk with that growth the further into an expansion cycle we move, which can create a widening gap between buyers' valuations and sellers' expectations.

Difficult to rival 2015 transaction value: With Constellation Brands and Treasury Wine Estates spending close to $1 billion on two transactions in 2015 (Diageo and Meiomi), it is likely that 2016, even with significant continued acquisition activity, will not match 2015 in total dollars transacted.

Zepponi & Co. is a mergers and acquisitions advisory firm focused on wine, craft beverages, food and agribusiness. Zepponi & Company is one of the most active merger and acquisition firms in its areas of expertise and has served as advisors in transactions involving Constellation Brands, Pernod Ricard, Diageo Chateau & Estate Wines, Jackson Family Wines, and F. Korbel & Bros. For more information, please visit zepponi.com.