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Top News • Top Deals • Top Hires • Top Products

The 100 Largest Vineyard Owners in Napa Valley
2017 Growing Season in Review



Aftermath

SPECIAL REPORT FIRE RECOVERY

- Smoke Taint Research
- Insurance Tips
- How to Help

Top Deals

Mergers & Acquisitions Review

Number of acquisitions down; premiumization, mid-tier growth continue

George Coope, Zepponi & Company



George Coope, senior director of strategy and analysis at Zepponi & Company, has more than 25 years of investment banking and advisory experience in the wine, beer and distilled spirits industries. Prior to joining the firm, Coope held senior roles at several boutique investment banks in San Francisco and was a founding member of the consumer practice group at Hambrecht & Quist LLC. Coope also worked in R&D and operations at Miller Brewing Company. He is a former director of Patz & Hall Wine Company and The Coppola Companies. Coope graduated with a BA from Stanford University, an MS in food science with a specialization in viticulture and enology from UC Davis and an MBA from Harvard Business School. Prior to attending UC Davis, he worked as an apprentice to the general manager and winemaker at Domaine Comte Georges de Vogüé in Chambolle-Musigny, France. George holds Series 7 (General Securities Representative), 24 (General Securities Principal) and 63 (California Securities Representative) securities registrations and a Certified Valuation Analyst (CVA) designation from the National Association of Certified Valuators and Analysts.

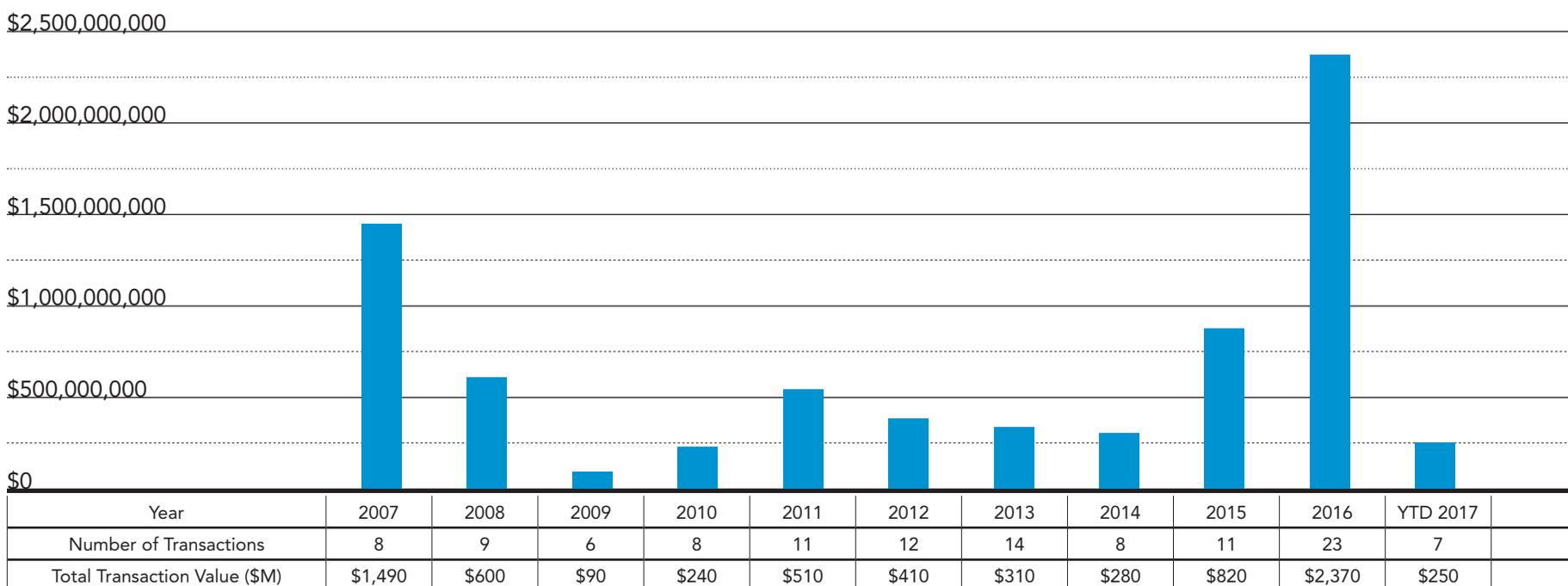
THIS YEAR MARKED THE eighth year of economic expansion following the recessionary low of 2009, with growth characterized as “slight to moderate” in the **Federal Reserve Bank’s** July report. Overall, low unemployment and record stock market performance created a favorable environment for consumer spending. Interest rates remained relatively low despite the general expectation that the Federal Reserve Bank would raise rates by year-end. The wine industry continued to do its part to contribute to economic growth, with **Nielsen** Scantrack data showing 2.4 percent year-over-year dollar volume growth in the food and liquor retail channels through August 12, 2017. This marked a continuation of the industry’s progress in 2016, which saw total wine sales in the U.S. increase 4.2 percent

to \$59.5 billion in retail value compared to 2015 while average annual wine consumption per U.S. resident edged upward to 2.94 gallons.

Merger and acquisition activity in the U.S. wine industry continued at a moderately strong pace in 2017. However, the total number and value of transactions did not reach the heights of 2016, which witnessed six deals exceeding \$100 million in value, led by the \$550 million sale of **Diageo’s** U.S. wine business to **Treasury Wine Estates**.

From the standpoint of acquirer motivations, a number of familiar themes that drove the wine M&A market in recent years were also at work in 2017. As in 2016, the premiumization trend appears to be the primary purpose behind a number of transactions as suppliers acquired \$20 and higher brands

Transaction Activity - \$10M+ U.S. Wine Acquisitions



Source: Zepponi & Company, press releases, SEC filings and other industry sources. Disclosure: Transactions of U.S. wine businesses where the transaction value was equal or greater than \$10 million, and excludes vineyard transactions.

TABLE: Notable Wine Industry Transactions Announced in 2017

Closing Date	Target	Acquirer	Assets Acquired	Location
January	Cameron Hughes Wine, Inc.	Vintage Wine Estates	Brand and Inventory	California
April	Jamieson Ranch and Reata Brands	WX Brands	Brand and Inventory	Napa, California
April	Bread & Butter	WX Brands	Brand and Inventory	California
April	Blossom Hill Winery	Delicato Family Vineyards	Facility	Central Coast, California
April	Stagecoach Vineyard	E&J Gallo	Vineyard	Napa, California
April	Geyserville Facility (Silver Oak Cellars)	Michael-David Winery	Facility	Sonoma, California
April	Klipsun Vineyard	Terlato Wines International	Vineyard	Red Mountain, Washington
April	Beaux Frères	Maisons & Domaines Henriot	Brand, Facility and Vineyards	Newberg, Oregon
April	Ovid Napa Valley	Silver Oak Cellars	Brand, Facility and Vineyard	Napa, California
May	Brewer-Clifton	Jackson Family Wines	Brand, Vineyards and Facility Lease	Sta. Rita Hills, California
June	Firesteed Cellars	Vintage Wine Estates	Brand and Inventory	Willamette Valley, Oregon
June	Bartolucci – Stice Lane Vineyard	Raymond Vineyards/Boisset Collection	Vineyard	Napa, California
June	Schrader Cellars	Constellation Brands	Brand and Inventory	Napa, California
June	Hawks View Cellars	Ponte Family Estate	Brand, Facility and Vineyard	Sherwood, Oregon
June	Standing Stone Vineyards	Hermann J. Wiemer Winery	Brand, Facility and Vineyards	Finger Lakes, New York
August	Calera Wine Company	Duckhorn Wine Company/TSG	Brand, Facility and Vineyards	Central Coast, California
August	Germain-Robin	E&J Gallo	Brand and Inventory	Mendocino, California
September	Prince Hill Vineyard	Silver Oak Cellars	Vineyard	Willamette Valley, Oregon

to upgrade their portfolios to match shifting consumer preferences. The acquisition of strategic vineyard and production facility assets to support volume growth, particularly in the upper price segments, was also a common theme. Mid-tier producers, pressured by consolidating distribution channels and the enormous clout of **E&J Gallo**, **Constellation Brands** and **The Wine Group**, acquired brands to continue to build scale in their businesses. Finally, a number of transactions fell under the banner of geographic diversification as domestic and foreign suppliers looked to establish or augment their presence in the Pacific Northwest and California's Central Coast. Not surprisingly, many of the acquisitions to be discussed in this review fall into more than one of these categories.

Premiumization, Continued

With consumers continuing to shift their wine purchases to the higher price segments, suppliers are motivated to follow them by acquiring additional upscale brands. In a transaction that attracted significant attention, Constellation Brands purchased Napa Valley's **Schrader Cellars** in June 2017. Schrader is a sub-5,000-case boutique luxury brand best known for its \$200 and up Cabernet Sauvignon sourced from **Andy Beckstoffer's** portion of the historic **To Kalon Vineyard** in Oakville. This acquisition gives Constellation the opportunity to divert grapes from its own portion of To Kalon Vineyard, acquired in the 2004 purchase of **Robert Mondavi Winery**, into the higher-priced Schrader label, thereby improving utilization of this unique vineyard asset.

TABLE: M&A Transaction Activity – Primary Drivers

Target	Acquirer	Premiumization	Assets to Support Growth	Mid-tier Players Building Scale	Geographic Diversification	Private Equity Platform
Orin Swift	E&J Gallo	●				
Robert Hall Winery	O'Neill Vintners & Distillers			●	●	
Duckhorn Vineyards	TSG Consumer Partners					●
Charles Smith Wines	Constellation Brands				●	
WillaKenzie Estate	Jackson Family Wines				●	
Bread & Butter	WX Brands			●		
Stagecoach Vineyard	E&J Gallo		●			
Beaux Frères	Maisons Domaines Henriot				●	
Ovid Napa Valley	Silver Oak	●				
Schrader	Constellation Brands	●				
Calera Wine Company	Duckhorn Vineyards			●	●	

Source: Zepponi & Company

In the under-the-radar luxury American brandy category, E&J Gallo acquired **Germain-Robin** of Mendocino County in August, including the brand and sizable stocks of aged, pot-distilled brandy. Founded in 1982, Germain-Robin is a highly respected, but often overlooked, artisan spirits producer that was arguably decades ahead of the craft spirits boom. Premiumization transactions were not limited to major companies, such as Constellation and Gallo. Napa's **Silver Oak Cellars**, whose Cabernet Sauvignon wines sell at \$75 to \$125, added an even higher price tier to its portfolio by acquiring **Ovid Napa Valley**, whose wines are priced at \$300 and above. Besides the Ovid brand, the purchase includes prime Pritchard Hill vineyard acreage, contributing to Silver Oak's long-term goal of expanding its portfolio of estate vineyards.

Strategic Assets for Growth

Pursuit of a premiumization strategy creates a commensurate need for top-quality vineyards and production facilities to support these brands. In 2017, several suppliers acquired strategic vineyard or production assets to fuel the growth of their premium brands. The marquee transaction of the year was undoubtedly Gallo's acquisition of the 600-acre **Stagecoach Vineyard** in Napa Valley, which supplies grapes to over 90 high-end wineries, including Gallo's own **Louis Martini** and **Orin Swift** labels. **Roger Nabedian**, senior vice president of Gallo's Premium Wine Division, explained, "This purchase affirms Gallo's commitment to compete in the luxury wine segment." Gallo agreed to honor the grape contracts currently in place but, over the long term, is likely to utilize an increasing portion of Stagecoach grapes in its existing Napa Valley brands and in new brands yet to be developed or acquired.

Moving Forward

The factors driving robust M&A activity over last several years are largely still in place.

Factors Supporting Continued Favorable M&A Environment

- Continuing consolidation of retailers and distributors
- Ongoing premiumization trend
- Competition for premium grape sources
- Recognition of Pacific NW quality and economic advantages
- Low interest rates
- Private equity "dry powder" at historically high levels
- High attractiveness of U.S. to international players

Source: Zepponi & Company

Delicato Family Vineyards acquired the 4 million-case capacity **Blossom Hill** winery facility near Salinas to support the growth of its family of brands, some of which are sourced from the company's Central Coast vineyards and growers. Hardly a newcomer to the Central Coast, Delicato has owned the **San Bernabe Vineyard** in Monterey County since 1988 and further increased its Monterey presence last year with the purchase of the **River Road Vineyard** in the Santa Lucia Highlands.

Michael David Winery of Lodi, producer of **7 Deadly Zins**, **Freakshow** and **Petite Petit**, established its first physical presence in the North Coast with the purchase of Silver Oak Cellars' Geyserville production facility in the Alexander Valley. The production facility became dispensable for Silver Oak in light of the opening of its new state-of-the-art production and hospitality facility in the Alexander Valley. Michael David already sources grapes from Sonoma and Mendocino counties, as blending components for its Lodi wines, and has long-term plans to build a Sonoma wine portfolio. In Napa Valley, **Raymond Vineyards/Boisset Collection** added to its portfolio of estate vineyards with the purchase of the **Bartolucci** family's **Stice Lane Vineyard** in the St. Helena AVA. The vineyard is located adjacent to an existing Boisset-owned vineyard and is a stone's throw from the Raymond winery facility.

Mid-tier Producers Build Scale

The U.S. wine industry is distinguished by its unique combination of extreme concentration and extreme fragmentation among producers. Based on 2016 depletions from **IMPACT Databank**, the top three wine marketers, Gallo, Constellation and The Wine Group, together comprise approximately 51 percent of the total U.S. market. However, after the big three, the next 20 companies together account for only another 32 percent of the market. **Trinchero Family Estates** is the largest of this second-tier group at a 5.2 percent share of depletions, and even such well-known producers as **Ste. Michelle Wine Estates** and **Jackson Family Wines** claim only low single-digit shares of total case volume.

The competitive implication is that suppliers outside of the top three operate at a chronic disadvantage in terms of relative influence and leverage with distributors and retailers, and need to keep growing to maintain relevance and visibility in the distribution channel. In 2017, there were a number of acquisitions by mid-tier companies that have been frequent acquirers in recent years. The year began with **Vintage Wine Estates'** purchase of **Cameron Hughes Wine** as part of a bankruptcy court settlement reached in January. The Cameron Hughes brand joins VWE's growing portfolio of mostly acquired brands, currently at 28 and counting.

WX Brands, which is building a portfolio of owned brands to complement its core private label business, acquired the **Jamieson Ranch Vineyards'** brand portfolio in April from an investor group. WX also announced in April the larger and more notable acquisition of **Bread & Butter**, a rapidly-growing \$12 to \$15 California Chardonnay and Pinot Noir brand. Two very active mid-tier acquirers in previous years, **Foley Family Wines** and **The Wonderful Company**, were surprisingly quiet in 2017.

Geographic Diversification

We have discussed in previous years' articles the increasing attraction of the Pacific Northwest and California's Central Coast as areas for investment in brands, vineyards and production assets. Reasons include these regions' growing worldwide reputation for quality, their superior planting and sourcing economics and their relatively lower regulatory constraints compared to California's North Coast. 2017 transactions in the Pacific Northwest included the purchase of the famed **Klipsun Vineyard** in Washington's Red Mountain AVA by **Terlato Wines International**, Silver Oak's acquisition of **Dick Erath's** esteemed **Prince Hill Vineyard** in the Dundee Hills appellation of Willamette Valley and the acquisition of Oregon's **Firesteed Cellars** brand by **Vintage Wine Estates**. Investment in the region was not limited to domestic players, as France's **Maisons & Domaines Henriot**, owner of **Henriot Champagne** and Burgundy's **Bouchard Père & Fils**, acquired the **Beaux Frères** brand and vineyard in Newberg, Oregon.

Shifting its focus to California's Central Coast, following a series of acquisitions in Oregon, **Jackson Family Wines** purchased **Brewer-Clifton**, a 100 percent estate producer of Sta. Rita Hills Pinot Noir and Chardonnay in Santa Barbara County. In August, **Duckhorn Wine Company** acquired **Calera Wine Company** in the Gavilan Mountains east of Salinas. Calera was founded in 1975 by **Josh Jensen**, considered one of the pioneers of California Pinot Noir. Calera represents Duckhorn's first Central Coast investment.



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What's Next?

While M&A activity in the U.S wine industry was moderately strong through 2017, it did not match 2016 in terms of sheer number of large deals or total transaction value. Perhaps the slowing of activity in 2017 can be seen as a temporary pause as the acquirers of 2016 “digest” their new purchases. As of 2017 year-end, most of the positive factors driving acquisition activity remained in place, including growth in the overall wine market, premiumization and low interest rates.

Nevertheless, it is prudent to be mindful that we are well along in an economic expansion cycle that has been fueled largely by consumer spending and low interest rates. The stock market is trading at historic highs based on price-to-earnings multiples that are high compared to longer-term averages. While the economy currently remains in relatively good shape, potential sellers of brands and assets in the wine industry should be cognizant that no cycle lasts forever. [WBM](#)

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