Industry at a Glance

Wineries in 2012

Key Statistics Snapshot

Revenue	Annual Growth 07-12	Annual Growth 12-17
$16.6bn	4.6%	5.2%
Profit	**Exports**	**Businesses**
$1.2bn	$1.5bn	7,069

Market Share

E. & J. Gallo Winery 21.8%

Constellation Brands Inc. 15.2%

The Wine Group, Inc. 8.1%

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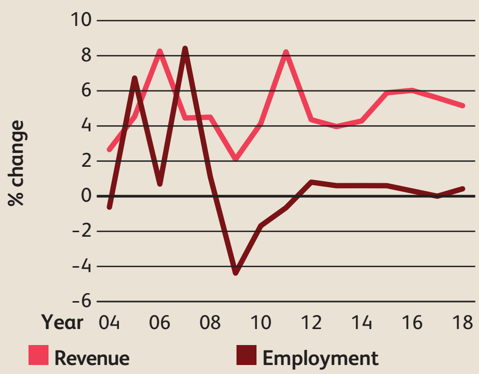
Revenue vs. employment growth



Per capita alcohol consumption

SOURCE: WWW.IBISWORLD.COM

Key External Drivers

- Per capita alcohol consumption
- Consumer sentiment index
- Demand from beer, wine and liquor stores
- Price of fruit
- Trade-weighted index
- Demand from bars and nightclubs

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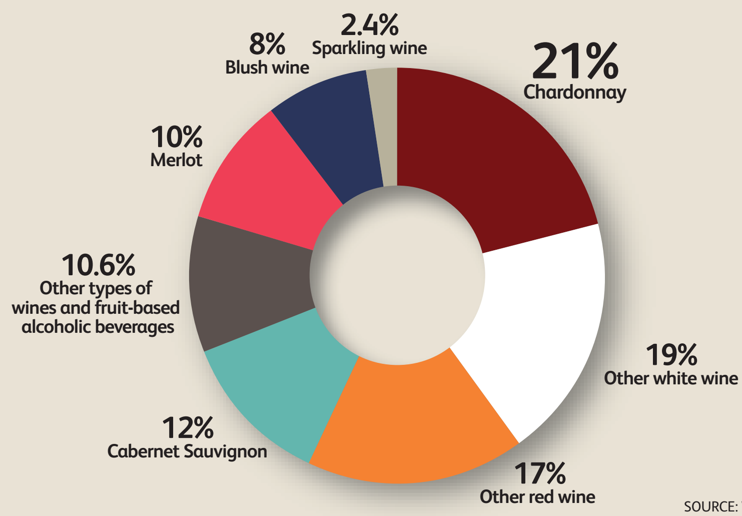
Products and services segmentation (2012)



SOURCE: WWW.IBISWORLD.COM

Industry Structure

Life Cycle Stage	Growth	Regulation Level	Heavy
Revenue Volatility	Medium	Technology Change	Medium
Capital Intensity	Medium	Barriers to Entry	Medium
Industry Assistance	Low	Industry Globalization	Medium
Concentration Level	Medium	Competition Level	High

FOR ADDITIONAL STATISTICS AND TIME SERIES SEE THE APPENDIX ON PAGE 46

Industry Performance

Executive Summary | Key External Drivers | Current Performance
Industry Outlook | Life Cycle Stage

Executive Summary

The Wineries industry is enjoying a growing base of wine drinkers, particularly among the millennial generation. Rising consumption has increased revenue at a rate of 4.6% per year on average over the past five years. The industry has not been without its troubles, however; during the economic recession, sales fell, and demand shifted to lower-priced wines, causing revenue to rise only a marginal 2.1% in 2009. Nonetheless, revenue rebounded in 2010 and grew strongly in 2011. Mirroring the improving economy, wine consumption is expected to increases further in 2012, allowing revenue to rise a moderate 4.4% to total $16.1 billion.

A growing base of wine drinkers trading up after the recession will bolster growth

Although operating profit increased in 2011 as consumers started to "trade up," profit is expected to decrease in 2012 as producers struggle to pass along all of the rising costs of grapes. Lower price points have benefited the larger players that are able to produce in bulk. However, smaller wineries are struggling to cope with consolidation among suppliers, wholesalers and retailers. Despite the consolidation trend, new wineries are still entering the industry. During the five years to 2012, the number of operators is expected to increase at an annualized rate of 4.3% to total 7,069. Over the next five years, consolidation throughout the supply chain is expected to continue, as producers build relationships with larger wholesalers and strive to meet increasing demand from consumers, particularly for low- to medium-price wines.

Smaller wineries are finding refuge in direct-to-consumer wines. Retail and on-premise (i.e. restaurant and bar) sales fell sharply during the economic recession, so many producers turned to selling via the internet and in tasting rooms. Regulations for direct sales vary by state, though, complicating this distribution method. Pending legislation is likely to increase hurdles in the coming years, which could negatively influence industry profit. In another blow to profit, grape prices are forecast to continue their upward climb. While revenue is projected to rise at an average annual rate of 5.1% to $21.4 billion through 2017, profitability is projected to decline over the period.

Key External Drivers

Per capita alcohol consumption

Consumer perceptions of alcohol and their level of alcohol consumption has a significant effect on industry demand. While overall alcohol consumption has been flat, per capita consumption of wine has increased in the United States over the last five years, largely as a result of new knowledge on the potential health benefits of moderately consuming wine. This driver is expected to increase in 2013, representing a potential opportunity for the industry.

Consumer sentiment index

The consumer sentiment index (CSI) tracks how consumers perceive their own financial situations and the general economy. As the CSI increases, individuals are willing to spend more money on wine because they have a positive view of their financial outlook. The CSI is expected to increase during 2013.

Demand from beer, wine and liquor stores

Retailers are a key link in the distribution channel since they sell wine to the final

Industry Performance

Key External Drivers continued

consumer. Wineries are particularly dependent on the level of demand from beer, wine and liquor stores. Demand from this segment is expected to decrease slightly during 2013.

Price of fruit

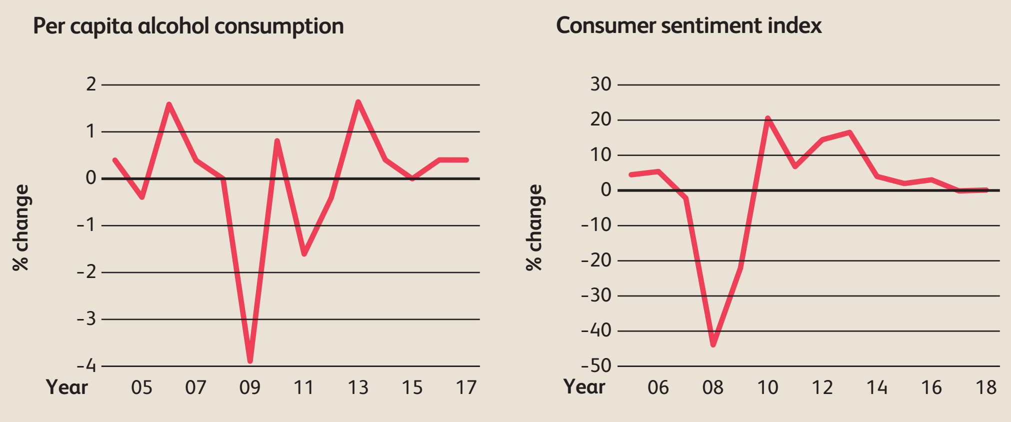
The price of fruit affects the profitability of wineries because grapes are a key input in the wine production process. These prices are affected by climatic conditions and the quality and quantity of grapes yielded. Therefore, an increase in the price of grapes can negatively affect an operator's bottom line, so it is important for winemakers to purchase grapes under contract arrangements. This price of fruit is expected to increase during 2013, posing a potential threat to the industry.

Trade-weighted index

As the value of the US dollars against other currencies increases, US wine becomes relatively expensive in comparison with wines produced abroad. This causes exports to decline and imports to increase. The trade-weighted index is expected to increase during 2013.

Demand from bars and nightclubs

Drinking places sell directly to consumers, so they are a key to the success of winemakers. Since drinking places choose which brands to stock, industry operators rely on their business in order to boost revenue. This driver is expected to increase during 2013.



SOURCE: WWW.IBISWORLD.COM

Industry Performance

Current Performance

The Wineries industry is large, expanding, complex and highly fragmented. Currently, the United States is a major wine producer and a growing exporter. During the five years to 2012, industry revenue has grown an average of 4.6% per year to total $16.6 billion. Growth of 4.4% in 2012 will represent a slowdown from 2011, as rises in grape costs drive up wine prices and slightly dampen demand growth. Although the economic recession diminished demand for higher-priced wine, sales expanded at a slow and steady pace due to overall rising wine consumption. As the US economy slowly recovers, the Wineries industry has been regaining its momentum. Continued steady growth in 2012 is attributed to the improving economy and the resulting increase in consumer confidence. As consumers begin to spend again on alcoholic beverages, including wine, competition in the industry is becoming more heated.

In 2010 the US surpassed France as the world's largest wine-consuming nation

Aiding the increase in the volume of wine sales, consumer preferences have shifted away from beer toward wine and spirits over the past five years. One factor driving this trend is consumer health concerns; medical studies released during the past decade have shown that moderate consumption of wine and spirits could benefit overall health. Also, the recent trend of low-carb diets has discouraged consumption of beer, which is generally high in carbohydrates, encouraging the consumption of wine as an alternative.

No toasts for the economy

In 2009, sales took a hit when consumer sentiment fell during the recession. Weak economic growth drove wine drinkers to buy more affordable wines at the expense of higher-priced wines; despite vintners shipping more wine than in the previous year, retail value fell. The above-average wine grape crop in 2009 further burdened wineries by adding to inventories. As a result, winemakers continued to reduce prices to spur sales growth in 2010. In addition, the recession drove individuals to be thriftier about spending money on luxuries like trips to bars or clubs, reducing sales even further. In 2010 and 2011, however, consumer spending picked back up, which resulted in more trips to bars and nightclubs. Spending growth at nightclubs is forecast to continue in 2012.

The changing consumption patterns of consumers also hit international wine markets. The value of US wine exports decreased in 2009, the first decline since 2005. Prior to the global financial crisis in 2008, the euro steadily appreciated against the dollar due to Europe's robust export trade, making US wine exports relatively cheaper for European buyers. Following the global financial crisis, however, investors around the world fled to safety in the US economy, causing the dollar to appreciate against the rest of the world's currencies, including the euro. The rise in the US dollar relative to the euro contributed to falling shipments to the European Union, though growing exports to Asia partly offset the weakness in the European market.

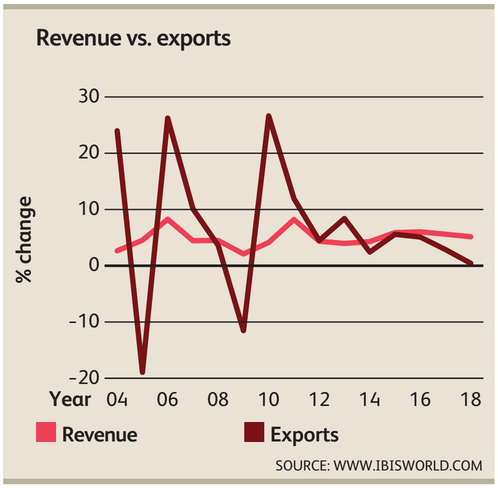
Industry Performance

Globalizing wine

The nation's largest wineries capitalized on the "trading-down" phenomenon that occurred during the recession, in which consumers opted for lower-priced wines at the expense of higher-quality varieties, by tapping into the increasingly globalized supply of cheap wine. Massive wineries like E & J Gallo, Constellation Brands and the Wine Group imported bulk wines, such as Pinot noir from France and Malbec from Argentina. These companies then bottled the wine in the United States and sold it to the US market. This trend of US wineries outsourcing wine production has been growing for several years, but it exploded in 2009, and is expected to expand in 2012 to an estimated 30.4%. The shifting paradigm has caused US wineries to be more conscious of foreign competitors.

The United States is a major target for exporting countries that suffer economically and are looking for opportunities to sell elsewhere. Traditional wine-drinking nations, such as France, Italy and Spain, have been facing dropping domestic consumption, pushing those nations to look for new markets for their wines. Meanwhile, the new-world wine industries in Argentina, Chile, Australia and New Zealand have far lower production costs than the United States thanks to technological advances like mechanized harvesting and pruning. These nations are targeting the US market, which heightens competition in the industry. Even producers of the highest-end wines are facing challenges from lower-price imported wines. The improving quality of bulk wines is changing consumers' ideas about how much they should pay for wine.

In 2012, the picked back up, as demand for wine regained momentum.



According to wine industry consultants Gomberg, Fredrikson & Associates, the United States surpassed France as the world's largest wine-consuming nation in 2010, purchasing almost 330.0 million cases. The value of exports also rebounded significantly in 2010, mirroring a decline in the value of the US dollar relative to the euro. That same year, imports also increased due to the progressive willingness of younger adults to experiment with new varieties and a reduction in the California winegrape crush.

As the world economy improves, exports are expected to continue rising in 2012 to reach 8.8% of industry revenue. Most of this growth has been in volume, but in 2011, consumers started to trade up to more expensive wines. According to the Nielsen Company, a provider of measurements and information to the wine industry, higher price segments have been dominating recent growth. In 2012, sales in the $20-plus category are expected to take more market share. This is a far cry from 2009, when the least-expensive segment showed the biggest gains.

Industry Performance

Distribution issues along the supply chain

Though several wineries and vineyards changed hands in distressed sales or foreclosures in 2009, in the five years to 2012, the number of enterprises is expected to increase 4.3% on average per year to 7,069. The number of establishments is expected to grow at a stronger 7.9% annualized rate to 8,407. During the recession, many properties carried too much debt or were new arrivals to the industry with significant investments in starting a business. This made it difficult for producers to exit the industry, contributing to the rising number of operators. Additionally, banks limited lending to fund mergers and acquisitions. In the absence of a traditionally strong presence from publicly traded beverage companies, privately owned wine companies became the focus of activity for standalone brands and wineries.

The poor economic environment has also encouraged consolidation at the wholesale level, which pressured distribution in the industry. While sales improved in 2011, small to medium-size wineries continued to face distribution and supply challenges because of consolidation along the supply chain. Wineries, such as Constellation Brands, the second-largest wine company, have been restructuring their distributor relationships, reducing the number of companies that they work with. Larger operators increased demand from distributors, which shut out smaller operators from the supply chain. Amid the trading down trend at the retail level and the considerable slowdown in restaurant sales, distributors had to decide which winery's sales targets they would meet. Consequently, more companies are consolidating and are turning to direct-to-consumer sales.

> Smaller wineries face distribution challenges because of consolidation along the supply chain

The largest companies account for a significant percentage of the industry. The more sizeable wineries aim to produce uniform wines through vertical integration, growing grapes in their own vineyards or having grapes grown for them according to winery-set specifications. Despite this control over grape procurement, all industry operators are susceptible to climate changes from year to year, which affects production and costs. Nat DiBuduo, president of Allied Grape Growers in Fresno, noted that the 2009 wine grape crop in California was the largest since 2005. The major varieties experienced significantly higher production, led by large crops on the Central Coast and northern interior. However, with freezing temperatures in April 2011, California's Central Coast lost about 40.0% of its grape crop after one of the worst spring frosts in history, according to the Paso Robles Wine Country Alliance. Meanwhile, the supply of California wine grapes is falling to keep pace with sales of finished wine. This is causing costs to rise and is expected to pressure operating profit down to 7.5% of revenue in 2012. The prices that producers must charge distributors, retailers and direct customers are expected to rise in 2012 because of this emerging shortage of wine grapes. Demand from consumers is expected to dampen as a result.