Wine & Spirits Monitor

Industry continues to benefit from rising consumer confidence.

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Trend Tracker

INVENTORY

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NOLVs

- NOLVs increased for producers by up to two percentage points over the previous quarter due to improved sales and market conditions, as well as decreased for distributors by up to five percentage points over the last year due to reduced margins.

SALES TRENDS

- Sales trends increased overall due to the successful introduction of new brands and varietals, increased sales of lower-priced labels, as well as a stronger overall fourth quarter in 2013 versus 2012.

GROSS MARGIN

- Gross margins increased for certain producers due to operational efficiencies and lower-cost vintages and decreased for other companies due to increased discounts and lower-margin product offerings.

INVENTORY

- Inventory levels increased for producers as they harvest and process bulk wine, while inventory levels decreased for distributors due to holiday sales.

PRICING

- Pricing was mixed for bulk wine depending on the demand of specific varietals and appellations, while corn and wheat prices decreased due to increased supplies.
Overview

Higher consumer economic confidence, continued consumption by Baby Boomers, rise of the Millennials, and an increase in direct-to-consumer sales have continued to propel the wine and spirits industry. Danny Brager, senior vice president of Nielsen’s Beverage Alcohol Practice Area, cites that across major consumer goods categories, only wine, coffee, and snacks have experienced consistent five-year growth (not including specific categories such as craft beer or prepared cocktails).

Consumers are also willing to spend on average 3% more on a bottle of wine than in years past, but “the pricing sweet-spot is still between $10 and $15,” says Brager.

Though Baby Boomers comprise the base of high-frequency wine drinkers, according to John Gillespie, president of the Wine Market Council, Millennials (ages 20 to 37) are not to be ignored. “The youngest Millennials will be of legal drinking age in 2015,” says Gillespie, adding, “and there are 70 million of them.”

Millennials comprise 30% of drinkers and purchase wine over $20 with frequency, though Baby Boomers still spend more money on average for a single bottle of wine. In addition, Baby Boomers carry the domestic market, but Millennials are more likely to purchase imported bottles, underscoring the generation’s exploratory spirit.

U.S. wine exports, 90% from California, reached a record high $1.6 billion in winery revenues in 2013, up 16.4% compared to the previous year, an increase for the fourth consecutive year by value. Volume shipments reached 435.2 million liters or 48.4 million cases, up 7.5%.

“Consumers across the globe continue to recognize the quality, diversity, and value of California wines, despite significant trade barriers and heavily subsidized foreign competitors,” said Wine Institute President and CEO Robert P. (Bobby) Koch. “While the U.S. remains our largest, most important market, California exports a fifth of its wine, and we are on track to reach our goal of $2 billion in exports by 2020. Our outstanding 2012 and 2013 California vintages, heralded for quality as well as quantity, were a record high so we have the ability to expand.”

As direct-to-consumer wine sales become more available, wine drinkers are exploring their options. Tourism and winery visits drive the majority of a winery’s repeat sales and wine clubs, but retailers are also stepping up their game. According to Brager, there are now 522,000 nationwide retail outlets for wine, beer, and spirits. Citing companies that have started carrying wine like Walgreens and 7-Eleven, Brager notes that there are now more chains than independent shops selling wine. “It’s helping to convert occasional drinkers into high-frequency drinkers,” said Brager.
WINE

California wine producers shipped an estimated 3.6% more wine to U.S. markets last year, increasing from 208 million nine-liter cases in 2012 to 216 million in 2013. U.S. wine shipments rose 2.7% last year to 370 million cases, according to estimates by Gomberg Fredrikson & Associates based on state and federal data through October or November.

“The industry is in a state of transition from a severe shortage to a more balanced market,” said industry analyst Jon Fredrikson. That transition came as a shortage of wine from smaller 2010 and 2011 California vintages created a surge in grape and wine prices in the past two years, Fredrikson said. Although 2013 was not great for wine sales, the industry is positioned for “strong” growth this year, he said.

Small wineries have been benefitting from more sales directly to consumers, now reaching 40 states nine years after the 2005 U.S. Supreme Court’s Granholm decision started to open such access. Increasing e-commerce by physical and virtual wine shops are providing even more options for producers, while the “flash” sale website phenomenon has been waning as winery inventories dwindled.

The volume of direct sales grew 9.3% last year, according to the latest figures from ShipCompliant, a major wine shipping regulatory compliance conduit.

U.S. off-premise wine sales increased 3.1% for the four weeks ended November 9, 2013 versus the prior year, according to data from Nielsen. Domestic and imported wine sales increased 3.6% and 1.7%, respectively. In case volume during the same period, domestic and imported case volume decreased 0.3% and 1.1%, respectively.

Sales for wine across all price points above $9.0 increased, with the over $20.00 segment exhibiting the most growth of 23.2% in sales and 19.0% in volume.

The $9.00 to $11.99, $12.00 to $14.99, and $15.00 to $19.99 segments all grew between 2% and 9% in sales and volume. All price points under $9.0 fell in both sales and volume.

Chardonnay continued to represent the top-selling varietal, maintaining 19.0% of the market share in sales and 19.4% in volume. During the four weeks ended November 9, 2013, chardonnay grew 0.8% in sales and 1.3% in volume. The second-largest varietal, cabernet sauvignon, represented 16.0% of sales and 13.4% of case volume. Over the same four-week period, cabernet sauvignon grew 5.4% in sales and 2.4% in volume.
Overview

SPIRITS

American distilled spirit exports broke new records in 2013, crossing the $1.5 billion threshold, according to the Distilled Spirits Council of the United States (“DISCUS”). This growth was driven by premium bourbon and Tennessee whiskey, which exceeded the $1 billion mark for the first time. Growing economic confidence in the U.S. and a burgeoning cocktail culture have helped to fuel demand for premium spirits.

“Eighty years after Prohibition repeal, this global whiskey renaissance is a trend that is benefiting producers, large and small, in the United States and around the world,” said DISCUS Chief Executive Officer Peter H. Cressy in a statement. “These export records are driven by industry innovation, a very positive perception of American distilled spirits quality and heritage, and market-opening trade agreements.”

Thanks in part to favorable demographics, higher disposable incomes, and a regulated distribution system, spirits sales in the U.S. are both resilient and highly profitable. The council reported steady 2013 supplier sales growth in the U.S. market of 4.4% to $22.2 billion, paced by whiskeys of all varieties. Total U.S. volume growth was up 1.9% to approximately 206 million cases, and estimated overall retail sales of distilled spirits in the U.S. market was upward of $66 billion.

In addition, the group estimated that the overall market share of distilled spirits grew for the fourth straight year, rising by 0.4% for a total of 34.7% share of the beverage alcohol market.

Key factors contributing to the U.S. market growth included industry product innovations; consumer fascination with premiumization, heritage, and cocktail culture; expanded access through state market modernizations; and effective hospitality tax restraint by legislatures, according to DISCUS.

“The wide product selection spirits suppliers offer consumers again paid off with solid revenue growth,” DISCUS Chief Economist David Ozgo said in a statement. “For the first time in decades, all whiskey categories saw some growth. Whiskey was once the dominant spirit of choice for most Americans. While growth had been picking up over the last few years, 2013 was a banner year.”

Ozgo reported that whiskeys of all varieties in the domestic market grew 6.2% to 52.7 million cases, worth just more than $7 billion in supplier sales, up 10.1% or $643 million in 2013. Highlights within the whiskey category include Irish whiskey, which was up 17.5% in volume to 2.5 million cases worth $500 million and up 20.5% in revenue; single-malt Scotch, which was up 11.6% in volume to 1.8 million cases worth $590 million and up 14.7% in revenue; and bourbon and Tennessee whiskey, which were up 6.8% in volume to 18 million cases worth $2.4 billion and up 10.2% in revenue.
Overview

BEER

Although mainstream beer is on the decline, craft beer is on the rise. In the U.S., wine and spirits sales have cut into beer’s market share. In 2002, 60% of consumers purchased beer, with only 13% and 27% purchasing wine and spirits, respectively. Today, beer still boasts the majority (51.1%), but it is not experiencing the same robust growth as wine or segments of the spirits industry. Sales of beer-adjacent beverages, such as ciders and flavored malts, however, are growing, and craft beer is basking in double-digit growth, with a third of the market share.

According to Technomic’s 2014 Special Trends in Adult Beverage Report: State of the Industry report, craft beer production was up 9.6% in 2013, while overall beer production fell 1.4%. This growing popularity of specialty beers is paving the way for a new crop of beer makers.

“Over the last couple of years, the number of new brewery openings has been at near unprecedented levels,” said Bart Watson, Ph.D., staff economist at Brewers Association, a craft beer industry group. “We’re seeing breweries open at about a rate of 1.2 per day.”

Craft beer is predominantly consumed by high-income, young white men, while the Wine Market Council determined that women are more likely to be high-frequency, high-end wine drinkers. While wine drinkers are overwhelmingly white, African-American and Hispanic drinkers are increasingly introduced to wine through blended wines, which is also a growing drink category.
Recent Appraisal Trends

WINE AND SPIRITS PRODUCERS

NOLVs for wine and spirits producers have increased by up to two percentage points over the previous quarter due to improved sales and market conditions.

Sales trends have increased overall due to increased sales of lower-priced labels, as well as a stronger overall fourth quarter in 2013 versus 2012.

Gross margins increased for certain producers due to operational efficiencies and lower-cost vintages and decreased for other companies due to lower-margin product offerings.

Based on the cyclical nature of wine production, aging, and release, producers maintain increased levels of bulk wine due to the recent wine grape harvest. The level of bulk wines will decrease as the 2012 vintage is aged and bottled.

WINE AND SPIRITS DISTRIBUTORS

NOLVs decreased year-over-year by up to five percentage points due to reduced margins.

For the companies that GA appraised, sales increased due to the successful introductions of new brands and varietals, while another company’s sales decreased due to the loss of a major contract.

Gross margins have decreased for distributors due to increased discounts and an increase in lower-margin product offerings.

Inventory levels decreased for most distributors as a result of holiday sales.
Pricing Trends

BULK WINE

Though California has been stricken by drought, the state celebrated a record wine grape harvest. According to Cyril Penn, editor of Wine Business Monthly, the state’s preliminary crush report says 4.23 million tons of wine grapes were crushed in 2013, representing an increase of 5% over the 4.02 million tons crushed in 2012.

One of the reasons for California’s second bumper crop in a row is that growers have been planting more grapes. The record harvest also benefited from good weather for grape growing in recent years. In places such as Napa Valley, there is still enough water underground to keep the vineyards thriving despite the drought.

Though some grape growers are making contingency plans for the potential lack of water in the future, grapes fortunately use less water compared to a lot of other crops.

Between November 1, 2013 and January 1, 2014, Ciatti values for bulk wine varied significantly based on origin and varietal. Prices for Napa Valley cabernet sauvignon and pinot noir increased by up to 6%, though decreased by up to 4% for merlot and chardonnay.

In Sonoma Valley, prices for cabernet sauvignon and pinot noir remained unchanged, while merlot and chardonnay decreased by up to 17%. In the Central Valley, prices for cabernet sauvignon and merlot decreased by up to 14%, while pinot noir remained unchanged and chardonnay increased 12%.

According to the California Department of Food and Agriculture’s preliminary 2013 grape crop report, new tonnage records were set stateside, while, on average, grape prices declined. Industry analyst George Schofield reported that “Napa is out of sync with everybody. The entire state is up in volume and down in price, and Napa is just the opposite.”

GA relies on bulk wine prices from the nation’s two leading brokerage companies, Ciatti Company and Turrentine Brokerage. Turrentine claims that its broad range of values covers approximately 95% of sales, while its most likely range applies to roughly 80% of sales. However, estimates from neither brokerage are guaranteed to reflect actual market prices.
CORN

The USDA estimates the U.S. harvested a record corn crop of 13,985 billion bushels in 2013/2104 from 92 million acres, with an average yield of 165.3 bushels per acre. The current corn crop is up slightly from the prior year’s record of 13,925 billion bushels.

High inventory levels will mean bigger inventories before next year’s harvests, leaving stockpiles on August 31, 2015 at 2.111 billion bushels, which would be the highest since 2005 and 43% larger than the 1.481 billion projected for a year earlier, according to the USDA.

“Even with smaller global crops, large carryover stocks of corn...will sustain competition for U.S. exports. Crop prices will continue to decline.”

The monthly average farm price received for corn has decreased for the 12 months ended January 2014 from $7.04 per bushel in February 2013 to $4.42 per bushel in January 2014, a decrease of 37.2%. The price as of February 28 was $4.47 per bushel.

Due to these lower prices, the Department of Agriculture said U.S. farmers were likely to plant less corn in the upcoming season, switching land to soybeans and wheat instead, but that normal weather would still result in bumper crops all around.
Pricing Trends

WHEAT

According to the USDA’s Wheat Outlook, the 2013/2014 season-average farm price range approximates $6.85 to $6.95 per bushel, which is a decrease from the record $7.77 per bushel reported for the 2012/2013 season.

U.S. wheat inventories are expected to rise to 587 million bushels before the 2015 harvest, compared with 558 million projected for June 1, according to the USDA. Production may rise 1.4% to 2.16 billion bushels as farmers harvest a larger percentage of planted acreage.

The monthly average farm price received for wheat decreased from $7.00 per bushel in October 2013 to $6.31 per bushel in January 2014, a decline of 9.9%. The price as of February 28 was $6.67 per bushel.

Wheat U.S. Average Farm Price Received
For the 12 Months Ended January 2014 versus 2013

Source: USDA, National Agricultural Statistics Service
## PRICING TRENDS

**Bulk Wine (California Varietals) – Percent change in varietal prices from the previous period**

<table>
<thead>
<tr>
<th>Region</th>
<th>Date</th>
<th>Cabernet</th>
<th>Merlot</th>
<th>Pinot Noir</th>
<th>Chardonnay</th>
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<tbody>
<tr>
<td>Napa Valley</td>
<td>January 1, 2014</td>
<td>4%</td>
<td>(3%)</td>
<td>6%</td>
<td>(4%)</td>
</tr>
<tr>
<td></td>
<td>November 1, 2013</td>
<td>(4%)</td>
<td>(3%)</td>
<td>(3%)</td>
<td>14%</td>
</tr>
<tr>
<td></td>
<td>June 1, 2013</td>
<td>(4%)</td>
<td>(6%)</td>
<td>(3%)</td>
<td>(15%)</td>
</tr>
<tr>
<td>Sonoma Valley</td>
<td>January 1, 2014</td>
<td>0%</td>
<td>(17%)</td>
<td>0%</td>
<td>(9%)</td>
</tr>
<tr>
<td></td>
<td>November 1, 2013</td>
<td>8%</td>
<td>(14%)</td>
<td>0%</td>
<td>16%</td>
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<tr>
<td></td>
<td>June 1, 2013</td>
<td>0%</td>
<td>0%</td>
<td>(9%)</td>
<td>(17%)</td>
</tr>
<tr>
<td>Central Valley</td>
<td>January 1, 2014</td>
<td>(14%)</td>
<td>(8%)</td>
<td>0%</td>
<td>12%</td>
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<tr>
<td></td>
<td>November 1, 2013</td>
<td>0%</td>
<td>(4%)</td>
<td>-</td>
<td>6%</td>
</tr>
<tr>
<td></td>
<td>June 1, 2013</td>
<td>0%</td>
<td>4%</td>
<td>-</td>
<td>(20%)</td>
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### U.S. Corn – Farm Price Received ($ per bushel)

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<th>Marketing Year</th>
<th>January</th>
<th>December</th>
<th>November</th>
<th>October</th>
<th>September</th>
<th>August</th>
<th>July</th>
<th>June</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014/2013</td>
<td>$4.42</td>
<td>$4.31</td>
<td>$4.35</td>
<td>$4.61</td>
<td>$5.40</td>
<td>$6.21</td>
<td>$6.79</td>
<td>$6.97</td>
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<tr>
<td>2013/2012</td>
<td>$6.96</td>
<td>$6.87</td>
<td>$7.01</td>
<td>$6.78</td>
<td>$6.89</td>
<td>$7.63</td>
<td>$7.14</td>
<td>$6.37</td>
</tr>
<tr>
<td>Change</td>
<td>(57.5%)</td>
<td>(59.4%)</td>
<td>(61.1%)</td>
<td>(47.1%)</td>
<td>(27.6%)</td>
<td>(22.9%)</td>
<td>(5.2%)</td>
<td>8.6%</td>
</tr>
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### U.S. Wheat – Farm Price Received ($ per bushel)

<table>
<thead>
<tr>
<th>Marketing Year</th>
<th>January</th>
<th>February</th>
<th>November</th>
<th>October</th>
<th>September</th>
<th>August</th>
<th>July</th>
<th>June</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014/2013</td>
<td>$6.31</td>
<td>$6.73</td>
<td>$6.85</td>
<td>$7.00</td>
<td>$6.80</td>
<td>$6.87</td>
<td>$6.93</td>
<td>$7.32</td>
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<tr>
<td>2013/2012</td>
<td>$8.12</td>
<td>$8.30</td>
<td>$8.47</td>
<td>$8.38</td>
<td>$8.27</td>
<td>$8.04</td>
<td>$7.89</td>
<td>$6.70</td>
</tr>
<tr>
<td>Change</td>
<td>(28.7%)</td>
<td>(23.3%)</td>
<td>(23.6%)</td>
<td>(19.7%)</td>
<td>(21.6%)</td>
<td>(17.0%)</td>
<td>(13.9%)</td>
<td>8.5%</td>
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</table>
Experience

GA was involved in the liquidation of Havens Wine Cellars and Billington Imports LLC and has liquidated several national and regional grocery stores that included wine and spirits such as A&P, Andronicos, Cost Cutter, Food Pavilion, and The Markets. GA has also worked with and appraised numerous companies within the wine and spirits industry. While our clients remain confidential, they include industry leaders, including large distributors and specialty retailers of alcoholic beverages, producers of wine and beer, and national and regional grocery stores. Products have included a wide variety of value-priced, mid-tier, premium, and ultra-premium brands throughout the industry including highly recognizable and reputable names. GA’s extensive list of appraisal experience includes:

- Leading regional distributors of spirits, wine, and beer with products such as vodka, whiskey, cognac, rum, brandy, scotch, tequila, various wines, craft beers, and non-alcoholic beverages such as mixers, water, and carbonated drinks.
- Producers and rectifiers of whiskey and other distilled spirits, including vodka, gin, tequila, liqueurs, and absinthe, which are sold under well-recognized, nationally distributed brands.
- A producer and distributor of private label wine, beer, and spirits for large retailers primarily in the U.S. and the U.K.
- One of the largest specialty retailers of alcoholic beverages in the West that offers more than 3,000 types of wine, 1,500 types of spirits, and 1,200 types of beer.
- One of the largest distributors of wine and spirits in the U.S. with revenues of over $1.5 billion and servicing liquor stores, grocery stores, restaurants, and bars, as well as casinos and reservations.
- National and regional grocery stores that sell a wide variety of beer, wine, and spirits.

In addition to wholesalers of case and bulk wine, including those mentioned on the previous page, GA also maintains extensive appraisal experience with numerous domestic wineries, allowing for additional specialization:

- A well-known producer of ultra-premium, luxury wines from estate vineyards in Napa Valley and Anderson Valley, as well as from vineyards in the Russian River Valley and Sonoma Valley.
- A producer of wines originating primarily from California’s North and Central Coasts, as well as from the Lodi AVA in the Central Valley, which are sold under its well-known labels throughout the U.S. and the world.
- A producer of moderate- to high-end wines, with varietals including pinot noir and chardonnay and sourced from its three estate vineyards in the Carneros American Viticulture Area, while the remainder is sourced from growers primarily in the same AVA in Napa and Sonoma counties.
- A bottler and distributor of wines under several proprietary labels, with varietals including cabernet sauvignon, chardonnay, meritage, and zinfandel, sourced from California and internationally.
- A Napa Valley producer of high-end wines sold under its well-known proprietary labels, with over 99% of its grapes sourced from its 235-acre estate vineyard in Rutherford, California.
- A producer and marketer of moderate- to high-end wines in the Napa Valley and Sonoma County, all of which are produced with estate-grown fruit and sold under three owned brands.
- A producer of moderate- to high-priced wines in the Pacific Northwest and California including eight well-known brands with an annual production of over half a million cases.
- A high-end producer of wines, including Bordeaux-style blends and varietals such as merlot, chardonnay, and pinot noir, which are sourced from its own 100-acre vineyard near Napa, California, while the remainder is from several California vineyards.
- Numerous importers and marketers of more than 500 foreign and domestic brands of wine.

In addition to our vast liquidation and appraisal experience, GA maintains contacts within the wine and spirits industry that we utilize for insight and perspective on recovery values.
Monitor Information

The Wine & Spirits Monitor relates information covering most wine and spirits, including industry trends, market pricing, and their relation to our valuation process. GA provides our customer base with a concise document highlighting the wine and spirits industry. Due to the commodity nature of bulk wine and spirits, timely reporting is necessary to understand an ever-changing marketplace. GA strives to contextualize important indicators in order to provide a more in-depth perspective of the market as a whole. GA welcomes the opportunity to make our expertise available to you in every possible way. Should you need any further information or wish to discuss recovery ranges for a particular segment, please feel free to contact your GA Business Development Officer using the contact information shown in this and all Wine & Spirits Monitor issues.

GA’s Wine & Spirits Monitor provides market value and industry trend information for a variety of wine and spirits. The information contained herein is based on a composite of GA’s industry expertise, contact with industry personnel, liquidation and appraisal experience, and data compiled from a variety of well-respected sources believed to be reliable. We do not guarantee the completeness of such information or make any representation as to its accuracy.
About Great American Group

GA is a leading provider of asset disposition solutions and valuation and appraisal services to a wide range of retail, wholesale, and industrial clients, as well as lenders, capital providers, private equity investors, and professional services firms. In addition to the Wine & Spirits Monitor, GA also provides clients with industry expertise in the form of monitors for the U.S. chemicals and plastics; metals; building materials and woodworking equipment; food; automotive; and textiles and apparel industries, among others. GA also offers Europe Monitors via its subsidiary, GA Europe Valuations Limited.