

PREMIUM WINE GROUP
MID-YEAR UPDATE 2005

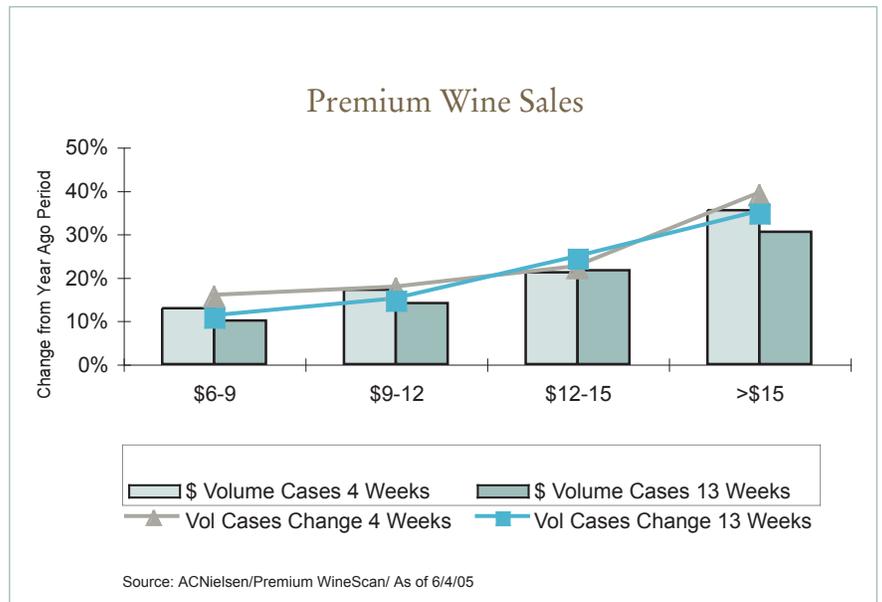
Now that we are through the frost, spring rains and the buds are set, we're optimistic about the second half of 2005. From our vantage point serving many premium wine businesses up and down the West coast, we've made a few observations that may prove helpful to you and your business in the coming months. According to an early estimate (using an inexact science), yields for the 2005 year appear to be normal to slightly higher — coming off of the past couple years where overall yields were off by 25 percent.

New in 2005

- We are seeing fewer and fewer discounts and promotions. Yet, given the large winery mergers and distributor consolidations, some near-term state-to-state sales disruptions have been caused.
- Of course, we view the Supreme Court decision regarding interstate wine sales as a positive for premium wineries since it promises to open up such promising markets as New York, the second-largest wine consuming state. The impact on the other states, however, is still in question and the timing of borders opening — even New York's — is still not clear.
- For those in the market for French oak, the recent decreases in the price of the euro are positive for those wineries that did not use hedging strategies to protect against exchange rate fluctuations. But, it's hard to say whether the recent euro softness will abate, so hedging is still something to consider. Demand for French oak appears to be marginally higher compared to last year, while American oak purchases are up significantly so far this year.

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As discussed in the SVB Premium Wine Group's Annual Forecast published in January of this year, demand and sales are up in the fine wine segment. This is a constant thread of discussion among virtually all the winery managers we talk to. Using Silicon Valley Bank's proprietary Peer Group Analysis* benchmarking program, sales in the first quarter of 2005 appear to be growing around 30 percent compared to the same period in 2004.



The WineryExchange's Premium WineScan data echoes this, showing domestic sales of wine priced above \$15 growing right around 35 percent for the first four months of the year.

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New in 2005 (continued)

- As the wine business publicly begins to reassert itself, there is a growing need for industry investors. We are seeing demand from the outside and within the industry for the purchase of existing winery properties, opportunities for one partner to buy out another, and various other equity based transactions.

* SVB Peer Group Analysis Program

Silicon Valley Bank's Peer Group Analysis program is a benchmarking tool the company developed to track and compare a variety of financial measures among premium wineries. Due to Silicon Valley Bank's niche focus and significant market share of premium wineries, it is able to develop meaningful benchmarking information and it makes the data available to its clients. The data, based on financial information from over 100 premium wineries over several years, also allows Silicon Valley Bank's Premium Wine Group to monitor industry trends.

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Progress continues to be made toward eliminating the excess wine supply in bottles at the producer level, though there is still inventory of 2000 Cabernet that needs to sell through in many wineries. According to Turrentine Grapes & Wine, bulk wine prices have stabilized and have started "creeping upwards." "Even Cabernet Sauvignon, which has suffered the most in the last couple of years from excess supply, is finally starting to move in substantial volumes and with some increasing prices," Turrentine reports.

From our perspective, the premium wine industry is well on its way to recovery, though, as with any two-sided story, there is a soft underbelly to consider. While many wineries made good decisions to limit production or slow growth in the trough or took early losses on bulk wine, many wineries were less capable of predicting their ability to sell in a more difficult market. Some wineries also made leaps into second labels. Some second labels worked. Some didn't.

A meaningful percentage of wineries are carrying too much debt in this rising rate environment. Being fully leveraged already, these businesses are not able to raise further debt to invest in the growth that the industry anticipates in 2006 and beyond. While improving winery profits can be used for future growth, profits on the whole are not yet significant enough to fully contribute the cash necessary.

From our viewpoint, the recovery is on track but mixed in impact depending on the winery. The 2005 growing season is promising. By the end of the year, we might be through the final oversupply at the producer level, and by 2006, perhaps we'll even see growth in the bottle price for wine again — at better margins.

Statement of the Obvious

We would be remiss if we did not mention that the above comments amount to our educated guess. We think it's a pretty good one, but we could be entirely wrong. We could have missed important facts, and events might yet occur (or future facts come to fruition) that would entirely change the opinion expressed. Furthermore, much of this is a generalization based on averages. Most wineries are not "the average winery," or in the same place financially — and not all wineries have the same models or competitive pressures. Each winery needs to evaluate its particular strategy using its own judgment and that of other advisors; do not rely on this report alone. That said, we hope this dialogue helps you plan and evaluate for the remainder of the year.