Silicon Valley Bank
A Member of SVB Financial Group

Wine Division

2011-2012
State of the Wine Industry

Dr. Rumack: *You'd better tell the Captain we've got to land as soon as we can. This woman has to be gotten to a hospital.*

Elaine Dickinson: *A hospital? What is it?*

Dr. Rumack: *It's a big building with patients, but that's not important right now.*

The 1980 spoof classic *Airplane* was a critical success, well, it was if you didn't listen to the critics, but that's not important right now. The movie introduced us to the lighter side of long-time character actor Leslie Nielsen who played the part of Dr. Rumack. Nielsen, who passed away in November of 2010 followed that "hit" with forgettable roles in *The Naked Gun* series, The *Scary Movie* series, and *Police Squad*. I think we should now pause to remember just what Leslie meant to each of us … OK that's enough. Maybe that's not important either.

Written By
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The movie *Airplane* was about a flight where both pilots died of food poisoning. Fortunately, the plane was carrying our reluctant hero Ted Striker. A former combat pilot who had lost his mojo to fly, Ted along with his lost love interest Elaine Dickinson, together find a way to land the plane and save the day, thus triumphing over their own fears and personal tragedy. Too bad about the pilots, but that's not important right now. What is important is *Airplane* is our canvas for painting a picture of the wine business this year with all of the ups and downs, misunderstandings and drama. Besides, it was really funny and might help you read this to the end. But for those needing more entertainment, in the electronic version of the report you will find links to clips from the movie. To co-opt a line from an airline, we know you have many choices in banks. So thanks for flying Silicon Valley Bank!

Executive Summary

The wine business has long been a sanctuary for the creative soul seeking refuge in a rural lifestyle, with an additional twist of elegance and occasionally, for some lucky souls, the promise of semi-retirement. Today, the U.S. wine industry has taken full flight, respected for the quality of its product, domestic consumption and its impressive international market share. But sadly in the process of climbing to cruising altitude, the industry hit heavy turbulence in the form of short-term cyclical and economic shocks to its bucolic roots along with longer-term structural changes driven by distribution consolidation and the digital revolution. No longer is the wine business a game for amateur pilots flying a Piper Cub. The industry has soared from being a cottage-based industry, into a jet-fueled growth business in which U.S. consumption alone is projected to increase by 9 percent to $23.8 billion by 2014.[1]

Flight Log

Looking back at the State of the Wine Industry flight log from last year (2010), we forecasted improving conditions in the fine wine business[2]:

- Improving consumer climate
- The end of the trading down trend
- Growth in $20+ price points ending the year 8-12 percent higher year-over-year
- Revenue growth in fine wine to outpace growth in lower price wine segments
- Improving affluent spending, corporate spending and restaurant sales
- Prominent level of discounting continuing into Q3
- Improving distributor purchases for the year as depleted wine is reordered
- Positive momentum in the adoption of direct-to-consumer sales tactics.

… but we noted several drags on producer performance:

- Persistent financial and economic hurdles nationally
- Fine wine sales would not return to the high point of the past decade anytime soon
- Downward price pressure in all but those wineries selling on allocation, large scale producers, or established brands in wide distribution
- Wineries selling sizeable production above $50 would find it a difficult time
- Producer profitability in family wineries would be negatively impacted
- Slightly too much wine at the producer level
- Too much wine at the distributor level
- Most growers supplying fine wine producers would get less for their grapes on expiring contracts

With the exception of our overly bullish guess on the timing of any improvement in discounting, we believe our predictions were largely quite accurate. In fact, we saw fine wine sales come in right in the middle of our forecast range of 8-12 percent.

2011-2012 Cautious Optimism?

Rumack: *Can you fly this plane, and land it?*

Ted Striker: *Surely you can't be serious.*

Rumack: *I am serious … and don't call me Shirley.*

Could you be cautiously optimistic if you were Dr Rumack? I hate that term when it comes from an economist. How does a winery owner plan with a cautiously optimistic outlook from an expert? It's like a pilot announcing over the cabin speaker, "Ladies and gentlemen, we've started our final descent. I'm not sure exactly when we are landing. Hopefully our angle won't be too steep and it won't be our final-final descent. But I'm cautiously optimistic about our chances." Well, that's comforting!

Following several years when we felt more like a coroner than a cheerleader, this year we are happy to declare we are off the bottom of the wine industry down cycle and we are solid optimists for the industry looking out several years. Based on our outlook for the economy and our knowledge of the wine business, we believe we are at the beginning of another long-term steady growth pattern in fine wine sales. We are off the tarmac and are predicting growth rates for the fine wine segment in the range of 11 - 15 percent this year, albeit with only marginally improving profitability.[3]

We are predicting:

- Growth in luxury goods will outpace the rest of the economy
- Trading up trend will accelerate in higher priced wine
- Marginally improved pricing power at the producer level
- Boomers and Gen X, not Millennials, will support most of the fine wine recovery
- Improving restaurant sales, specifically in full-serve restaurants
- Producer level inventory closer to balanced than most seem to think
- Sales growth in fine wine of 11-15 percent with marginally improving profits

> "We believe we are at the beginning of another long-term steady growth pattern in fine wine sales."

Spoiling what otherwise is a smooth takeoff, we note the following headwinds:

- Continuing distribution issues/changes
- Shifting threats to the legal landscape for direct shipping
- Flat or declining pricing on grape contracts except in best properties
- Decline in the number of affluent spenders between the ages of 35-54
- Low adoption rates in the use of digital marketing tools
- High fixed costs to produce wines with lowered and reset price points
- Slowly improving economy, but several issues that hold back the recovery:
    - Euro zone challenges
    - State, municipal and large pension funding/budget problems
    - Geopolitical risk in oil-producing countries
    - Surging commodity prices act like a tax on consumption
    - Federal spending: to spend or not to spend?
    - Inflation in emerging markets and the EU
    - Increasing domestic interest rates
    - Quick swings in the FX markets
    - Balancing a weak dollar against inflation, recovery, huge debt burden and rate hikes

Despite the concerns mentioned, output from the SVB Wine Conditions Survey shows winery owners believe 2011 will be a better than average year on most fronts, and the industry is becoming more convinced that there might be some smooth air ahead. While we generally support their increasingly optimistic view, we suggest there is still a fair bit of headwind. As we've said for the past two years, it's unlikely we will experience price levels or see price increases similar to those that existed prior to the crash anytime soon.

That said, it's important to realize that the obstacles wineries face continue to be winery-specific depending on several factors, including grape contracts, price points, brand strength, appellation, volume produced, and most importantly, individual skill in executing their sales strategy. A wide disparity between winery business models continues to exist, making the "average winery" even more difficult to find today. What might be a defined risk for one winery could be strength for another. This increases both the opportunity to redefine and differentiate a given winery and brand, but also raises the risk for owners, investors and lenders alike who might otherwise act on instinct, patterns and rules of thumb.

The dominant question for the fine wine business today is: Who are your customers and what do they want? To answer that question, wineries should consider the following issues. Do customers want cheap wine and is it really all about price? Are they all smartphone-carrying Millennials who talk in 140 characters or less, have no land phone and never check e-mail? Are they arthritic Boomers or mid-career Gen-Xers distracted by young kids and with no time or money for affordable luxuries? Maybe they want to be part of your wine club, or maybe they hate your idea of a club? Did you ask if they had any suggestions to make your program better? Maybe they are green and want something that is authentic and environmentally-friendly? Maybe you are sending them red wine, but they only like white wine? How would you know? If your customer's attitudes are changing, what will you do to stay relevant with them? Are you one of the approximate 3 percent of wineries who actually use CRM and can answer those questions or are you in the 97 percent who have made little investment in answering that most basic of questions: Why do people buy my wine?[4]

We hope you will find the following helpful in sorting through some of your top-level thoughts, and that exercise will assist in your decision making and drive greater success for your business in 2011-2012 and beyond.

2011-2012 State of the Wine Industry

Contrails

Steve McCroskey: *Looks like I picked the wrong week to quit drinking.*

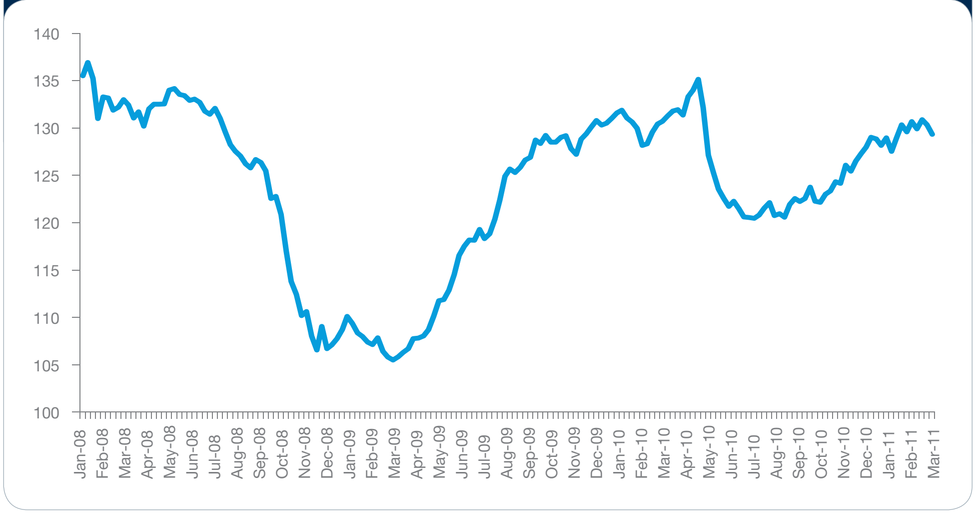
With an *Airplane* theme, maybe we shouldn't talk about "The Crash." Steve McCroskey did what a lot of people did in late 2008: quit drinking. Well they didn't quit really, they traded down to cheaper wines and glue. (Trust me, you'd have to see the movie clip.) Anyway, in 2008 with the economic hardships surrounding us, the foul mood of the U.S. taxpayer, and resultant inventory bulge ensuing from slack retail sales, many thought the luxury goods business was dead. Gone were the vestiges of conspicuous consumption and public celebrations. Consumers were trading down to lower price points and producers capitulated, discounting their wines to meet the consumer's price expectation.

Moving into 2010, the fine wine business started to show a pulse early in the year, but the summer was touch and go. Even into late Q3 there was still discussion of a double dip mirroring the business cycle from the Great Depression. Some even put the odds as high as 50/50.[5] Clearly, wineries had no upward pricing opportunity against that backdrop.

Then one day in Q4 an almost palpable change came about. It seemed the fog on the deck cleared, traffic patterns opened, giving way to VFR[6] for the first time since the market meltdown. Maybe it was the addition of QE2, or perhaps the investing community approved of the gridlock in Washington, thus sealing the extension of the Bush era tax cuts. Maybe consumers were just tired of earning less than the cost of inflation for their savings and were ready to take on more risk. Whatever happened, by Q4 2010 business was good — not great. But it was at least good again, and that was great news for the producer. That change in fortune is reflected in the ECRI LEI chart (Figure 1), and also in Nielsen Scan Data (Figure 2) that showed the strongest price point growth in the $20+ category last year. And with many fuel tanks at bingo in Q4, a little in-flight refueling was much needed.

"Even into late Q3 there was discussion of a double dip mirroring the business cycle from the Great Depression."

Figure 1: ECRI Weekly Leading Indicator Index



Source: Economic Cycle Research Institute

Figure 2: Trading Down?

Lat 52 $ Share	Price Segment	Volume% Chg			Volume% Chg	
		Lat 52	Lat 26		Lat 52	Lat 26
100%	Ttl Table Wine	+4.5%	+4.8%		+3.2%	+3.5%
8.4	$0-$2.99	-1.3	-2.5		-2.4	-2.6
29.3	$3-$5.99	+4.4	+4.2		+4.8	+4.9
20.2	$6-$8.99	-3.4	-3.3		-1.0	-0.9
20.8	$9-$2.99	+10.0	+10.5		+12.4	+12.5
10.0	$12-$2.99	+7.8	+8.1		+10.3	+10.2
6.2	$15-$2.99	+7.0	+9.4		7.7	+10.3
5.0	>$20	+11.4	+11.8		+9.2	+11.0

Source: Nielsen Beverage

Roger Murdock: *Flight 2-0-9'er, you are cleared for take-off.*

Captain Oveur: *Roger!*

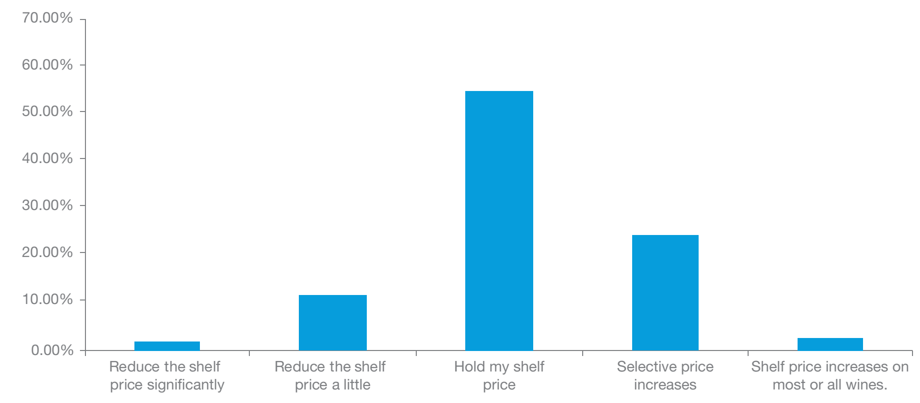
Roger Murdock: *Huh?*

The fine wine industry is taking off again. The real question is in which direction. It's a little confusing to find the right vector, Victor, especially when it comes to pricing decisions. So, in SVB's Wine Conditions Survey, we asked wineries what they intended to do with their pricing in 2011. The responses are reflected in Figure 3. Roughly 25 percent of the 598 respondents said they thought they would have selective price increases in 2011. In fact, by a small margin, the responses again indicate we are past the bottom of the recession and trending up. But in our current view of the industry, we see only very limited upward pricing prospects considering inventory balance, distributor challenges and the enduring, soft economy. The fact there is any upward pricing pressure, however, is noteworthy.

Just where is the pricing opportunity? Surprising to many perhaps, it's not with $20 wines. It's with more expensive wines.

Figure 4 compares by average price point, those wineries who believe they could increase prices from those who said they needed to reduce it further. From that, we are able to see wines selling over $41 show a greater likelihood of increasing price in 2011, compared with those wines priced between $15 and $40.

Figure 3: Price Changes in 2011



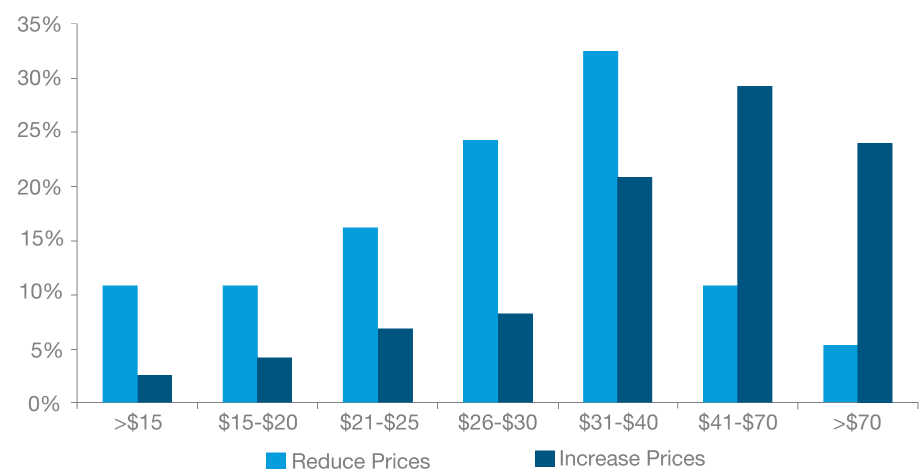
Source: Silicon Valley Bank

Since the press has been full of stories in the past year of cult wineries cutting price, finding this result seems a little like expecting a lead airplane to fly — although technically lead planes could fly with the right wind speed and lift. Obviously, the luxury end of the fine wine business has gotten lighter; the news isn't as bad as we think; or the economic atmospherics have changed.

From our desk, we would vote for the latter. Although the economy as a whole still works to avoid financial wind shear, the consumer atmospherics have evolved and the affluent consumer is back spending, while the middle class makes some inroads as supported with lower unemployment rates and higher levels of job creation. In addition, it's the job of every producer to balance inventory and many times that means blending down to lower tires. So the chart really is reflective of the drying up inventory bulge and a very positive sign foretelling the end of this down cycle.

The economic recovery has not been equal across all income groups. Until 2011 the growth in sales came largely

Figure 4: Price Changes by Price Point



Source: Silicon Valley Bank

from the affluent because the impact of accommodative policy and low rates has floated the stock market again where they had investments. On the other hand, for the middle class who have little stock investment and more of their wealth tied to their homes, life has not been close to being what it was pre-crash. As of this writing, about 23 percent of all homes in the U.S. have equity that is less than the mortgage amount. That's not only a drag on the healing economy, it's a drag for that percentage of the population who are in a bad spot and unlikely to spend much on luxuries. But the start of 2011 has started with real job growth accompanied by the first decline in the jobless rate in some time. Consumer confidence is improving and we expect to see the start of a healing middle class that will have a positive impact on fine wine sales.

But the reality is the affluent have a dominant role to play in retail sales in the U.S., especially for fine wine. It's the recovery of the affluent consumer that is moving the luxury end of the wine market forward. This can be seen in part by the divergence of the Dow Jones Luxury Index from the S&P in Figure 5. While the middle class in America is making slower progress in recovering, sales of higher-priced wines are weighted to the affluent and, as such, a reduction in the unemployment rate won't have the same impact as improvement in major stock indices. But it's another good sign the industry is recovering and moving on. The declining unemployment rate will support some level of increased purchases.

For there to be upward pricing opportunity in all luxury price points, though, we are going to need to see the

Figure 5: Dow Jones Luxury Index vs. S&P 500

Source: Bloomberg and SVB Financial Group

middle class more forcefully join the recovery, specifically with respect to housing. Regrettably, most economists point to a further decline in U.S. home market prices in 2011 with new housing inventory still higher than what is needed for a healthy balance of supply. In addition, the summer prospects for the continuing pace of job creation to continue are clouded at best as of this writing.

Flight School

Captain Oveur: *You ever been in a cockpit before?*

Joey: *No sir, I've never been up in a plane before.*

We all have long memories of our foundations in the wine business, our first sip of wine, first taste of a wine grape. Like our movie theme, we probably have had a mentor of some sort who gave us guidance and asked us the difficult questions in life such as, "Do you like movies about Gladiators?" and maybe the occasional misperception such as Kareem never playing defense in the regular season. Some of those early teachings stick with us. One that many of us might hold to is a long-held belief that if you drop your price on a SKU, you will train consumers to pay less for better wine and then play hell raising price back later. Reading the press we constantly see the statement that wineries have trained the consumers to believe that they can find better wines at lower prices. Is that true? Our belief is that if your wine is truly a luxury good, that kind of thinking is fraudulent on its face.

> "When wine inventory goes back to a balanced state, price can and will rise."

Consumers of fine wine in an information age are far more aware of what they like and don't like. While there are wide substitutions available — especially in lower-priced wine — high-priced wine as a luxury when the business is in balance or in short supply has fewer pure substitutes and carries more of an up and down demand curve.[8] That means recovering price is quite realistic under the right circumstances. Those circumstances are a healthy, affluent consumer and wine supply that is not long. Consistent with the winery owners' views that there are selective price increases available, we believe we are moving in the direction that will firm pricing up this year. We anticipate that we will begin to see upward movement in price in future years as the consumer is healing and inventory is close to or in balance, depending on varietal, price point and appellation.

In practical terms, it's important to remember that when a shock hits the economy, there is a predictable reaction from distributors and producers. Distributors, when confronted by a change in demand or supply, stop ordering while they work down their stocks.[9] Once they reach their optimal inventory level, they start ordering again to match depletions. The same is true for restaurants and even consumers with cellars.

In reaction to a shock, producers blend down reserve wines into lower-priced offerings, and sell off bulk supplies. The higher-quality bulk is then purchased by other wineries, oftentimes for less than the cost to produce, and put into less expensive SKUs. The end result is the value-conscience consumer can find better value at lower prices. But that trend is not sustainable because it's not economically viable.

The production of fine wine is an expensive, lot-by-lot and barrel-by-barrel undertaking. Wineries won't produce uneconomically for much more than one to two years as they balance their supplies. Once inventories are corrected in the cellar, wine consumers who discovered great values in a disjointed market are presented with the choice of paying the same money for lesser quality wine in the bottle, or have to be willing to price up slightly to find the quality they want.

So, with cost-conscious consumers feasting on values over the past two years, we predict the trend will end this year (lower-priced and higher quality). The next most obvious question is when wineries will stop blending down their good juice into less expensive wines. Knowing that answer gives a good indication of where we are in the inventory-balancing cycle, as well as an indication of how likely discounting is to continue at the distributor level. When wine inventory goes back to a balanced state, price can and will rise.

Fuel

First Jive Dude: *I say hey, sky... subba say I wan' see...*

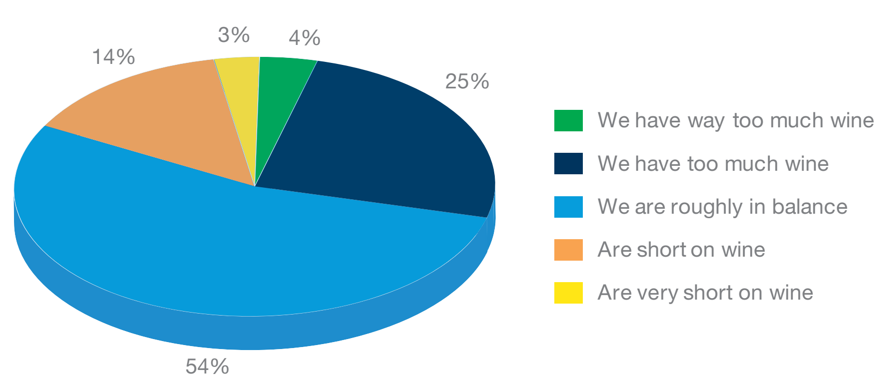
Second Jive Dude: *Uh-huh.*

Inventory and Appellations

Getting good information is really difficult in the fine wine business. Then once you get it, sometimes you need a translator because it can sound like straight out jive talking. Even if someone can read the tea leaves, there can still be misunderstandings. It's something we struggle with every day in our jobs. So, trying to sort out inventory in last year's SVB Wine Conditions Survey (January 2010), it was a bit of a surprise to us that 35 percent of respondents said they still had too much wine on hand in the cellar. That number seemed high because we had seen clients and prospects aggressively discounting, blending down, and selling bulk, taking their first loss and positioning for the future. After discussions with brokers, we decided to predict a balance in wine supplies around Q3 2010 and a gradual ending to discounting.[10] We were wrong and, in fact, discounting continues to this day for many labels.

Maybe we'll make the same mistake again, but from all we see right now, coming off a slightly small harvest we think inventories are now, or very close to being, in balance this year. Survey responses show that wineries

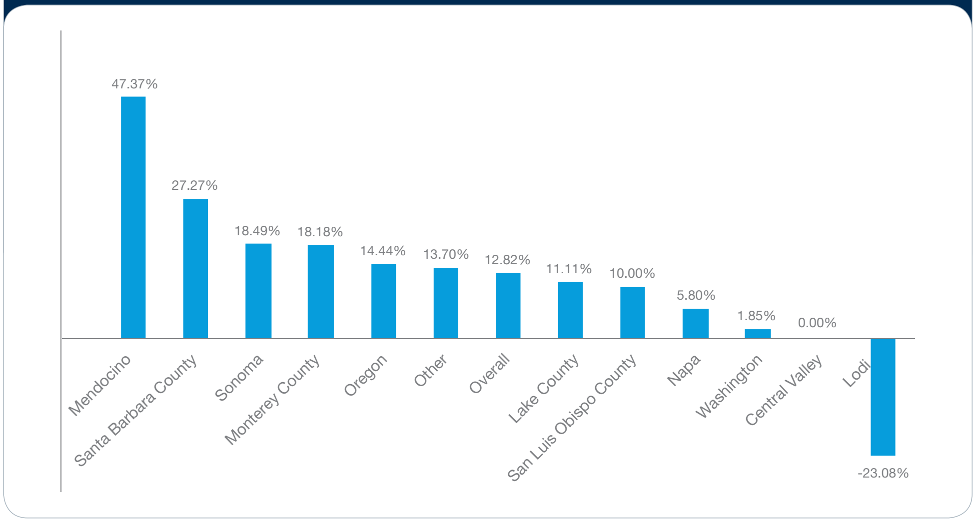
Figure 6: Current Inventory Positions



Source: Silicon Valley Bank

reporting long positions have fallen to 29 percent (Figure 6). That still seems intuitively high, so we took a look at inventory sorted by case production to see if we could spot an anomaly. But the responses are only slightly skewed to smaller wineries, so that was not a help in explaining the intuitive and survey differences. The only conclusions we can come to are that we are wrong (which of course is impossible) or the respondents are less optimistic than we are for 2011 and expect lower growth rates.

Figure 7: Ranked Inventory Imbalance



Source: Silicon Valley Bank

Looking purely at a net long/short for the fine wine industry doesn't give all the information we would like either, as fine wine is appellation-based (if a winery needed Russian River Pinot Noir, it doesn't really matter that the Santa Rita Hills have an excess). To better understand the appellation positions, we netted out the responses of those wineries that reported excess positions against those reporting short positions, ignoring those who said they were in balance. Figure 7 shows that Mendocino has the largest imbalance and the appellations that produce wines in higher-scale and in lower price points are the closest to being in balance. The region reporting the only net shortage is Lodi. While that may be an accurate assessment, it should be noted that it is a small sample set and, as such, more prone to sampling error.

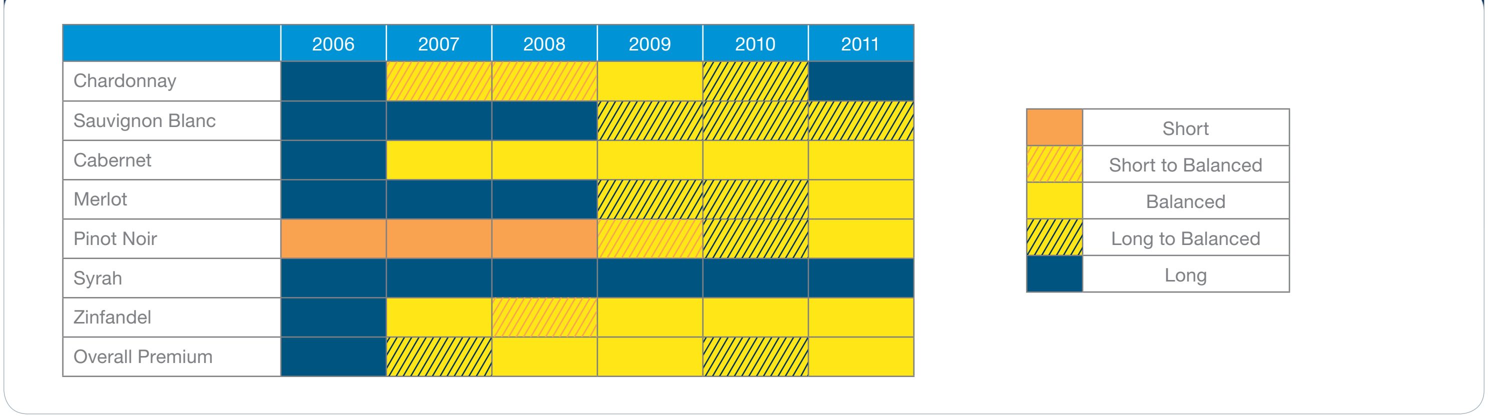
The clear message to us is that while prices have reset lower, we will continue to see less true discounting in 2011. There will still be some good value wines available to the consumer for part of 2011. Snap them up, though, because those kinds of uneconomic buys will soon come to an end.

Varietal Inventory

We have monitored the level of bulk and grape supply by varietal in Figure 8 since 2006 to understand the impact on evolving and changing tonnage from the vineyard and bulk markets. As we have said in the past, the best thing about the just completed recession (it is over in theory) is that we are largely not in a position of over-supply and this downturn hasn't had the trailing impact of non-bearing acreage, making the current imbalance worse.

This year, with the slightly small harvest, there are only two varietals we view as long: Syrah and Chardonnay, with the latter probably a tweener. Even with the recession, we are closer to being in balance than many may believe. But

Figure 8: Bulk Wine Positions



Source: Turrentine Wine Brokerage, Silicon Valley Bank Proprietary Research that is an average and there will be some vineyards this next season that may still find it hard to get a contract, while others in higher demand will have their choice of suitors.

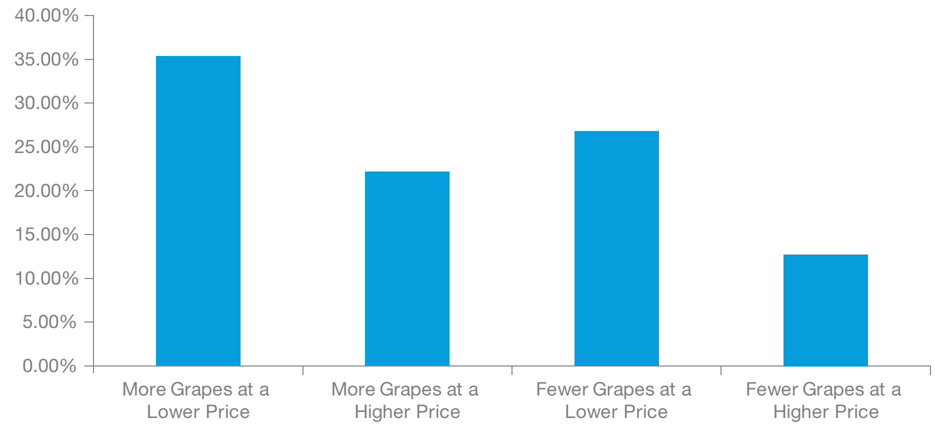
While as an industry we have been doing a good job of discounting and moving wine to clear the runway for takeoff, the price that vineyards owners pay for grapes has continued to be pressed downward.

In reality, the vineyard owners are the last ones to feel the pain in the supply chain, in part because they are under longer-term contracts that producers are faced to honor or renegotiate even when grape prices drop. So wine-grape growers are the last entities in the supply chain to see price recover.

To get a handle on what wineries were expecting to do with their purchases of grapes in 2011, we asked them simply how much they expected to buy and at what relative price. The answer is about what we would anticipate in that 56 percent of respondents say they expect to buy more fruit in 2011 over last year, but 64 percent said they also expect to pay less (Figure 9).

It's a time where perceptions may not necessarily be reality in the field. Wineries with relationships worth protecting may want to consider extending important contracts out, and negotiating to lock in price at 2011 levels because per ton prices will start to reverse once bottle prices start to inch back up. If sales of premium wine grow as we expect this year, and the harvest isn't large, perceptions of what is available and at what price should change to the positive from the grower perspective this next year.

Figure 9: Grape Purchases vs. Price in 2011



Source: Silicon Valley Bank

Atmospherics

Morphing Models

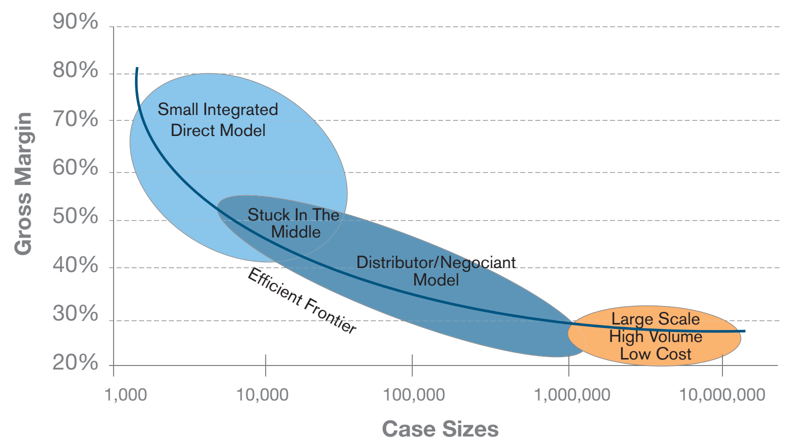
Striped controller: *Bad news. The fog's getting thicker.*

Johnny: *(jumps to an overweight controller) And Leon is getting laaaaarrrrrger.*

The wine business has evolved almost imperceptibly, as if in a fog, first with the rapid growth of small wineries. But in the end, it's the larger wineries that really have the position and negotiating power with the sales channel, leaving the craft manufacturers to find their way to clear skies.

When SVB began its dedicated wine practice in the early 1990s, it was common to see successful business models in nearly all volume segments and price points. Small brands making a few thousand cases of super premium wine seemed to thrive right alongside estate operations making 10,000 cases, or negociants making 50,000 cases of popular premium wine, larger-scale

Figure 10: Business Models



Source: Silicon Valley Bank

wineries making 100,000 cases and more. Each had a very similar selling strategy: they moved wine through a nationwide distribution system and sold a little in their tasting room. A very small winery might not make a lot of money, but it could at least break even and find several distributors willing to work with them.

The foundation for selling has been morphing for 20 years — slowly until recently when we now witness the almost complete consolidation of both the distribution system and the large retailer accounts for chains and restaurants. Now, the relationship between distribution and the family winery can kindly be described as in transition.

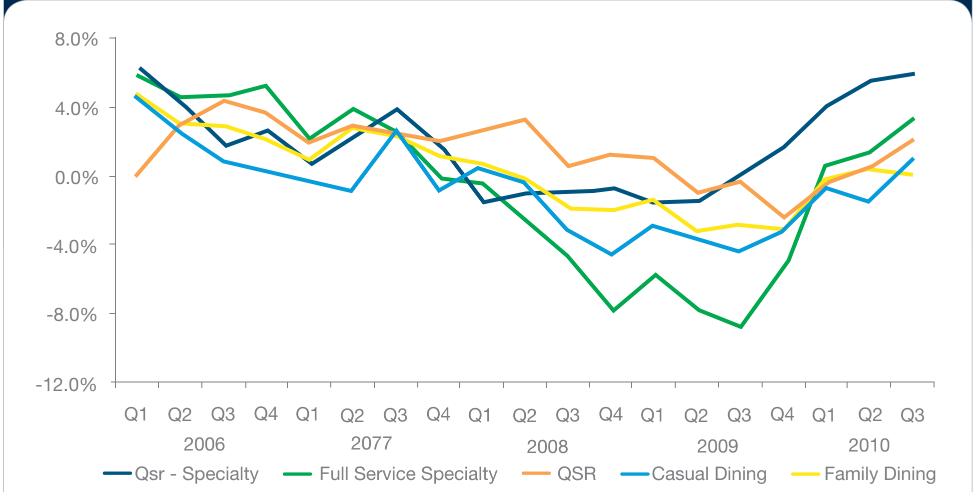
SVB has been underscoring the trend illustrated in Figure 10 for at least the past eight years and encouraged both clients and prospects to consider their place with this chart as a backdrop for a discussion of their business model. We realize that when the business is working, it's hard to change, although once it's not working, it could be too late to take corrective action.

Restaurants

Most wineries selling fine wine move between 20-30 percent of their product through restaurants. So, the changes that have taken place in restaurants subsequent to 2009 have been of particular interest to the fine wine business. That said, the changes really started in early 2007 when the restaurant industry began a contraction phase according to the National Restaurant Association (NRA). That downward trend was later magnified by cuts in corporate T&E budgets and a recession-based shift to more at-home entertaining. When negative press about the big bonuses for CEOs and Wall Street bankers collided with news of bailed-out insurance giant AIG's lavish spending on corporate retreats, corporate T&E and conspicuous consumption of all types was snuffed out. According to The National Restaurant Association and the Demeter Group, the most impacted part of the restaurant trade had been the higher-end, full-service white tablecloth restaurants — precisely the target accounts in which fine wine is sold (Figure 11). Examining the NRA Current Situation Index,[11] we note that as of this writing the index has been above 100 for the fifth time in six months driven by improving same-store sales, growing customer traffic levels, mounting optimism, and expectations for staffing growth that is now at the highest level in nearly four years (Figure 12).

According to Malcolm Knapp, president of the New York-based consulting firm bearing his name, sales at full-service eateries, will rise 0.7 percent in 2011

Figure 11: Restaurant Segment Growth Rates



Source: Demeter Group

Figure 12: NRA Current Situation Index

Source: National Restaurant Association

after adjusting for inflation — the first year-over-year increase since 2007. That's more good news for the wine business and again indicative of higher year-over-year wine sales.

Financial Performance of Wineries

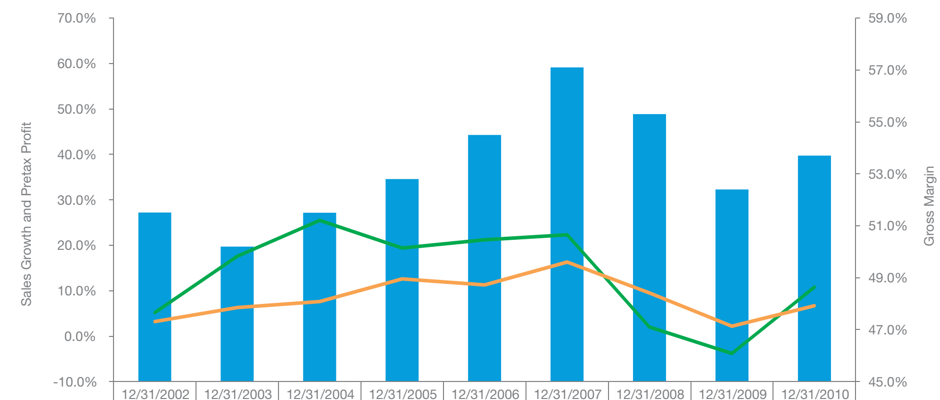
(reading newspaper headlines)

Rex Kramer: *Passengers certain to die!*

Steve McCroskey: *Airline negligent.*

Johnny: *There's a sale at Penney's!*

Figure 13: Wine Industry Financial Performance



	12/31/2002	12/31/2003	12/31/2004	12/31/2005	12/31/2006	12/31/2007	12/31/2008	12/31/2009	12/31/2010
Gross Margin	51.5%	50.2%	51.5%	52.8%	54.5%	57.1%	55.3%	52.4%	53.70%
Sales Growth	5.2%	17.6%	25.5%	19.4%	21.2%	22.3%	2.0%	-3.8%	10.80%
Pretax Profit	3.2%	6.3%	7.6%	12.6%	11.3%	16.3%	9.5%	2.2%	6.70%

Source: Silicon Valley Bank

We have good news and bad news as we look at the financial position of wineries this past year. The bad news was last year had higher-cost trailing inventory pass through the balance sheet, which lowered profits. The good news is there was still a sale on fine wine ... Wait, is that good news? Maybe if you were a consumer, but there is good news for wineries when you look at the growth in fine wine sales this past year. Sure, there was still a wine sale and discounting, but the industry is gaining altitude again with improved gross margins.

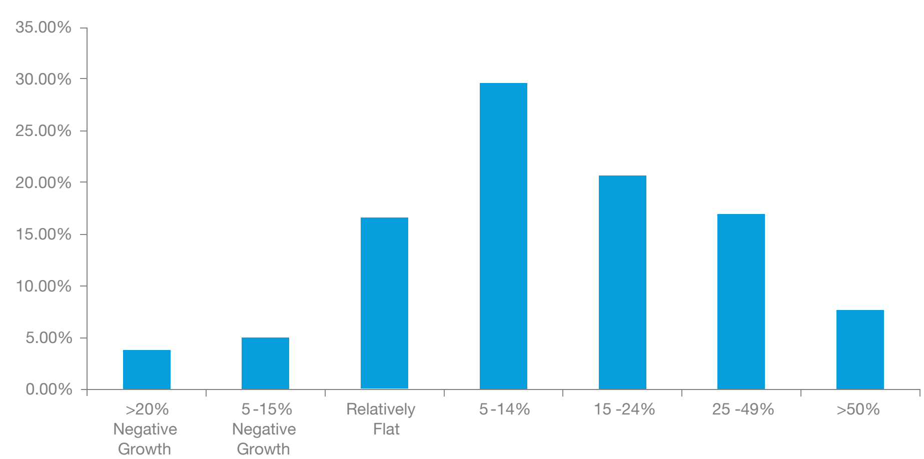
> "What is nice to see in this data is a firm bottom noted in the improving gross margins, sales growth and pretax profit."

Reports using proprietary but still unaudited financial information from SVB's PGA[12] showed full-year sales growth through Q4 about 10.8 percent for the year versus 11.8 percent from Nielsen scan data — roughly in line with our 2010 producer-level sales forecast of 8-12 percent for fine wine last year. What is nice to see in this data is a firm bottom noted in the improving gross margins, sales growth and pretax profit (Figure 13). It should be noted that the information is sourced largely from company-prepared and unaudited financial information. Year-end tax planning will likely reduce gross and pretax profit somewhat. Nonetheless, it's a great sign of emerging health for the industry.

Confirming the positive year-end results, in the conditions survey we asked wineries to estimate their full year 2011 sales growth. The overwhelming majority of respondents reported flat or positive growth with most reporting growth in the 5-15 percent range and few reporting declines (Figure 14).

Examining gross margin and pretax profit, in the prior full year ended 2009, the fine wine segment had cycled back to the lowest levels of profitability since 2002 — the bottom of the tech recession. Some might want to look back and try to predict that this time we'll have the same type of recovery off the bottom of the recession, but there is a difference in the recovery compared to the recession experienced in the early

Figure 14: Winery Estimated Sales Growth for 2011



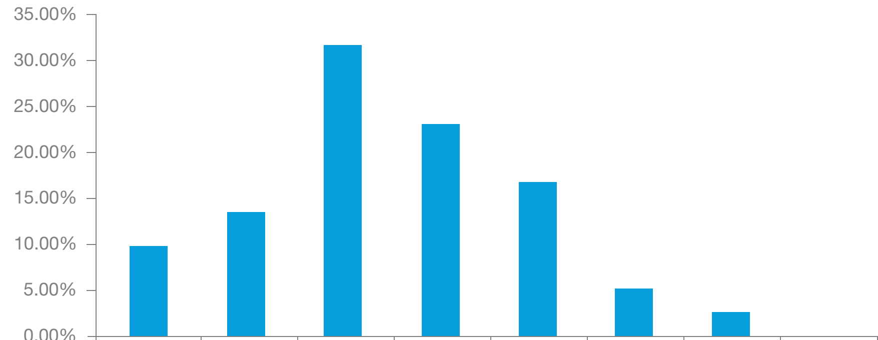
Source: Silicon Valley Bank

2000s. That was an isolated, shallow and fast recession. We were led out of it by increasing home values bolstered by a massive amount of liquidity looking for an investment. We also didn't see the same level of price resetting we see this time. The slower recovery this time around will continue to produce a drag on the financial performance of family-owned wineries and make price recovery a multi-year task.

How do winery owners view their own financial health? That's a question that we posed in the conditions survey and again surprisingly there was little year-over-year change between the results from the 2010 survey and the 2011 survey. The good news is that about 70 percent describe themselves in the range from "good" financially, to "rock solid." Another 7 percent describe themselves in the range from "slightly weak" to "dead."[13] That percentage is more than likely the un-bankable segment and again about the same percentage as last year (Figure 15).

What we have observed is small wineries have been amazingly resilient in this downturn. Time and again, they find ways to cut costs to survive and hold on. That said, the majority of those will need to be recapitalized or sell soon. It's unlikely a winery in that situation — losing money and unable to get more debt — will find a way out of the high fog without changing pilots or refueling.

Figure 15: Current Financial Health



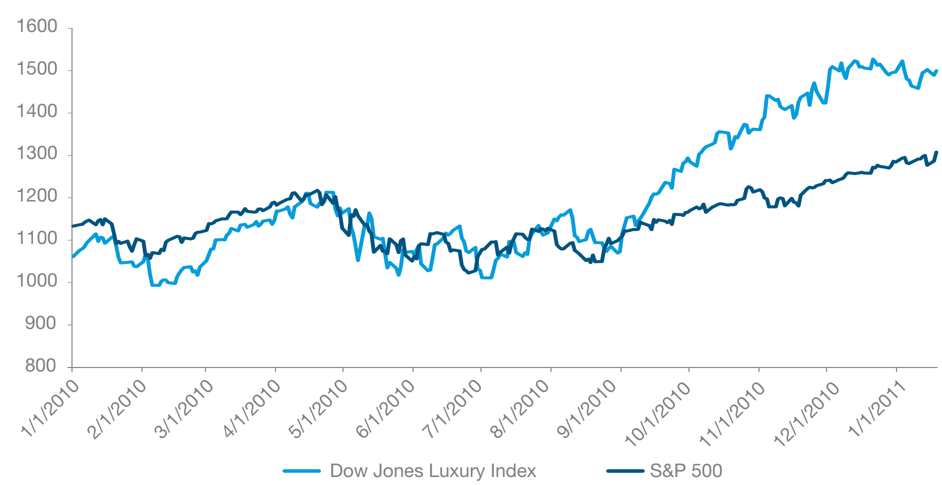
	Rock Solid	Very Strong	Strong	Good	Slightly Weak	Very Weak	On Life Support	Dead
Overall	9.24%	13.11%	31.60%	22.69%	16.47%	4.54%	2.02%	0.34%

Source: Silicon Valley Bank

Sometimes the simplest answer is the right one and sometimes it's not. Take off the sunglasses and you still get the same look. The case being made for Millennials this second is overblown if you believe they are the group to chase and you sell a $30 bottle. They are not the dominant consumers of fine wine. In fact, they are barely on the map. That's obvious when you consider most are not of legal drinking age, have the highest unemployment rate, aren't established in careers with discretionary income, and have the smallest amount of wealth of all the demographic tiers.

Understanding who is buying your wine and knowing why they buy is far more important than trying to categorize age groups and looking for generalizations so you can sell a luxury good. Why? It's not age that matters. It's discretionary income that matters, no matter if you are 21 or 101. Keep in mind that you aren't just selling wine, you are selling an experience: what the wine does for your consumer. Affluents more than any class of consumers can have any "thing" they want. It's an experience they desire, and those wineries that focus on the brand and experience will have more success than those who don't.

Figure 16: Dow Jones Luxury Index vs. S&P 500



Source: Bloomberg and SVB Financial Group

Demographics, Affluent Consumers and Luxury Brands

Rex Kramer: *Alright Steve let's face a few facts. (Removes his glasses to reveal glasses)*

Affluents represent a much smaller percentage of the consumer by number, but have far greater impact on retail spending. Pam Danziger of Unity Marketing points out the top 20 percent of U.S. households[14] represent:

- 50 percent of the nation's income
- 40 percent of all consumer spending
- 90 percent of discretionary income left over after the necessities are paid
- 80 percent of all premium wine sales[15]

Not unlike the full service restaurant sector, luxury retailers took a pretty steep nosedive when the markets collapsed, but results began to change in the 2009 holiday sales period. By mid-2010, performance in luxury brands started to pull away from lower tier competitors as was noted in Figure 16, showing the Dow Jones Luxury Index matched against the S&P 500.

With fine wine sales, we have noted the same trends reflected in luxury retailing. The absolute cult brands that sell on an allocated basis — those with long waiting lists of customers just to be offered a bottle — sold out their wine with no price adjustments in 2009 and 2010. But just below that level, 2009 was a difficult time, particularly for wineries selling wine above $50 if they were doing so in any significant volume. By 2010, a still small but growing percentage of expensive luxury wine producers was beginning to participate in the recovery, too. That said, a non-allocated wine selling for more than $50 a bottle is still a difficult sale, but the situation is getting better and will continue to improve in 2011.

Who are the people buying fine wines today? If you read popular press you might think the Millennial is the salvation of the business. That will be true someday, but not this year. Examining Figure 17 from Nielsen, the 55 and above crowd is responsible for 44.1 percent of purchases — more than double that of the Millennials. Not to undercut all the positive notions of Millennials being more wine savvy than their parents at similar times in their lives, but we need to put a dose of reality into the discussion. The under 34-year-old age group has a very high unemployment rate and, as we demonstrated last year in the State of the Wine Industry report, a miniscule percentage of consumer net worth. No job and no wealth makes it hard to buy luxuries. On the other hand, in reviewing confidential retail information sorted by age, what we have noted is the Millennial is willing to spend the most per bottle on average. However, a scratch of that data revealed the numbers of expensive bottles purchased were few compared to older demographics who bought the expensive wines and a lot of less expensive wine as well, driving down their average purchase price.

Work from Unity Marketing supports a concept that resonates with us. It points out a "Window of Affluence," a prime-time window of spending. That window for retailers selling luxury goods is the sweet spot for luxury consumption. It's a period where careers are a little more established and there is more disposable income and a willingness to take on debt because of increased expectations of higher personal cash flow in future years. That window is between the ages of 35-54. Today, that spans the trailing edge of Boomers and Gen X, which if you look at Figure 17 from Nielsen represents a combined 38.3 percent of total wine consumption. That's second only to the Boomers today. The data lead us to wonder, who is marketing to Gen X as that seems to be the missing opportunity now versus the Millennials?

Figure 17: Demographic Sketch of Wine Drinkers

	Unemployment Rate	% of Population	% of Wine
Race/Ethnicity			
White	8.5	68.9	78.5
Hispanic	13	13.4	8.9
African Americans	15.8	10.8	7.3
Age			
21-24	15.3	7.4	4
25-34	10.1	18.7	13.6
35-44	7.8	19.6	16.3
45-54	7.5	20.6	22
55+	6.9	33.7	44.1
Education			
High school diploma	15.3	19.2	10.2
No College	10.6	28.4	20.2
College Grad		24.3	39.9

Source: Nielsen Beverage Division

Random Traveler: *Excuse me sir. We'd like you to have this flower?*

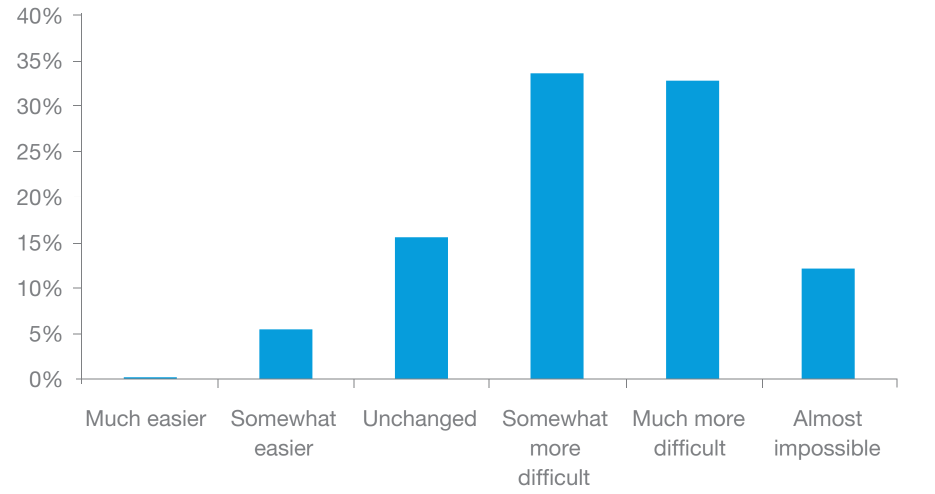
This was a scene where Robert Stack was coming into the airport to save the day and accosted by everyone he met. Back in the olden days, free speech meant running a gauntlet of people in the airport who were proselytizing and fundraising for their preferred charity. Before the market meltdown, that scene was a little like bankers at a wine conference: everyone was chasing down a winery owner, delivering their pitch and hyping their organization.

What's happening today? When we asked wineries to compare commercial credit availability, terms and price pre- and post-crash, the answers were far more negative than we expected with 78 percent noting credit has become more restrictive (Figure 18). Perhaps our experience is unlike other banks. SVB's wine division has certainly seen a significant up-tick in new borrower requests this past year, and we grew substantially as a result. According to survey data, however, credit conditions have actually tightened slightly in 2011 over 2010. We see a fair number of competitors ourselves, but definitely not as many as before the crash. Perhaps the change year-over-year is explained by more activity from those lenders who are more inexperienced in the business.

A bank jumping into the wine business after the last recession would have experienced favorable conditions through Q3 2007. Most deals they booked would have performed well in the growing economy. But regulators get very direct when a portfolio of loans has more than about 12.5 percent of the loan balances characterized as having a "material weakness," especially when there is no positive change and even more so with the scrutiny given banks since the crash.

With 7 percent of the industry describing themselves as "very weak" today and really little change in the overall way wineries describe their financial condition year-over-year, it's not hard to imagine a lender taking on more than average risk in the years leading up to the crash, expecting to see a recovery bailing them out of a poor credit decision and now being required to make changes to their lending practices. Those changes would apply to healthy and weak borrowers alike. It's unfortunate from a borrower perspective. Those winery owners would clearly be confused or frustrated over changes in their lending relationship when they are doing well and even perhaps improving. The variable in this case is the specific financial institution's understanding of the wine business and/or their regulatory health.

Figure 18: Credit Availability Since Market Crash



Source: Silicon Valley Bank

Wine 2.0, CRM, Surveying and Social Media

Steve McCroskey: *Gunderson, check the Radar Range. Anything yet?*

Gunderson: *(gets up and opens the door of the Radar Range microwave, which is roasting a turkey) About two more minutes, chief.*

Steve McCroskey: *Two more minutes? They could be miles off course!*

Rex Kramer: *That's impossible. They're on instruments!*

There is a lot of confusion about electronic and digital support. Most remember when social media consisted of a flyer from the Elks Lodge and CRM was an abbreviation for cream on your shopping list. But the world evolves and access to markets has become increasingly complex. Competition comes from every side now; legal turbulence remains; digital tools continue to evolve, but are not yet sufficiently integrated; and traditional distribution is increasingly ambivalent to the small producer. The digital world and the Internet are now critical for success. While only a small part of the digital world, online wine sales are now estimated at approximately $500 million dollars, 20 percent of which is being driven by the emergence of flash sites.[16] That said, electronic support seems to have its own lifecycle of introduction, adoption, misuse, correct use and finally acceptance of some defined use by the masses. Jump in too fast and you waste time and money. Don't jump in and you risk being left in the dust, needing to burn the after jets to catch up.

Think back not too long ago and most of us still remember when the e-mail era began. Some early adopters used it as a cost-effective way to send mass e-mails to lure people into purchase decisions with discount offers.[17] That was cool, until the term "e-mail blast" became synonymous with spam[18] and lost its usefulness. Then the Web became real and wineries all got Web pages. That was pretty cool too, because it meant computers were connected with each other. But nothing happened with sales until the advent of electronic shopping carts, faster modems, fulfillment and the addition of POS tools. About that time we started driving eyeballs to our sites and became obsessed with clicks, thinking a sale was all about the number of at bats, versus the quality of the plate appearance. More recently we have seen the dynamic growth and evolution of social media. If you had built a model on clicks back in the day, you would have wasted a lot of time and money. But if you never even got a Web page, you are probably already irrelevant. So in the evolving digital world, where should you invest scarce resources? Where do you dive in and where do you observe from the sidelines?

Social Media

Facebook recently outpaced Google as the most trafficked site on the Internet. What is more amazing today is the transformation in how we consume information and how we are able to share information. We have lived in a Google economy for over a decade. Search engines have given us unprecedented power to find information. No longer is the consumer only armed with search engines to explore the world, now they are empowered with exponentially increasing networks of friends through social networks.

> "Social Media is the fiber for discovery."

There is nothing in the world we can't find if put in a search engine. However, the challenge with search engines is we can't find what we AREN'T looking for. Outside of surveying a known demographic, there is no easy and trustworthy mechanism for discovery until now.[19] Companies are increasingly storing personal information about consumers and developing profiles that one day will allow the individual to see only things he cares about purchasing. For today, there is the personal recommendation and blog that's cutting into traditional wine reviews. Consumers enjoy something and share it with friends/followers, and they have ability to discover something new and share it. We are more fortunate than other industries because we are an experiential industry and people enjoy sharing those experiences on social media.[20]

In reality, the evolving use of social media may be to connect with your customers and hear what they think, more than specifically selling to them. Either way, we hope you have adopted the use of social media in some form, if not just to audit the growth and scope of the phenomenon. If you haven't, that flight is boarding and ready to close the doors. While we hope you are getting on, our survey of West Coast wineries revealed only a minority use social media today in a meaningful way, with fewer still dedicating an employee to run the digital side of marketing.

Surveying and CRM

In this market, the wineries that will do best will be those that devote time and resources to developing customer-level preference information and embed curiosity into their culture. Questions such as: Why did members leave the club? How old are my customers? Do younger buyers purchase different SKU's? How do my customers prefer to communicate? Do they like to come to consumer events, or do they really prefer to entertain at home with my wines? How often do they buy? Are older buyers purchasing more than younger buyers? Are those who buy my wine using social media? What is the most a given age group paid for a bottle of wine in the last six months?

> "Instinct can be deceiving when there are changeable atmospherics surrounding the business."

Just what is your digital media strategy? Are you targeting mature affluents or are you targeting the Millennials with your social media efforts? You might be getting friends and followers, but what is social media creating for your brand image? Is that positive or negative? Who uses social media anyway? The list of questions is endless and each drives at actions that can be taken to improve sales and marketing.

There are many ways to collect data, including asking the sales force to collect information from their drive-arounds, having tasting room staff to do verbal interviews, using highly-evolved CRM tools, and taking advantage of inexpensive or free online survey tools that wineries can employ to get at some of these answers.[21]

There is a saying carpenters often cite: "Measure twice. Cut once." Even weekend carpenters hate to make a mistake measuring and be forced to make another trip to the lumberyard. When it comes to pricing decisions and marketing, family business owners too often skip the measuring step. They estimate once, make a decision, and then adjust with thousands of dollars in lost opportunity in play. Instinct can be deceiving when there are changeable atmospherics surrounding the business.

It's somewhat ironic that as we push deeper into a digital existence, it only emphasizes the need to return to the fundamentals of knowing your customer. Fortunately, tools are finally emerging that help us understand and properly scale client experiences so you can deliver seemingly individualized experiences in groups of communications.

> "How can a winery deliver an appropriate client experience if it doesn't fully understand the client?"

Our industry is well behind in adopting what should be rudimentary tools in sales. After our recent survey, we've discovered CRM is barely touching our industry with less than 3.5 percent, adopting it in any meaningful way, no matter the case size. How can a winery deliver an appropriate client experience if it doesn't fully understand the client? There is no better investment in the success of your brand than putting resources into understanding first, THEN servicing your customers.[22]

The FAA

Legal and issues surrounding social media and Web 2.0 are evolving areas of interest coming into legislative and legal focus as the Internet moves to satisfy the marketing and information needs of consumers, colliding with laws made decades before the Internet was even envisioned. The legal questions are overwhelming and could apply even to blog posts and Tweets according to John Hinman.[23]

Much of this fear started with a narrow trade advisory from the California Department of Alcoholic Beverage Control in 2009. Essentially, it said, "What's not expressly permitted is prohibited." That was certainly a way to quell the entrepreneurial spirit of those who were trying to find modern-day solutions to selling wine. It's quite a pickle. On the one hand, the old laws don't address the Internet. On the other, you have an advisory that seems to say that because the Internet isn't expressly addressed, it's prohibited. In other industries, a big company would lawyer up and push through a solution. But in the wine business largely made of family wineries and boot-strapped companies in e-commerce, nobody wants to risk being the test case for a new law.

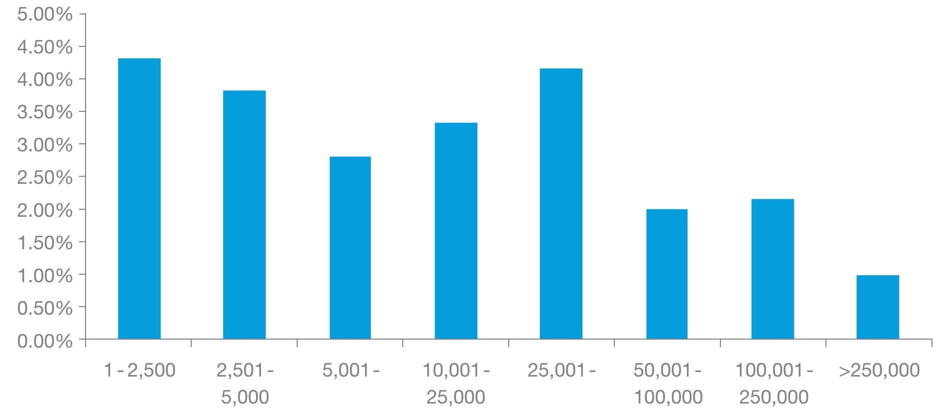
Mired in this debate are third-party marketing agents, businesses that promote, market or sell alcoholic beverages but generally don't take title. Examples include flash sites like Ru-La-La, Wine Woot, Lot18 and others such as Groupon, Snooth and phone agent models. The good news is the TTB is working on an industry circular to clarify some of this issue.

> "Our position is the discounters will either change their business model or will fail."

That said, from our perspective, there are really two questions that need answering. One is, of course, the legal one, but the second is the business model itself of some of the third-party marketing agents. We've heard many discuss discount models and their survivability in wine. In our opinion, those that replicate the wholesaler's theoretical job and focus and own the wine buyer's experience should be successful because they have pricing power and the most important asset: the buyer. But those who have established a following by taking overstocked wines off producers' or retailers' hands on slim margins, then sold on price will have a supply problem in an inventory-balanced fine wine space. Producers won't sell their wines to those sites when they can get better margins through other channels unless the dollar gains strength and they can move to offshore products.

Figure 19: Wineries with an Employee Dedicated to Digital Marketing

We have at least one dedicated employee (their sole job) to help us focus on digital branding and sales, social media, and emerging practices employing electronic tools



Source: Silicon Valley Bank

Make no mistake, there is the opportunity for marketing agents to evolve into being highly relevant in the business and bring professional retailing skills as an outsourced function, if they are legitimate and avoid the mistake of selling luxury goods on price alone.

E-commerce

E-commerce still is the fastest growing DTC channel in our industry despite it being the most underfunded.[24] We have unprecedented access in our industry with more states than ever being open to DTC shipping. The ability to reach the customer (even if it is not a direct sale) is more important than ever. But e-commerce is only a concept unless we staff it with qualified people, marketing dollars and good infrastructure. It also is not an instant success. You can't just turn on the e-commerce switch and suddenly expect a wave of sales. It takes a real strategy as well as infrastructure and people with goals and experience.

Mobile

The mobile phone just outpaced the computer for accessing the Web. More than half the households in America don't have land lines. Smartphones are now smarter and the Internet is quickly becoming accessible in everyone's pocket. It already is the number one tool for accessing search and soon will be the primary tool for accessing social networks. I'm sure you have been on a wine aisle and seen someone researching a wine on their phone. With the evolution of mobile devices and phone applications, getting relative position in cyberspace so your brand is represented is becoming one more digital discussion you need to have.

But outside of research, people are even more interconnected via the mobile phone and able to praise or criticize a business in their personal network wherever they are physically. What if someone compliments or pans your wine at your tasting room while on a phone, or does the same at a fine restaurant? How are you going to engage that customer and convert the experience to a positive one? What is your strategy? How will you enable your digital presence for that ever-growing user base of consumers? They are looking for you on their phone. They are talking about you on the Internet through their phone. Are you connected?

In the SVB Wine Conditions Survey, we asked about resourcing of digital strategies and discovered that no matter the size of the winery. Fewer than 5 percent of the respondents staffed this most important of functions with a dedicated employee (Figure 19). The take-away is we have a long way to go to understand the digital world, make it a part of our business and planning, staff and resource it and follow up for success metrics. At some point, that too could evolve to an outsourced function, but it's so early in the game, wineries don't yet see the need for allocating dollars to the budget. So, expecting a support business to emerge for this need might still be a little way out, unless it's a business that enters the wine space with an existing list of clients in other areas who can support overhead.

Forecast

(repeated line, to Ted and Elaine)

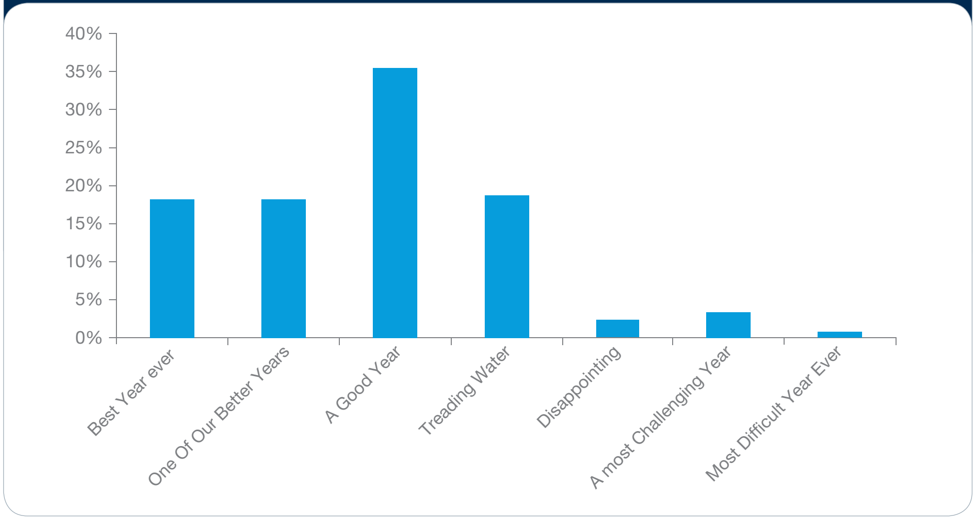
Dr. Rumack: *I just want to tell you both good luck. We're all counting on you.*

At SVB, we do one thing in our wine division: provide banking services to wineries and vineyards on the West Coast of the U.S. We don't do anything else. If you fail, we fail. So we are grateful for the success of our clients and hope the expertise and the tools we offer have helped you to achieve some level of success and assisted in navigating the last couple years. So, from all of our families for the next 12 months we'd like to say: Good luck. We're all counting on you.

We always start the forecast part by asking what winery owners expect the next year to look like. It's hardly a perfect gauge of what is likely to happen because information is imprecise and owners generally seem to lag on this question somewhat and predict a continuation of what they presently see. Be that as it may, this year they are more divided than last year and we've seen more responses move to the ends of the chart with fewer in the middle. It's hard to draw too many conclusions from that change, but it is consistent with both the bifurcation in business we noted in slide (See Business Models Figure 10 on page 9), and the belief that the recovery isn't floating all business models. Some are slipping more, while others are recovering.

The outlook for small, family-owned wine business in 2011-2012 is best described as improving, with success defined more by the business model, capitalization, professionalism of management and, more than anything, the sales strategy (Figure 20). There will be more winners this year and fewer losers as well as some startups and support businesses taking advantage of opportunities created by change. We also expect to see a few more wineries changing hands as the rising tide isn't floating all boats. Some have too much ballast. (Sorry for the off-theme nautical reference.)

Figure 20: 2011 Outlook



Source: Silicon Valley Bank

In 2011, we expect sales of fine wine to grow in the range of 11-15 percent. Our forecast is supported by improving luxury consumer trends, bottoming of the de-stocking phase of the business cycle, recovering stock market wealth, improving retail sales, lower unemployment, improvement in restaurant sales and the national economy remaining somewhat more stable.

We believe the financial performance will be negatively impacted by some continued, but declining, levels of discounting as inventories balance out this year. Factors influencing this trend are demand, emerging legal and legislative changes, distribution and channel shifting issues, and more echoes of the market crash that will be addressed in national and global politics, then played out in world debt and equity markets.

Overall profitability in the family-run wine business will begin to rebound this year with most of the expensive grapes from pre-crash vintages now passing through the income statement. Growers will continue to find difficult conditions renegotiating for the prices paid in prior agreements, however, except for the most prized fruit. They will see their lot in life change when the producer is better able to raise prices.

Taxiing

Rumack: *Now we know what we're up against*

Elaine Dickinson: *How serious is it doctor?*

Rumack: *Extremely serious. It starts with a slight fever and dryness of the throat. When the virus penetrates the red blood cells, the victim becomes dizzy, begins to experience an itchy rash, then the poison goes to work on the central nervous system, severe muscle spasms followed by the inevitable grueling.*

Rumack: *At this point, the entire digestive system collapses accompanied by uncontrollable flatulence (Oveur begins to fart uncontrollably)*

Rumack: *Until finally, the poor bastard is reduced to a quivering wasted piece of jelly.*

So now you know what you're up against. It's good news and bad news. To sum it all up, we are cautiously optimistic. So make your plans and plot your vector, Victor. Good luck. We're all counting on you.

GOVERNMENT WARNING: (1) ACCORDING TO THE SURGEON GENERAL STRESSING ABOUT THINGS YOU CAN'T CONTROL WILL LEAD TO DEFECTS IN LIFESTYLE.(2) COMPLETELY IGNORING THESE DEPRESSING EVENTS THOUGH WILL LEAD TO THE EARLY TERMINATION OF YOUR CHOSEN PROFESSION.(3) LISTENING TO THE FAR LEFT OR RIGHT REGARDING ROOT CAUSES OF THE ECONOMIC MELTDOWN WILL CAUSE INCREASED CONSUMPTION OF ALCOHOLIC BEVERAGES WHICH IS A GOOD THING IN MODERATION BUT IMPAIRS YOUR ABILITY TO DRIVE A CAR OR OPERATE MACHINERY, AND MAY CAUSE HEALTH PROBLEMS IF SAID MACHINERY IS BIGGER THAN YOU. (4) THE GOVERNMENT IS HERE TO HELP AND HAS THE SITUATION UNDER CONTROL.

Silicon Valley Bank's Proprietary Peer Group Metrics

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 the company'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.

About SVB Financial Group

For nearly three decades, SVB Financial Group and its subsidiaries, including Silicon Valley Bank, have been dedicated to helping entrepreneurs succeed. SVB Financial Group is a financial holding company that serves companies in the technology, life science, venture capital, private equity and premium wine industries. Offering diversified financial services through Silicon Valley Bank, SVB Analytics, SVB Capital, SVB Global and SVB Private Client Services, SVB Financial Group provides clients with commercial, investment, international and private banking services. The company also offers funds management, broker-dealer transactions and asset management, as well as the added value of its knowledge and networks worldwide. Headquartered in Santa Clara, Calif., SVB Financial Group (Nasdaq: SIVB) operates through 26 offices in the U.S. and international operations in China, India, Israel and the United Kingdom. More information on the company can be found at www.svb.com.

About Silicon Valley Bank's Wine Division

Silicon Valley Bank is the premier commercial bank for emerging, growth and mature companies in the technology, life science, venture capital, private equity and premium wine industries. Its Wine Division specializes in commercial banking for premium wineries and vineyards and the industries that support them. SVB has the largest team of commercial bankers dedicated to the wine industry of any bank nationwide. Founded in 1994, SVB's Wine Division has offices in Napa and Sonoma counties and serves clients in the fine wine producing regions of California, Oregon and Washington. By virtue of its dedication to the wine industry, Silicon Valley Bank is able to support its clients consistently through economic and growth cycles, and offer guidance on many aspects of their business, beyond traditional banking services. Silicon Valley Bank is a member of global financial services firm SVB Financial Group (Nasdaq: SIVB), with SVB Analytics, SVB Capital, SVB Global and SVB Private Client Services. More information on the company can be found at www.svb.com.

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[1] *International Wine & Spirit Record* (IWSR) and Xavier de Eizaguirre, Chairman Vinexpo.

[2] We define fine wine as that selling over $20 a bottle, for no other reason than there are more data available using that as a demarcation line. It is not, however, a universally accepted term.

[3] We establish our forecast on the expectation that no major additional economic surprises come into view which drive fear and set the financial markets back in a material way, and that federal support in the form of stimulus and QE2 are not suddenly pared back. Another regulatory wildcard is the CARE ACT (H.R. 1161) which is the attempt by the wholesaler lobby to roll back the Granholm v. Heald decision of the U.S. Supreme Court. The Act could change the playing field in many ways, but it's really about safeguarding our kids and communities if you look at the linked web site. So I guess we should all get behind it.

[4] SVB 2011 Wine Conditions Survey.

[5] James A. Bianco, President Bianco Research, L.L.C.

[6] Visual Flight Rules, for the non-aviators in the crowd, are used when you can see well enough to fly without instruments.

[7] The SVB Annual Wine Conditions Survey is sent out early each year as part of the preparation for this report. This year, the survey was completed on January 15 by nearly 600 West Coast respondents. The complete set of responses, charts and summary analysis is sent exclusively to the participants along with exclusive access to a webinar that provides and analysis of the results. All wineries are welcome to participate. To participate in the 2012 survey, please e-mail the author at rmcmilla@svb.com.

[8] A pure luxury good in economic terms is one for which an increase in price has no negative impact on volume. Conversely, a pure commodity is one for which any price increase has a material negative impact on volume sold. The closer a wine is positioned as a true luxury good, the easier time you would have with raising price — in theory. Substitutes are goods that will move opposite a change in price of another good. So for instance, if luxury wine increased price as a whole, some might in theory start drinking more craft beer if that were truly a substitute good. It is not and survey data we've seen over the years places wine closer to a need versus a want in a recession.

[9] Distributors need to know they can get the wine. In a short market, they horde as a measure of safety. In a long market, they don't worry about it and go to as close to just in time ordering as they can get. But it doesn't matter if the situation was a demand shock caused by recession or a supply shock caused by over-planting. The reaction is very much the same in the distributor's world.

[10] There is liberal usage of the term "discounting" in the wine business. If the retail price of a wine has reset and remains at that price, that's not a discounted price. That's the price of the wine.

[11] The Current Situation Index measures current trends in four industry indicators (same-store sales, traffic, labor and capital expenditures). Any reading below 100 signifies contraction in the current situation indicators.

[12] SVB Peer Group Analysis is a proprietary financial data base that includes both SVB client and prospect information. Aggregated into custom peer sample sets to maintain privacy, it allows SVB relationship managers the opportunity to compare a given winery against a sample set of financial peers. The service is free to SVB clients but un-available to non-clients. With consolidated information dating back to 1991, we are also able to use the homogenous information as a tool to express top-level industry financial trends.

[13] After getting the results back, we were surprised some wineries reported their condition as dead. While we are sad to hear that news, we also wonder how the dead report. It's a little reminiscent of Chicago elections.

[14] The upper 20 percent of wage earners make approximately $100,000 or more annually.

[15] Pam Danziger, Unity Marketing, Direct to Consumer Symposium, Santa Rosa, CA January, 2011

[16] Paul Mabray, CEO Vintank.

[17] I remember when the e-mail era began at SVB and, believe it or not, still have my first e-mail address from 1990. It's Rmcmilla@svbank.com if you need a good wine bank. I didn't get to finish my name completely on the address as you might notice (it's missing the final 'n'). That's because we were concerned about the processing and storage of bits and bytes in 1991. (I am starting to sound like my dad. You guys have it easy. I remember mimeographs ….)

[18] According to the Internet Society and other sources, the term spam is derived from the 1970 Spam sketch of the BBC television comedy series "Monty Python's Flying Circus." I discovered that last year, but it's a cool fact you can throw out when you want to impress someone.

[19] Social Media Revolution 2. If you want to see some entertaining stats on the engagement of digital, watch this: http://www.youtube.com/watch?v=lFZ0z5Fm-Ng.

[20] Paul Mabray, CEO Vintank. (http://blog.stroutmeister.com/2011/03/social-media-is-better-for-experiential.html).

[21] Some examples of online survey tools include http://www.kwiksurveys.com/, http://www.surveymonkey.com/, http://www.freeonlinesurveys.com/, http://www.freesurveytools.com/ and a host of others.

[22] Zappos.com provides a good example: http://about.zappos.com/zappos-story/looking-ahead-let-there-be-anything-and-everything.

[23] John Hinman, Founder and Partner, Hinman and Carmichael, 2011 Unified Symposium, Sacramento, CA.

[24] Company stats from Jason Enroth, CEO, ShipCompliant

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