

Supply and Demand Dynamics of High-End Vineyards in California: Emerging Shortages

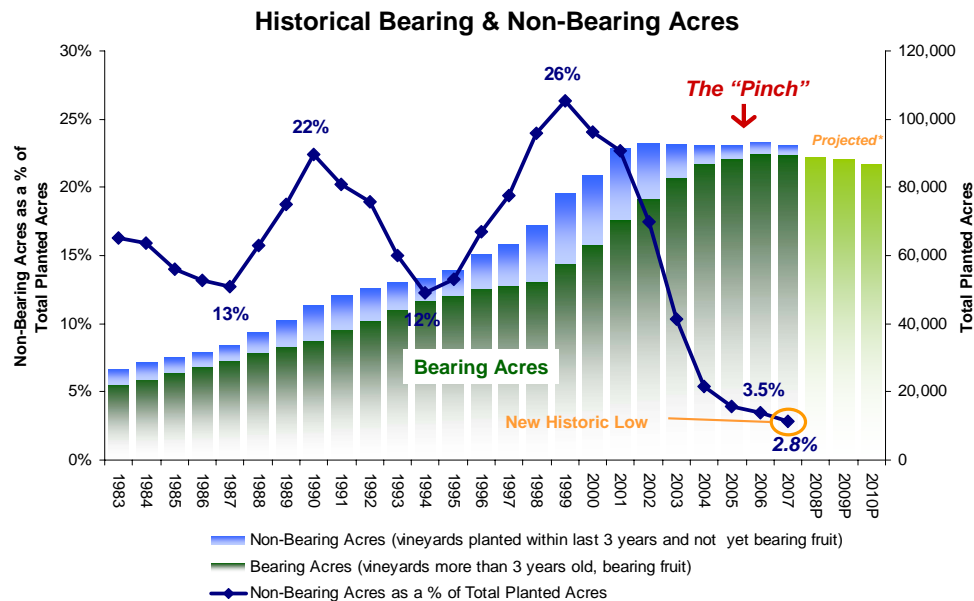
By Ian Malone¹

The California Department of Agriculture released its annual Grape Acreage Report on April 14, 2008 for the 2007 harvest year. Non-bearing acreage (vineyards planted within the last 3 years) fell to a new historic low, from 3.5% of total planted acres in 2006 to 2.8% in 2007 for key varieties in high-end coastal regions (regions geared towards wines selling for over \$25/bottle).² Given the backdrop of growing demand for fine wine, vintners are facing a significant shortage, even if there is a repeat of the large planting cycle that occurred from 1995-2001.

Key highlights/findings:

- Both bearing and planted acres declined in high-end coastal regions of California in 2007 compared to 2006
- Non-bearing acreage at a 25 year historic low—2.8% of total planted acres
- Bearing acres likely will remain flat or decline through 2010
- Even assuming low demand growth, significant shortages will occur
- '05-'07 Pinot Noir plantings have been concentrated in Monterey and Interior, a dramatic reversal from '99-'01 when plantings in high-end coastal areas predominated
- Significant increases in grape prices and vineyard values in high-end coastal regions are likely

The chart below represents the number of planted acres in key high-end coastal regions, with green bars representing 'bearing' acres, and blue bars representing 'non-bearing' acres. The blue line represents non-bearing acres as a percent of total planted acres.



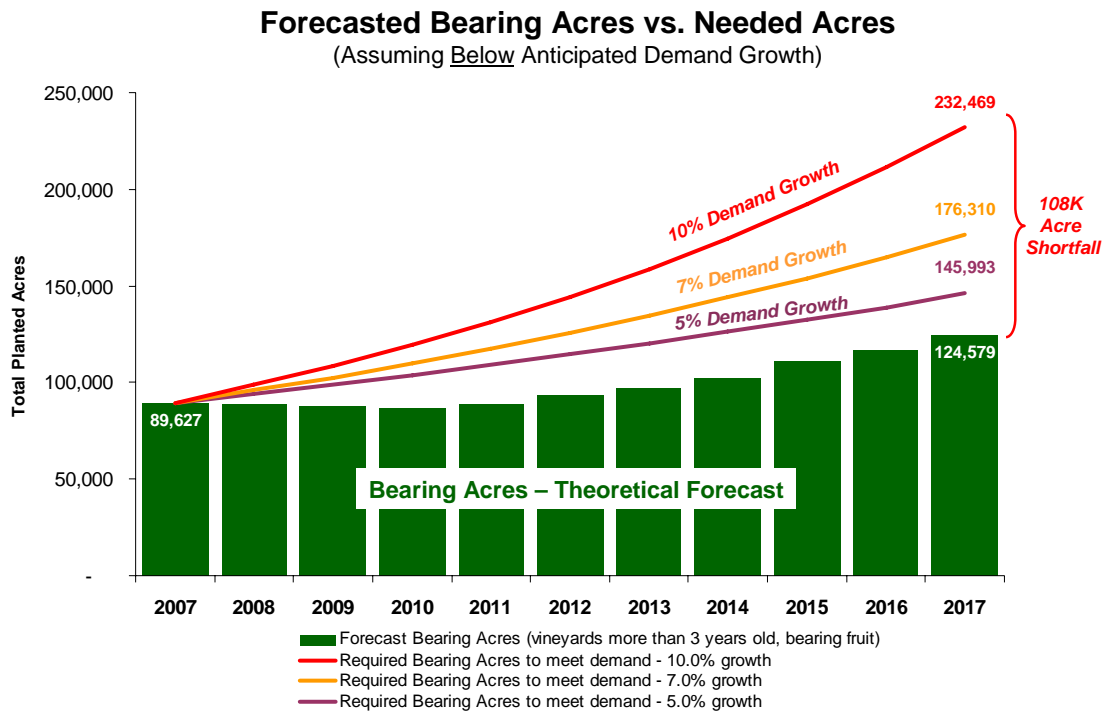
Includes: Napa Cabernet Sauvignon, Napa Merlot, Napa Cabernet Franc, Sonoma Cabernet Sauvignon, Sonoma Chardonnay, Sonoma Merlot, Sonoma Pinot Noir, Mendocino Pinot Noir, Santa Barbara & San Luis Obispo (District 8) Chardonnay and Santa Barbara & San Luis Obispo (District 8) Pinot Noir.
Source: California Agricultural Statistics Service.
* Projected bearing acres based on 2007 non-bearing acres maturing into bearing acres, less 2% annual replacement of older vines (assumes 50 year average life of vines).

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² These regions and varieties include: Napa Cabernet Sauvignon, Napa Merlot, Napa Cabernet Franc, Sonoma Cabernet Sauvignon, Sonoma Chardonnay, Sonoma Merlot, Mendocino Cabernet Sauvignon, Mendocino Merlot, Mendocino Pinot Noir, Santa Barbara & San Luis Obispo (District 8) Chardonnay, Santa Barbara & San Luis Obispo (District 8) Pinot Noir. This is not meant to be a comprehensive list of all high-end regions and varieties, just the major ones that Premier Pacific Vineyards targets.

We project the number of bearing acres from 2008 to 2017, assuming a repeat of the large 1995-2001 planting cycle in 2008-2014. We then compare the forecasted bearing acres to conservative levels of demand growth for fine wine (5%-10% annual growth).³ We find that even with a repeat of the 1995-2001 planting boom, significant shortages in bearing vineyard acreage will emerge, due in part to the fact that essentially no new plantings have occurred from 2001-2007 and current non-bearing acreage is below replacement rate.

The chart below shows projected bearing acreage (green bars) from 2007 through 2017 and compares that supply to needed bearing acres, assuming 10%, 7% and 5% demand growth per year.



Given the increasing scarcity and cost of the best land, increased development costs and regulatory hurdles, it is unlikely that the number of acres planted will reach past levels. However, even assuming (i) past increases in plantings are prologue to the future; and, (ii) conservative fine wine demand growth of 5-10%, there will be an accelerating shortfall. Economic theory suggests that some combination of price increases and product substitution (either from imports or other products) will bring the market into equilibrium. We speculate that there will be significant increases in grape prices and vineyard values in these regions. There will also likely be some increase in imports above \$25/bottle, but at very high price-points supply is constrained globally and wines do not compete based on price alone.

³ The supply of grapes and wine are fundamentally a function of the supply of bearing vineyard acres, as long-term increases in average per-acre yields are generally not possible (although vineyards planted to higher vine densities can yield more tons per acre than those planted to lower vine densities).