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Industry Update

An "Allied Press" Newsletter Publication

January 2008



Change your Expectations:

It's a new year, and a new time in the California wine industry. U.S. wine consumption is at an all time high, and supply is moderating, not only in California, but even from a global perspective, specifically the southern hemisphere. For some time, many industry observers have been saying that the forces of supply and demand will eventually move the current in a positive direction for grape growers. That may finally be happening. It appears that many grape growers have had enough after another disappointing year, with many vineyard removals occurring once again this winter.

Although the 2007 grape market didn't provide any immediate indications that the market is improving, the bulk wine market has. 2005 and 2006 bulk wine inventories have been clearing out since the latter part of 2007. Even through harvest, we experienced adequate, almost impressive, bulk wine interest and movement. Buyers are already discussing 2008, and we expect some of the buyers that were previously non-players to once again be in the market, creating competition.

Statewide, white winegrapes seem to be catching the attention of buyers. There is more demand for Pinot Grigio than there is for other whites, but Chardonnay and even Sauvignon Blanc can perk a buyer's ears these days. At the value-priced spectrum of the market, generic whites like French Colombard and Chenin Blanc are in demand, and for juice concentrate, interest in Thompson Seedless is developing rapidly.

For red winegrapes, the demand is a bit softer. However, we do anticipate that the market will be substantially better than last year. That may not be saying much considering that last year's market was about as bad as it could get in many parts of the state, but the cards are falling in the right place for multiple buyers to have interest, particularly if packaged with white grapes. This interest creates competition, something last year's market was almost completely void of. Even though Merlot may still be considered long, we wouldn't say it is a deal-breaker anymore. Cab Sauv is on the verge of balance and red Zinfandel will likely be balanced, at least in the coastal regions.

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The changing market dynamics necessitate a change in expectations by both growers and

buyers. Many growers should no longer expect that they will have to sell at or below their cost to a minimal number of potential buyers, and buyers should not expect that the grape and wine supply will automatically be there for them when they want to buy.

This year's market should also be much different than last year's because of the amount of grapes now off of multi-year contracts. The percentage of grapes on the spot market will be higher going into 2008. Buyers should have a need for those grapes, since many of their supply contracts have expired. 2008 will allow us to truly discover what the market is, because there will be many willing buyers and sellers. The volume of transactions should be higher than what we have seen in recent years, creating an active and potentially liquid market.

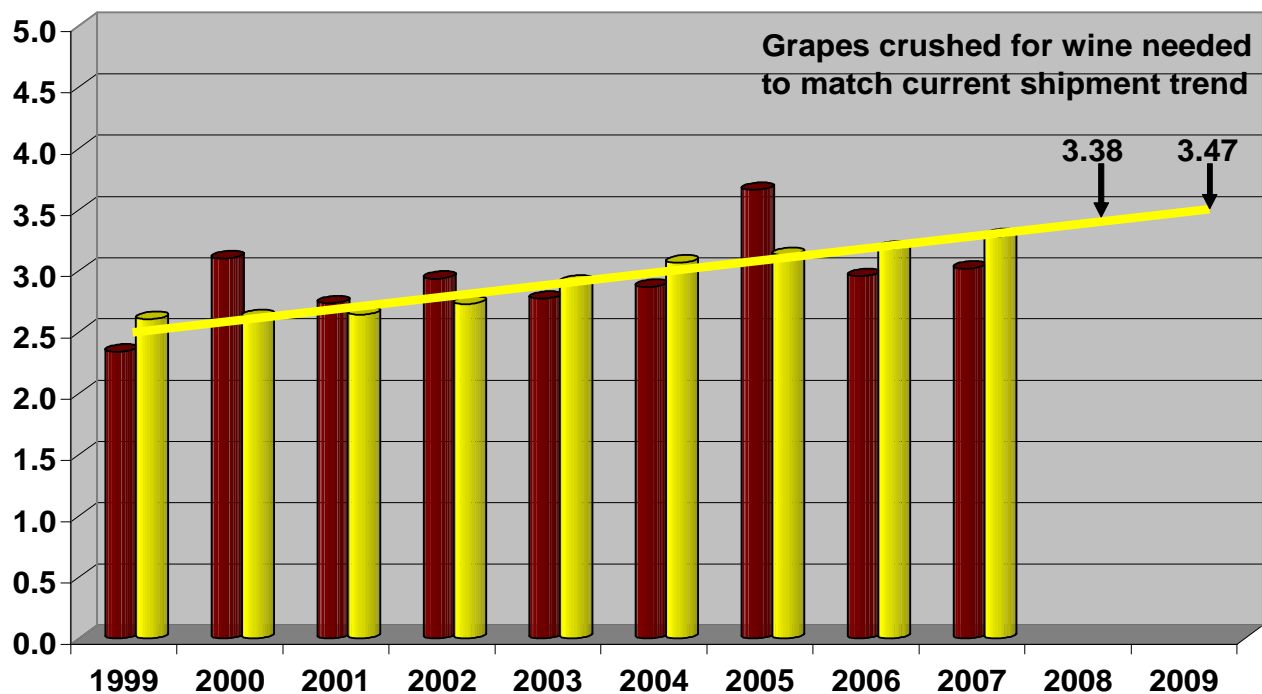
Shifting Trends:

Last year, about this time, we analyzed overall wine shipment and supply trends and pointed out that the industry needed Mother Nature to provide two crops that were average or below in production for 2007 and 2008 in order to experience a balanced grape market from that point on. We are glad to say that we're half way there! 2007 looked to have been near average in production, if not slightly below. An average crop year would've produced about 3.2-3.3 million tons based on the current acres in production and average yields. The State of California is currently estimating the 2007 winegrape crush at 3.2 million tons, and our estimates of the same are close enough that we agree.

The trend is shifting, and 2008 will be the pivotal year for the grape market.

What happens in 2008 in terms of crop size is very significant to the next three years, and even beyond. Looking at the graph, it is clear that the trendline for shipments is moving upward into the future. This will be during a time in which we project total bearing acreage to remain almost completely flat. According to the current growth trend in wine shipments, we need 3.38 & 3.47 million tons of grapes crushed for wine in each of the next two years to match the projected 2008 & 2009 shipments. The fact that grapes do not turn into wine and get consumed immediately is irrelevant, because the point is that we have the potential to supply the market with the same amount of wine it ships annually, creating overall in-and-out inventory balance. The real question is: What exactly is our inventory position going to be at the beginning of the 2008 harvest? The inventory going into 2008

Estimated California Grapes Crushed for Wine vs. Wine Shipments, 1999-2009 (in millions of tons)



Wine Shipment Data Source:
The Gomberg Fredrikson Report
(2007 wine shipments estimated by AGG)

■ Grapes Crushed for Wine ■ Wine Shipments

combined with the 2008 crop size will define demand, both for 2008 and most likely into the immediate future.

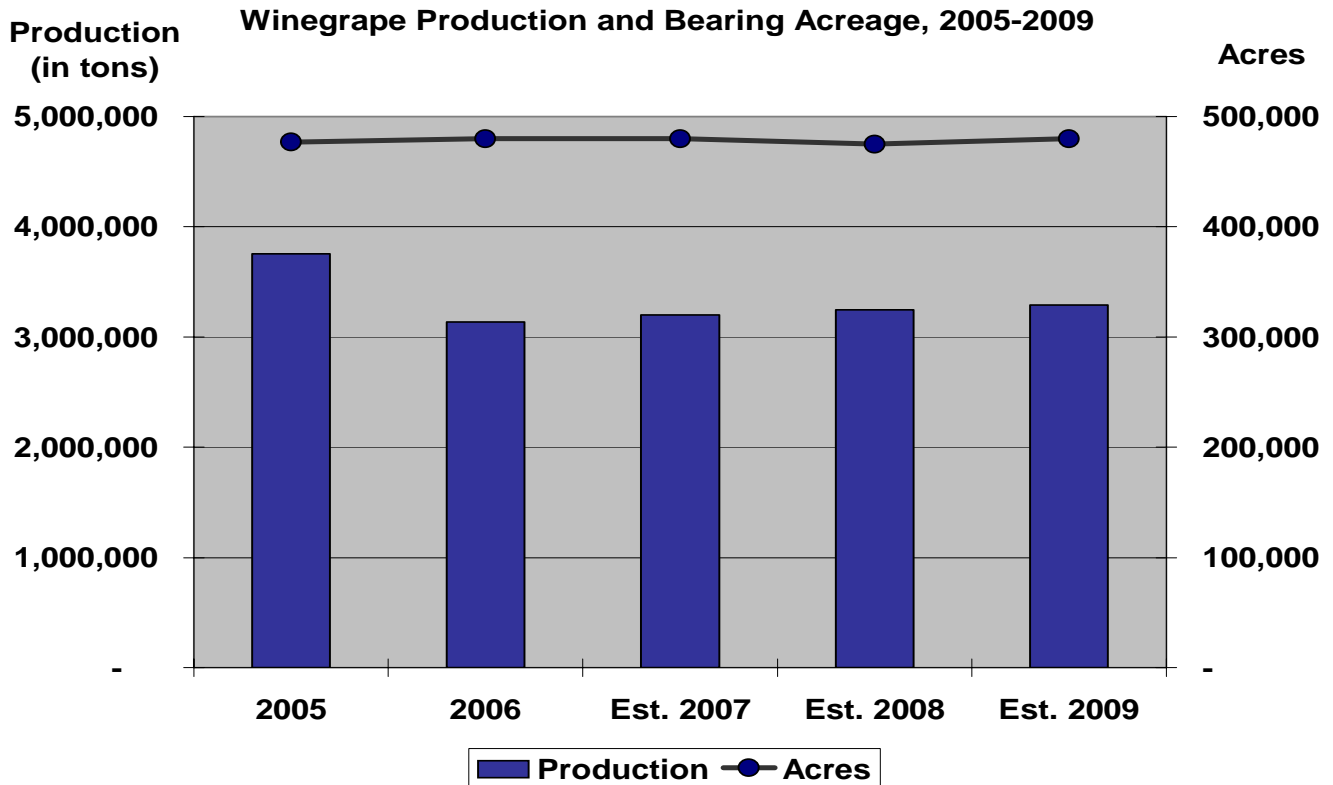
According to the projected acreage and production graph below, through 2009 we anticipate an ability to produce an amount of grapes that could match the wine market demand discussed earlier, given average-sized crops. In fact, we may even end up on the shorter side, depending on how many winegrapes are used in brandy and/or concentrate. But if wine demand is strong, it is less likely that we would continue to see the same amount of winegrapes used that are currently going to these outlets.

Even though we are presenting these numbers as absolutes, there are many factors that influence the outcome in the end. We have done our best to adjust for these factors, but the reality is that markets and crop sizes are ever-changing and wineries respond accordingly. Some of the factors include

the following:

- 1) Many wineries add water during the winemaking process. This can be for amelioration or to actually extend the volume for lower-end formulated products. As supplies shorten, the amount of formulated wine may increase.
- 2) The amount of all grape types (i.e. wine, raisin & table) used for wine, concentrate and brandy changes annually. If there is more profit potential in a specific category, then there would be a currently unknown shift in grape utilization, affecting the supply of grapes for wine in either direction.
- 3) Blending rules allow wineries flexibility in how they allocate their internal supply for their various programs, and recent changes in vintage date regulations have expanded such flexibility for the future.

So given these unknowns, it is not an absolute that things will turn out how predicted, but we can say with a strong degree of confidence that the 2008 grape



market will almost certainly be stronger than 2007, as long as we don't produce another 2005-sized crop.

Applying what we know about continuing vineyard removals, the limited amount of new acres coming into production and an apparent slow down in new plantings due to increasing costs and lack of confidence in California's water supply, we are actually projecting a slight decrease in bearing acreage for

2008 with 2009 and beyond not slated for expansion by any significant percentage. Even if buyers surfaced at this point with reasonable offers to plant grapes, we wouldn't see those acres fully producing until 2012 or 2013. Ironically, if production flattens and current shipments predict future demand, in a few years we may actually be hoping for a 2005-sized crop again! The key to supplying the market accurately will be managed growth.

Popick on Weather:

California grape growers should prepare themselves for a generally warm and dry spring followed by a potentially hot and dry summer and early fall, if the latest long range outlooks recently issued by the Climate Prediction Center are to be believed.



These forecasts continue a model trend, that was established last summer, of an increased probability of a drier than normal winter followed by a warm and dry 2008 growing season. The culprit here is the current La Nina, featuring cooler than normal sea surface temperatures well out in the tropical Pacific - conditions which tend to inhibit precipitation for the southern half of the west coast, from about the Bay Area southward. The 2007-2008 rainfall year has tended to bear this out, as very dry conditions were prevalent throughout the state, with the exception of the far North Coast, until copious statewide rains at the end of December and beginning of January brought most reporting stations back to within a few percentage points of normal, if not slightly above in some places.

Recent high pressure has exerted a blocking influence on incoming storms, and statewide we will almost certainly begin to fall behind as the fair weather pattern remains in control into the early part of February before breaking down enough to allow the return of regular winter storms.

Specific outlooks for the February-May period include below normal precipitation for the region south of a line extending roughly from Santa Cruz to Stockton to South Lake Tahoe along with an even greater probability of drier than normal conditions for the southern San Joaquin Valley (SJV). The North Coast is forecast to receive near normal precipitation, at best, during this time frame. Temperatures are forecast to be above normal for the SJV with normal temperatures for the remainder of California's viticultural areas.

The chances of a warmer than normal summer are high for most of the state - particularly for southeastern CA. The trends mentioned above are forecast to continue into the early fall. Improving computer models coupled with more complete and reliable data input have combined to make these long range forecasts considerably more accurate than they were just a few years ago.

President's Message:

I would like to wish you a belated Happy New Year & what is shaping up to be both a happy and better year for the winegrape industry. I'm very bullish on 2008 for both the winegrape growers and the wine industry overall. In mid-late December 2007 we were already being approached by wineries wanting to secure the same varieties and tonnages they had purchased in 2007. They were also asking what additional grapes may be available since they would probably be looking to expand purchases in 2008. Discussions are, and have been, at prices higher than 2007. As we evolve into this new era within the industry, we must understand our actual costs of doing business so we can effectively negotiate adequate prices.

Before being approached by buyers looking for grapes, you should know what your costs are per acre, as well as per ton, depending on some variable scenarios. For example, what are your costs per ton if the winery wants only 3, 5, 8 or 10 tons per acre or no tonnage cap at all? You may incur additional cost to reduce crop or additional cost to carry a large crop. If we are looking at a longer term contract, growers need to forecast what their future costs may be, (i.e. labor, fuel, fertilizer, etc. continue to rise). What are the costs (interest) on the funds you will need to farm? We must be cautious to study price & terms of contracts that span time, because we will be required to deal with those terms and prices into



“I look forward to longer term contracts, but we must be smart and review them before we commit.”

the future. I look forward to longer term contracts, but we must be smart and review them before we commit.

As previously mentioned, total cost of farming should also include a ROI. That investment includes the land and vineyard development costs. It shouldn't matter if you invested last year, 10 years ago or the vineyard is paid off, because there is still money “tied up” in the investment regardless of the current debt. I believe a grower's ROI should also be tied to lost opportunity. We have seen many grape acres removed and planted to more profitable crops. Growers have seen that they can make more money with many other crops.

Consider a vineyard that after actual growing costs, returns to the grower \$1,000 per acre. If his vineyard is worth \$30,000/acre, the ROI is 3.33% vs. what the value of that \$30,000 would be in another investment or sitting in a CD. When I asked an astute vineyard manager what his investors were seeking as a ROI, it

was 12-15%. There is room in the winegrape industry to return somewhere above 3% to the grower for his time, effort and investment. We want growers to look at their total cost of farming, not just their hard costs associated with making an annual crop.

This discussion is intended to educate growers that when they have an opportunity to sell their grapes, be sure to understand total costs. Don't settle for “barely getting by” anymore. Explain your costs to the buyer, including your time and the opportunity costs of your real estate investments.

**Vit Tips - A New Year's Resolution:
(By Emilio Miranda)**

Our fieldstaff drives through most of the state's grape growing regions, and it's not necessary to travel far before coming across an overly vigorous vineyard. Most winegrape growers do a good job of managing the vigor in their vineyards, however, we almost always find 10 to 20% of them that could benefit from bringing their vines into balance through proper irrigation.

Winemakers usually say that less water and fertilizer is better. By this, they are promoting smaller berries, with better skin to pulp ratios, increased color and phenolics, more concentrated flavors and, in general, smaller yields. Sometimes their use of irrigation to achieve these goals is too extreme with loss of yield, increased pest pressures, future reduction in yield and loss of vine vigor. However, just as too little water is detrimental to vine health, so is over-irrigation. For those who spend too much time running cane cutters/trimmers through the field or those unable to see any clusters as you walk down a row, I hope you will read on.

“Just as too little water is detrimental to vine health, so is over-irrigation.”

If you are in a situation in which you keep adding spurs or canes and your crop is the same or less, perhaps too much shade and not enough sunlight is the culprit. You are caught in a vicious cycle of leaving more wood, which means you use more water and fertilizer. In the end, this does not solve your problem but actually worsens it. Except in years of high soil moisture due to rain, we should not, and do not, want shoots growing too vigorously at bloom or fruit set. Bud fruitfulness has a lot to do with the

environment around the shoot in the first few weeks after budbreak. Vigorous vines tend to have lower fruitfulness partly due to shading. Research indicates that

too much shade in our canopy increases the number of buds showing necrosis (death). Excess nitrogen causes rapid shoot growth, pulling carbohydrates away from buds & reducing fruitfulness.

There is other research indicating that shoot thinning and positioning (i.e. more sun and less shade) increases bud fruitfulness. If you evaluate your vineyard and are one of those 10- 20% who could benefit from devigorization through managed irrigation, then make it your new year's resolution.

SJV Syrah vineyard #1:

Good vigor due to controlled irrigation



SJV Syrah vineyard #2:

Too much vigor; over-irrigated vines



These pictures were taken on the same day in the Spring of 2007.

Allied Member Profile:

This edition's member profile features long-time Madera County growers, the Erickson family. Jim Erickson, pictured in the center, was born and raised in Madera. He graduated from California State University, Fresno (CSUF) in 1982 and has been married to his wife Lori for 26 years. His grandfather started farming in the Madera area in 1920 with peaches and olives. Jim and Lori have three children. The oldest, Jason (pictured on right), is a 2005 graduate of CSUF and recently married. Lee (pictured on left) graduates from CSUF this year and is engaged to be married. The youngest, Kristi, is currently attending Cal Poly, SLO. The boys have recently become partners in Erickson Farms and represent the 4th generation of their family to live and farm in Madera.

Erickson Farms operates about 1,000 acres, both leased and owned, of olives, almonds, open ground, raisins, and winegrapes (Muscats, Cabernet Franc, Nebbiolo and Carignane.) They also

operate a custom spraying business with 20 spray rigs, 12 of which run full time covering well over 1,000 acres per year. In their "spare time" and for "fun", Jim and his sons are members of the Sierra Summit Ski Patrol.

In 2007 Jim, and partner Joe Lilles, bought Madera Trucking and now do almond hauling for area farmers. Jim is a board member of the Madera County Farm Bureau, as first VP, and is active in Madera Ag Youth, and Madera Ag Boosters. Erickson Farms is well-respected in the Madera area for their service, reliable custom work and quality farming operation.



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