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SLA Luncheon presentation

Wine: A Whole New World

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Presentation Structure



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Section I

Section II

Section III

Section IV

- Rabobank
- Current U.S. Wine Trends
- U.S. Wine Sector
- South American Wine Sector



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Your vision
Our insight

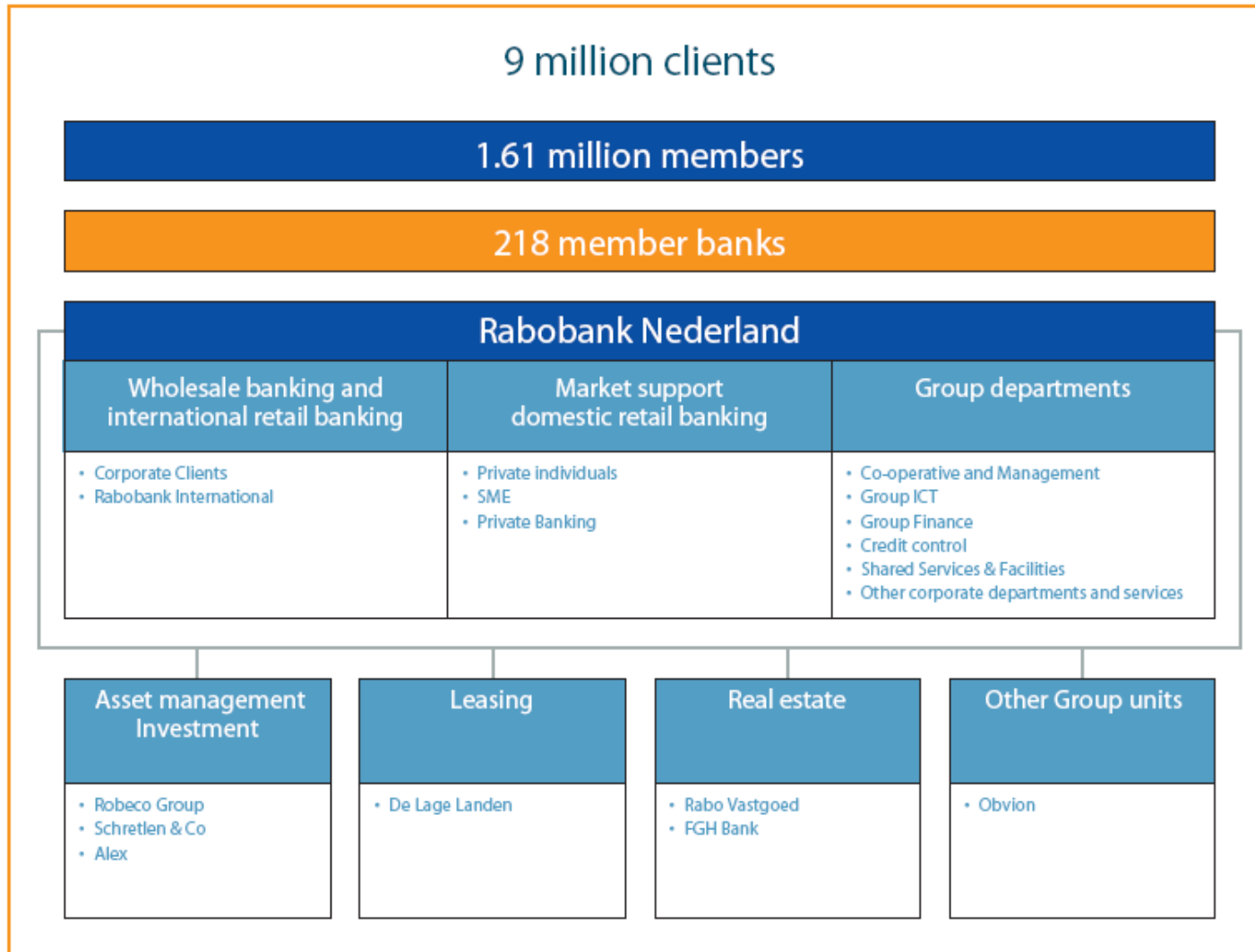
Section I

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Rabobank is a Cooperative bank...



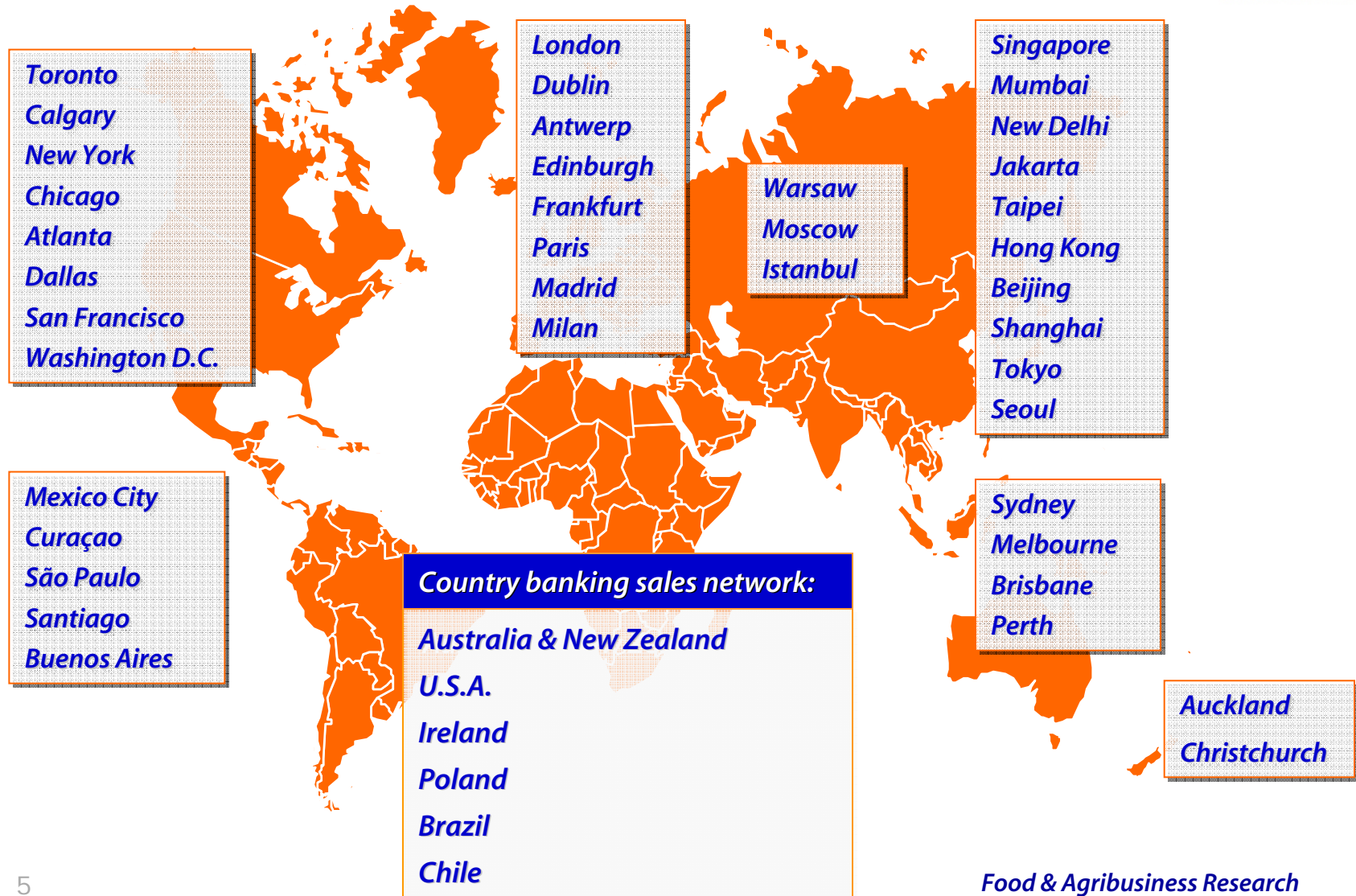
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... with offices all around the world



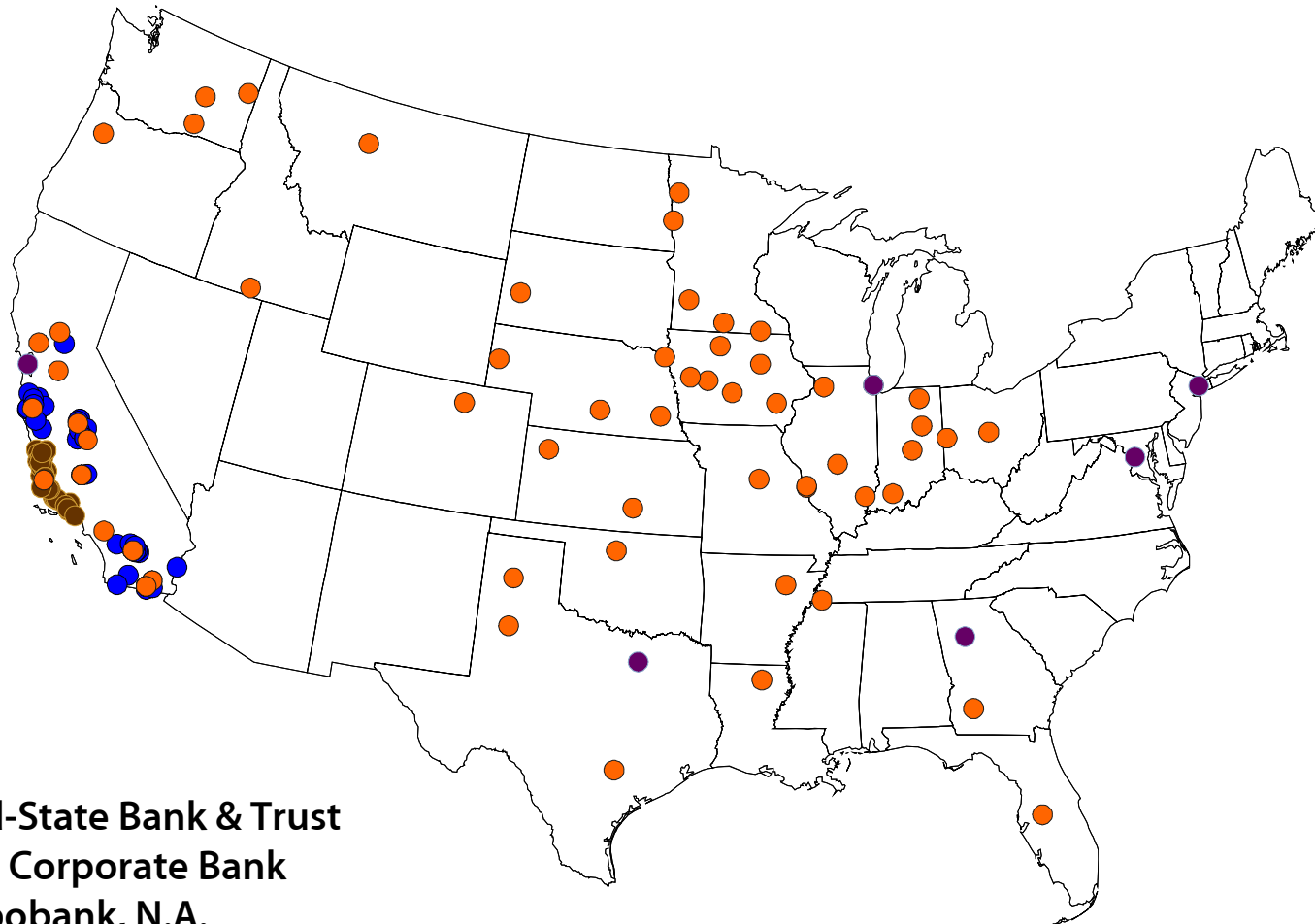
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Rabobank's agricultural/retail banking initiative is driving expansion in the U.S.



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- Mid-State Bank & Trust
- RI - Corporate Bank
- Rabobank, N.A.
- Rabo AgriFinance Office

Enhanced by our global coverage, sector knowledge is a key competitive advantage



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Rabobank's Food and Agribusiness Research (FAR) group is comprised of 80 professionals spread out over 15 countries *Food & Agribusiness Research*

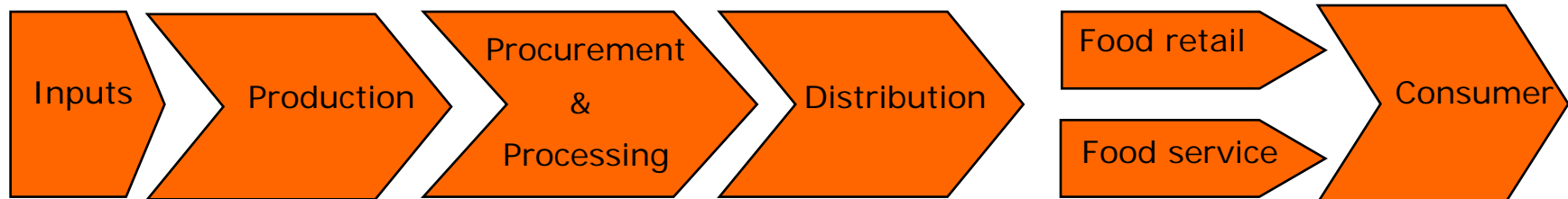
FAR analysts cover all the major Food and Agribusiness sectors throughout the chain...



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- Agricultural Chemicals
- Agricultural Equipment
- Animal Feed
- Animal Protein
- Baby Food
- Beverages
- Cotton
- Dairy
- Edible Oils
- Fertilizers
- Food Ingredients
- Food Processing Equipment

- Food Retail
- Foodservice
- Forestry
- Fresh Produce
- Grains and Grain-based products
- Rendering
- Rubber
- Sugar
- **Wine**
- Wool
- and more . . .



...making this information available to our clients via publications and presentations



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- North American Food & Agribusiness Outlook
- Industry Notes - Short topical publications
- F&A Reviews - Extensive industry reports
- Ag Focus for farmers
- World Maps





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Your vision
Our insight

Section II

Current U.S. Wine Trends

In the U.S., attitudes toward wine have evolved considerably over the years...



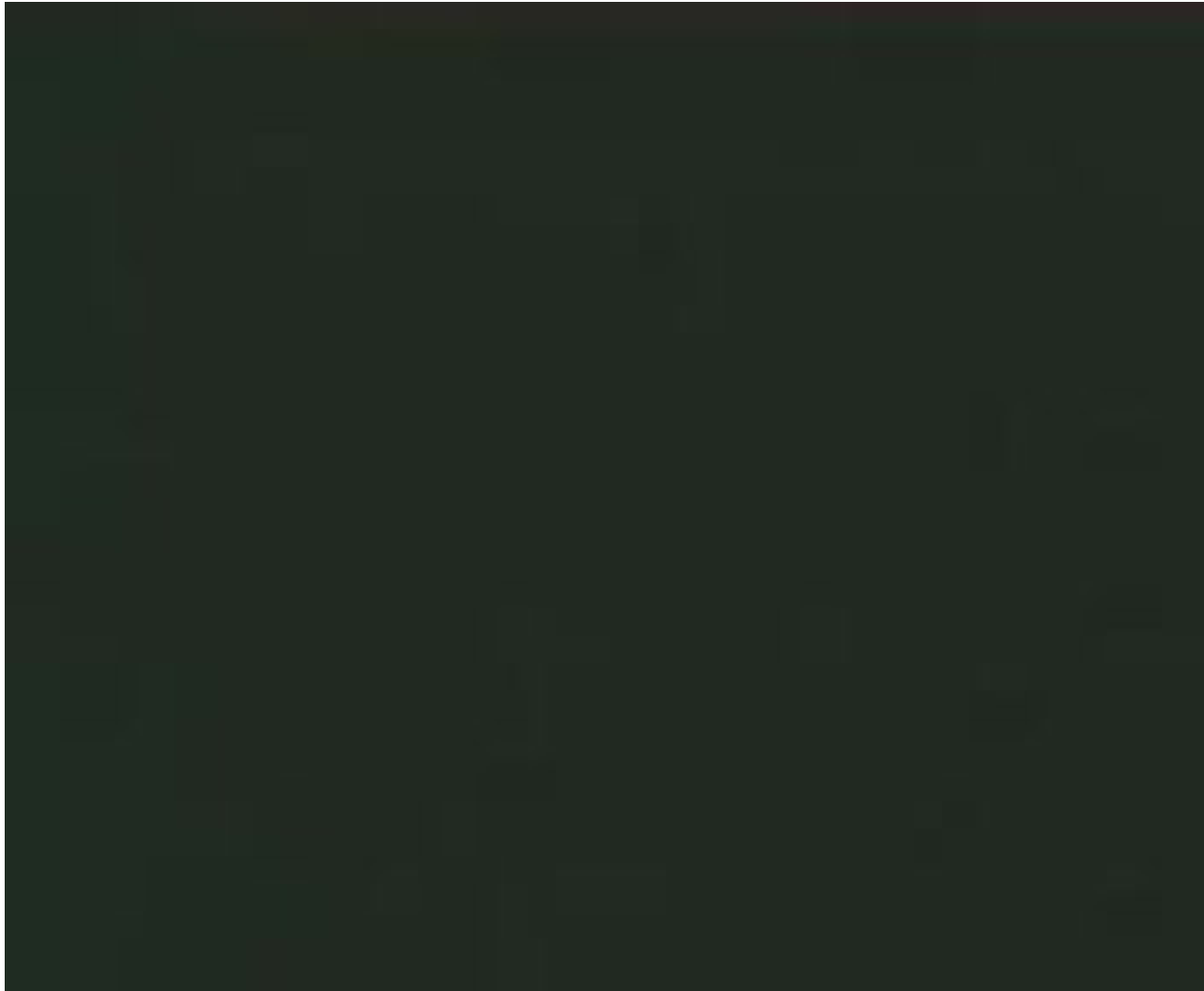
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- From embracing wine consumption (turn of the 18th century):
 - “The discovery of a wine is of greater moment than the discovery of a constellation. The universe is too full of stars.”
--Benjamin Franklin (1706-1790)
 - “I think it is a great error to consider a heavy tax on wines as a tax on luxury. On the contrary, it is a tax on the health of our citizens.”
--Thomas Jefferson (1743-1826)
- To Prohibition (1920-1933)
 - Effectively ended the fledgling U.S. wine production industry
- To the 1991 airing of a Sixty Minutes special entitled “The French Paradox” which led to an increase in the popularity of wine
 - Showed a connection between regular, moderate wine consumption, particularly red wine, and low heart disease rates among the French, despite a lifestyle of a high-fat diet, smoking and little exercise

... to today, a time when wine is becoming increasingly intertwined with pop culture



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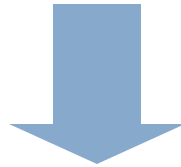


The U.S. is now one of the world's largest and most promising wine markets...



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- The “Sideways” phenomenon highlighted a number of key aspects of wine consumption in the U.S. today:
 - 1) Generally, consumers are more aware of varietals when purchasing wine
 - 2) Consumers are more knowledgeable about the origin of their wine
 - 3) Beginning to incorporate wine into more than just special occasions
 - a) But Thanksgiving is still the #1 day for consuming wine in the U.S.



As a result, **American consumers are becoming more value-conscious**, and choosing wines from non-traditional regions (traditional being western Europe) that have greater perceived value, such as:

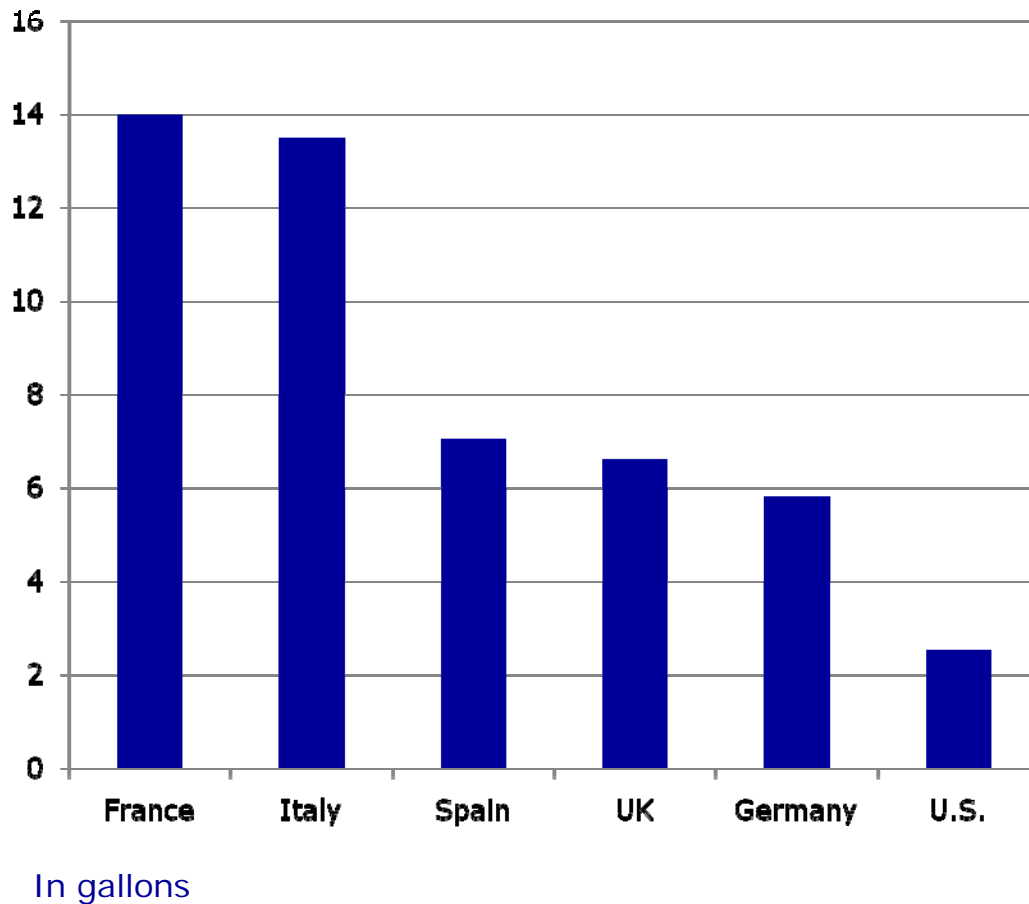
- **In the New World:** Chile, Argentina, and specifically in the U.S.; California (outside of Napa/Sonoma), Washington, Oregon, New York, and even fledgling areas such as North Carolina

...but in the U.S., there is no such thing as an "average" consumer



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Per Capita wine consumption, selected countries



- Per capita U.S. wine consumption is low by western European standards at 2.5 gallons per year
 - Equates to 80 glasses of wine per person
- 25% of U.S. adults drink at least 1 glass of wine per month
- But 38% of consumers do not drink any alcohol at all

Shifting domestic demand preferences and value propositions are driving innovation...



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- Charles Shaw wine -- "Two-Buck Chuck"
 - Geared toward extreme value-minded wine drinkers
 - Price ranges from \$1.99 in California to up to \$3.99 in New York City and other eastern markets
 - Derived from bulk grapes from California vineyards



- Casillero del Diablo -- #1 imported brand from Chile
 - Geared toward value-minded drinkers who are interested in high-quality varietal wine
 - Generally priced between \$6 and \$10 per bottle
 - Competes with lower-end California wines from the Napa and Sonoma Valleys



- Red Cat wine -- Hazlitt Vineyards
 - One of the top selling wines derived from wine grapes grown in the New York Finger Lakes region
 - Varietals relatively unimportant, but sweet taste and low price (\$7) attracts non-traditional wine drinkers

...but high-end wines will remain appealing to the sophisticated U.S. wine consumer



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- Opus One -- Bordeaux-style California produced wine
 - Joint Venture between Robert Mondavi and Baroness Philippine de Rothschild
 - Retails between \$75 and \$200 a bottle, depending on the vintage



- Joseph Phelps Insignia -- Napa Valley wine
 - 2005 Wine Spectator magazine's "Wine of the Year"
 - Price point was not extraordinarily high, leading to high demand from wine connoisseurs
 - Type of wine that exhibits so-called "snob appeal"



- Limited-run boutique wines
 - Multitude of family-owned wineries that produce wine in small batches and production is sold solely through the wineries themselves
 - Low supply and high-quality command high prices



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Our insight

Section III

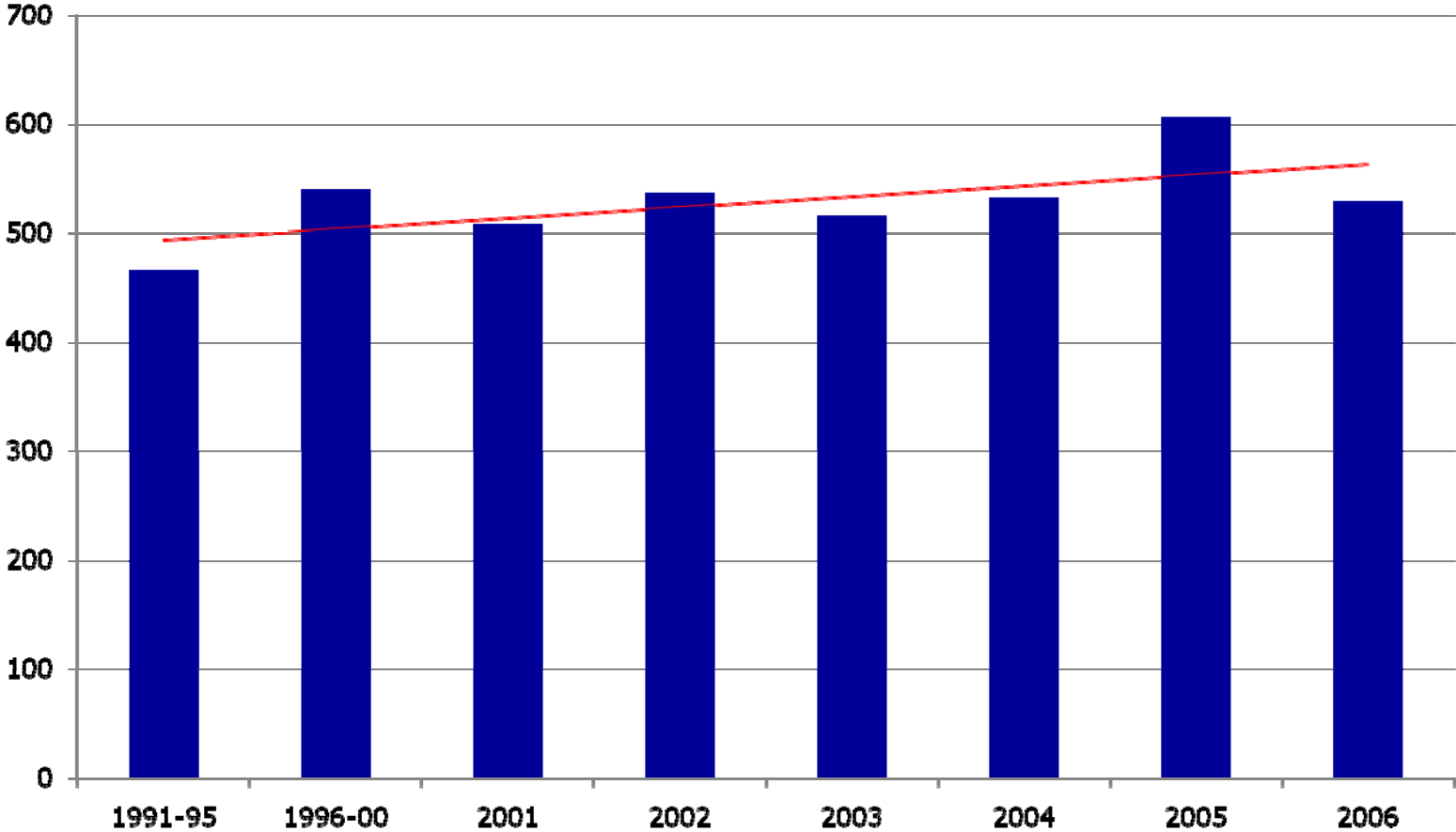
U.S. Wine Sector

U.S. wine production has been increasing steadily since the early 1990's



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Evolution of U.S. wine production



In million gallons

90% of total U.S. wine production comes from the state of California



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- California's Mediterranean climate provides for warm, dry days and cool evenings
- Five wine producing areas are home to 97 designated AVAs
- Napa and Sonoma Valley appellations are world-renowned for their wines
- Central Valley is mostly bulk wine, as summers get too hot for quality wine production
- Santa Barbara County on the Central Coast was the setting for the movie "Sideways"
 - Emerging wine area

The Central Coast has become a marquee wine producing area over the past 10 years



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- The Central Coast wine region is located about halfway between San Francisco and Los Angeles
 - Accounts for roughly 15% of state's total wine grape crush
- Prices for Central Coast wine grapes average USD 1000 per tonne versus about USD 1700 per tonne or more in North Coast
- Main varieties include Chardonnay, Merlot, Cabernet Sauvignon and Pinot Noir
- Central Coast wines currently a good value, but **land prices and popularity on the rise**

Washington and Oregon make up around 4% and 1% of U.S. wine production, respectively



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- Washington is located at about the same latitude as Bordeaux and Burgandy in France
- Includes nine AVAs, three of which share territory with Oregon
- Known for blends and willing to experiment with unique varieties
- Oregon is a smaller wine grape growing region, but expanding
- Now includes 15 AVAs
- Pinot Noir is Oregon's signature varietal, and has really capitalized on the success of "Sideways"
- The number of Oregon wineries has tripled in the last decade

The state of New York produces around 2-3% of total U.S. wine output



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- New York's cooler and wetter climate limits the potential for red wines
 - Similar to Germany, white varieties such as Riesling can thrive in NY's climate
- Currently home to six designated AVAs
- Some of the most popular New York wines are sweet and appeal to new and value-conscious consumers
- Due in part to high price of land, Long Island wines are more geared toward higher-end (NYC) market

The U.S. wine sector is still developing, but tends to focus too much on higher-end market



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- In California, non-traditional wine owners have invested heavily in the premium wine segment
 - Pushed up land prices in areas (especially the North Coast) to the point where wine produced with these grapes need to sell for \$20+ per bottle just to breakeven
 - Some companies not producing the quality necessary to secure the price they need, and weak brands are hard to sell
- The growing value wine segment has been populated with lower priced, good quality competitors from abroad
 - Australia's critter wines (Yellow Tail and copycats) pioneered a new value segment in the early 2000s, leaving the U.S. in the dust
 - Currently, some of the best U.S. value wines come from California's Central Coast and areas such as Washington, Oregon and New York



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Section IV

South American Wine Sector

Chile is blessed with diverse geography and huge span of latitude...



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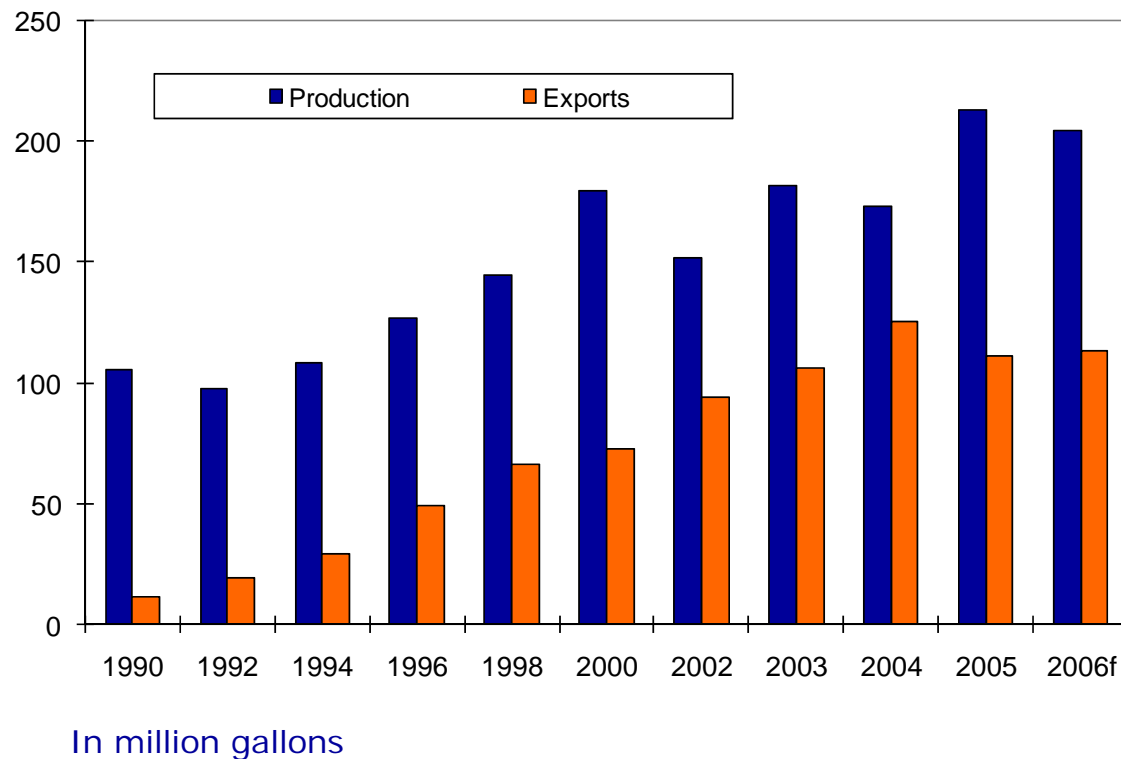
- Besides wine, Chile's geography allows for production of many types of agricultural products
 - Major wine producing areas clustered near Santiago
- Additionally, Chile has natural barriers to disease and pests
 - West: Pacific Ocean
 - East: Andes Mountains
 - North: Atacama Desert
 - South: Antarctica
- Allows Chile to control sanitary and phytosanitary conditions
 - Better enables the control of vine diseases

The Chilean wine sector has grown by focusing on increasing exports...



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Chilean Wine Production and Exports



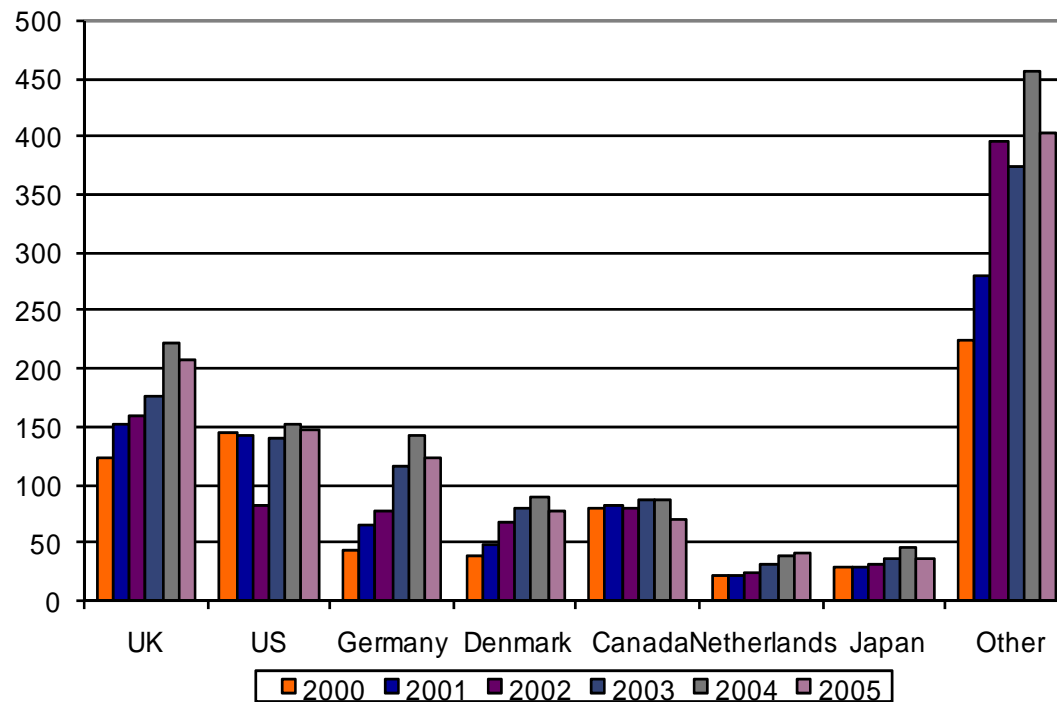
- By targeting the value segment of developed markets, Chile has been able to gain significant market share
- Leading wine companies Concha y Toro, Santa Rita and San Pedro have been intently focused on high-quality value wines
- Approximately 75% of Chilean wine production is of red varieties, such as Cabernet Sauvignon, Carmenère and Merlot

... but future success will depend on Chile's ability to improve quality and price points



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Chilean Wine Exports, by destination



In million gallons

- UK and U.S. are the top markets for Chilean wine
- Exchange rate fluctuations have created recent challenges for the sector
 - Strength in copper price has caused the Chilean peso to appreciate, which impacts returns for products in which local costs (labor, etc) are important component of overall costs
 - Between 60% and 70% of the cost of producing wine are local costs

Outlook for Chilean wines in the U.S. market



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- Appreciation of the Chilean peso will cause leading wine exporting companies to continue to reevaluate their positioning strategies
 - Shift even more to the bottled segment
- Look for the top Chilean brands to increase their exposure in the \$10 to \$15 single varietal red wine category in the U.S. -- a market that is fiercely competitive with California wines
 - Quality of Chilean wines will be the differentiating factor
- Even still, there will still be a number of high-quality Chilean wines available in the value category
 - In particular, try the Carmenère variety, which is unique to Chile

The world's 5th largest wine producer, Argentina is an emerging exporter of quality wines



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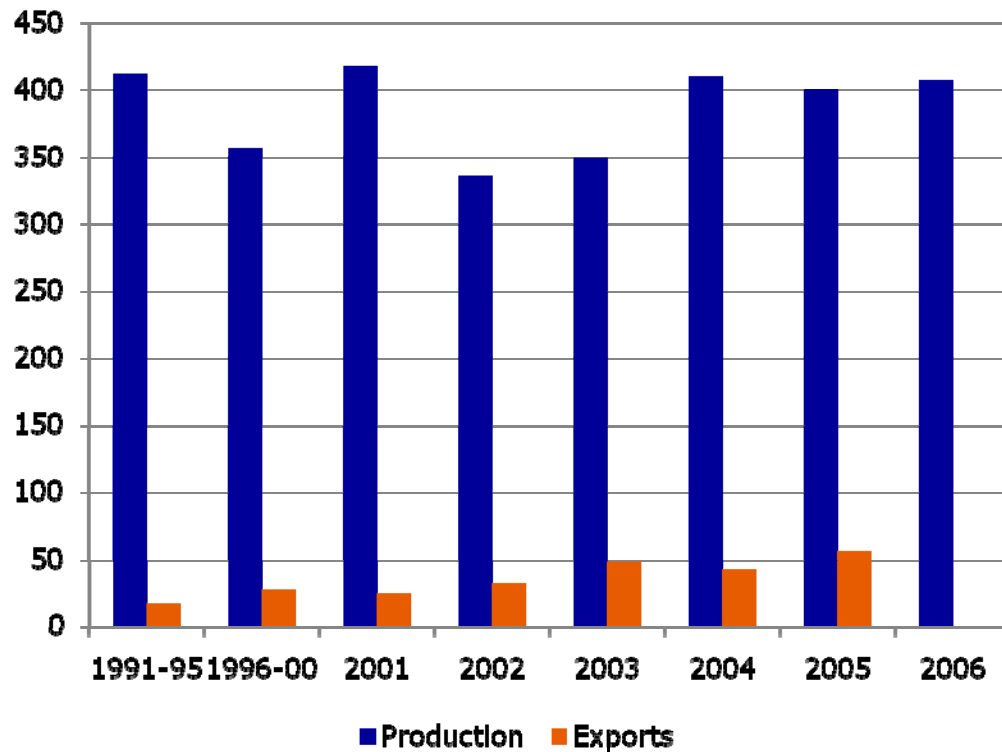
- Currently Argentina is the 11th largest exporter of wine
 - Produces a significant amount of bulk wine for export to mostly developing countries (Paraguay, Russia, Brazil)
- Recent stability of the economy (post-2002) and devaluation of the Argentine peso has increased its competitive export position
 - Especially compared to Chile and Australia
- Encouraged investment in quality bottled wine production for export

Argentina has strong potential for expansion of wine exports, particularly red varieties



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Argentine Wine Production and Exports



In million gallons

- In comparison to Chile, which exports almost 50% of its wine, Argentina exports less than 15% of its total production
 - Vast potential for expansion of exports
- White wine grape varieties account for more than half of planted area, but much is substandard quality
- In the export market, Argentina is known for red wine varieties such as Malbec and Bonarda

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Outlook for Argentine wines in the U.S. market



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- Current exchange rate scenario and low cost price for land and wine grape production is attracting significant investment
 - Shifting even further into the quality bottled wine segment, which accounts for 30% of total production, up from 10% not long ago
 - Even the top Chilean wineries are taking stakes in Argentine wineries, knowing that Argentina will be able to create a better value proposition with the current exchange rate situation
- Malbec to become a top varietal in the U.S. value segment
 - Already seeing some entry into higher price categories as well, such as the Luigi Bosca brand, competing with mid-priced California wines
 - Quality is often times higher than even Chilean wines
- Argentine wine sector is looking to expand marketing efforts
 - Brand development will improve image and sales, leading to increased consumer recognition and exports to the U.S.

When looking for value wines from the New World, keep this in mind...



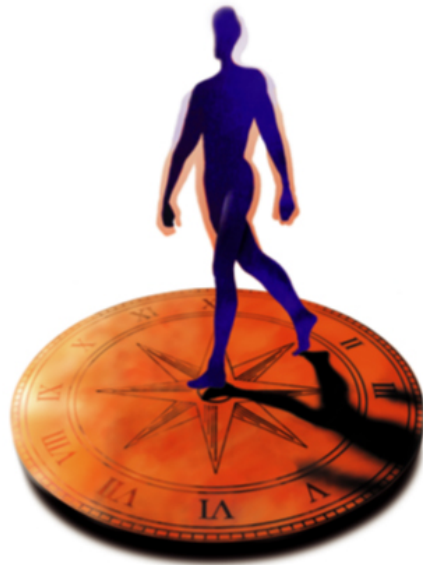
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“I think that the best way to learn about wine is to drink the cheapest wine you can find. If you can't find any cheap wine you like, then spend a few more dollars. And then a few more, and more, and more.... Depending on what you can afford to pay for wine, the unfortunate truth is that generally, better wine costs more, however, it isn't necessarily true and wine that costs more is better.”

--Unknown



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