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2020 YEAR IN REVIEW

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2020 YEAR IN REVIEW

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2020 Wine Industry Merger & Acquisition Review

Cody Jennings

LOOKING BACK to the beginning of 2020, any discussion of the greater U.S. economy would have centered on escalating tariffs threatening to upend a record period of economic expansion. Similarly, the wine industry was facing its own set of troubling, but not terribly acute, market trends: declining per capita consumption, market share attrition to alternative alcohol segments, and a growing backlog of wine inventories compounded by significant oversupply in the grape and bulk wine market. Today, the most pressing challenges facing the wine industry are very different. The impact of the coronavirus pandemic, as well as a devastating year of wildfires across the West Coast, have shaped a dramatically different industry landscape. As we enter the fourth quarter of 2020, it is clear that uncertainties related to COVID-19 will persist into 2021, dictating where and how wine will be able to reach consumers. Robust wine sales within the three-tier system suggest that wineries, retailers, and consumers have

adapted well to the initial shock, while wine's relevance has only grown during the pandemic. Yet, lasting damage has likely occurred to the restaurant industry and on-premise wine sales, particularly as some purchase activity may have moved to direct channels for good. The wildfires of 2020, meanwhile, have largely erased oversupply concerns within the grape market but in doing so created a whole different set of operational and supply issues to contend with.

With respect to industry merger and acquisition activity, there is a clear demarcation between pre- and post-COVID-19 activity. Operational disruptions, travel restrictions, and a heightened sense of general uncertainty has had a notable cooling effect in 2020, particularly as producers pause to consider how a post-pandemic environment may look different. The following is an account of 2020's most notable deals, the key trends that have shaped them, and our best guesses for what lies ahead.

Closing Date	Target	Acquirer	Assets Acquired	Location
January	Bonny Doon Vineyard	WarRoom Ventures	Brand	Santa Cruz, California
January	Flora Springs Winery and Vineyard	Cathiard Family	Winery and Vineyards (no Brand)	St. Helena, California
January	True Myth, Tangent, Baileyana, Zocker	WX Brands	Brands	Edna Valley, California
February	Valley of the Moon Winery	Bundschu Family	Winery and Vineyards (no Brand)	Glen Ellen, California
March	Waters Winery / 21 Grams	Third Leaf Wines	Brands	Walla Walla, Washington
March	Diamond Creek Vineyards & Winery	Champagne Louis Roederer	Brand, Winery and Vineyards	Calistoga, California
April	Booker Vineyard, My Favorite Neighbor	Constellation Brands	Brands (Minority Investment)	Paso Robles, California
May	Cat Canyon Vineyard	Sran Vineyards	Vineyard	Santa Barbara County (Los Alamos), California
June	Ferrari-Carano Vineyards and Winery	Foley Family Wines	Brand, Winery and Vineyards	North Coast, California
June	Pampelonne	Precept Brands	Brand	French-Sourced Sparkling Wine Cocktail
July	Empathy Wines	Constellation Brands	Brand	California-Sourced
July	Folio Fine Wine Partners	EPI Group	Service Provider (Majority Investment)	Napa, California
June	Paso Robles Vineyard Portfolio	PSP Investments	Vineyards	Paso Robles, California
July	Sagemoor Vineyards	Resource Land Holdings	Vineyards	Multiple Locations, Washington State
August	Kerr Cellars	Constellation Brands	Brand	San Francisco, California
August	Steele Winery	Shannon Ridge Family of Wines	Brand, Winery, Vineyards	Kelseyville, California
August	Sojourn Cellars	Sonoma's Best Hospitality Group	Brand	Sonoma, California
September	Joseph Vineyard	Institutional Investor	Vineyard	Bradley, California
September	Burgess Cellars	Gaylon Lawrence Jr. / Carlton McCoy Jr.	Brand, Winery and Vineyards	Howell Mountain, California
September	>1,000-Acre Paso Robles Vineyard	Institutional Investor (Confidential)	Vineyard	Paso Robles, California
October	BNA Wine Group	Miller Family Winery	Brands	California-Sourced

Top M&A Deals

Diamond Creek Vineyards: The Sale of Napa Valley's Crown Jewel

Undoubtedly the headline transaction of 2020, and one of the last to close before pandemic lockdowns went into effect, was Maison Louis Roederer's acquisition of Diamond Creek Vineyards in March. This acquisition of one of Napa Valley's most iconic and highly coveted legacy brands continued an ongoing trend of French investments in U.S. luxury wine brands. Founded by Al and Boots Brounstein in 1968, Diamond Creek Vineyards is perhaps Napa Valley's most storied and acclaimed winery. The acquisition of Diamond Creek Vineyards provided the French Champagne producer with a cult-status Napa Valley Cabernet Sauvignon brand that has worldwide recognition despite its annual production of less than 3,000 cases. This is the second California investment in quick succession for Roederer, following its purchase of Sonoma County Pinot Noir specialist Merry Edwards in 2019.

As is often the case in transactions involving rarified cult status wine brands, the decision to sell Diamond Creek Vineyards emanated from a longstanding relationship between the two family owned organizations and a natural transition point for the brand following the passing of Boots Brounstein earlier in 2019. Given the marquee nature of the brand, it is unsurprising that not even an unprecedented global public health epidemic was able to derail the transaction.

Pre-COVID: Healthy Portfolio-Building

By the time "shelter-in-place" orders were issued across much of the U.S. in March, the wine industry was otherwise well into what was shaping up to be an active year in sale transactions. Ongoing portfolio-building initiatives among mid- and large- sized wine companies, as well as a strong desire for luxury assets from foreign buyers, contributed to a relatively robust M&A market at the outset of the year.

In the first high-profile transaction of the year, Santa Cruz-based Bonny Doon Vineyard sold a majority interest to San Luis Obispo-based WarRoom Ventures. The sale capped off a series of successful transactions for founder/winemaker Randall Grahm, whose previous divestures included the sale of the Big House and Cardinal Zin brands to The Wine Group in 2006.

2020 saw another long-term wine producer take a proverbial "second bite of the apple" when WX Brands acquired the Niven Family Wine Estates brand portfolio, including the True Myth, Tangent, Baileyana and Zocker wine brands in January. Anchored by a fast-growing True Myth Cabernet Sauvignon program, the approximately 120,000-case portfolio was the second major brand divestiture for the Niven family in less than a decade. They had previously sold their interest in Edna Valley Vineyard & Winery to Gallo in 2011. For WX Brands, the acquisition filled a critical portfolio gap at the \$15+ per bottle Cabernet Sauvignon category.

One transaction that largely flew under the radar was the sale of the Valley of the Moon winery to Sonoma's Bundschu family at the end of February. The deal included the historic Glen Ellen winery and vineyards but excluded the Valley of the Moon and Lake Sonoma brands. For the Bundschu family, the acquisition was a strategic fit that will provide significant production capacity for Gundlach-Bundschu, as well as a hospitality center for the recently launched Abbot's Passage brand.



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Strategic Acquisitions Prove Resilient

An untold number of transactions initiated before the pandemic unfolded were likely scrapped due to the virus' abrupt impact on the wine industry. While many businesses were ultimately able to adapt to the changed market realities and may have even seen a net positive impact to their financial position, the prevailing mindset of many buyers during the first several months of the crisis centered around addressing their own internal challenges. As a result, longer-term strategies that may have incorporated growth via acquisitions took a back seat to more acute operational problems at-hand. Adding on the volatility of financial markets, as well as the novel complications of negotiating and completing transactions remotely, some buyers inevitably determined that the safer bet would be to place acquisition activity on hold for the indefinite future.

Despite these challenges, M&A activity did not die out completely in 2020. While the number of major transactions and overall dollar volume were lower compared to 2019, there was a steady stream of deals throughout the course of the year. In all likelihood, the vast majority of these commenced prior to the pandemic crisis, yet had enough momentum, and/or were such a strong strategic fit, that the short-term uncertainties were outweighed by the long-term benefits. In almost all cases, the primary dynamics driving deal activity were carried over from prior years and largely independent of the changes in consumer habits that arose in 2020.

In a continuation of the most dominant trend over the last decade, wine companies continued to employ acquisitions as a means to weight their portfolios toward higher retail price points. Constellation Brands, still putting the final touches on an arrangement to divest its lower-priced

brand portfolio to Gallo, doubled down on the luxury segment with a significant ownership investment in Paso Robles cult wine producer Booker Vineyard, which also includes the My Favorite Neighbor brand. The deal checks a number of boxes for Constellation, including a strong direct to consumer (DTC)-focused brand in Booker, as well as a foothold in one of the industry's most promising wine regions. Paso Robles has generated significant attention over the last few years as California's emerging new luxury wine region, having garnered acclaim for its Rhone-style wines and, more recently, Cabernet Sauvignon and red varietal blends. My Favorite Neighbor capitalizes on the latter, featuring Paso Robles vineyard designate wines priced between \$50 to \$70 per bottle, as well as Bordeaux-style red blend wines priced between \$30 and \$40. Constellation is likely taking particular interest in the growth of the company's \$30 to \$50 wine portfolio as a means to tap into the "mass luxury" Cabernet Sauvignon category that has been the growth engine for some of the region's leading brands, such as Daou and Justin.

Foley Family Wines completed its largest winery acquisition to date with the purchase of Sonoma County winery Ferrari-Carano Winery & Vineyards in August. This transaction is the latest by Foley Family Wines in a series of estate winery acquisitions that spans from Santa Barbara to Oregon. The deal adds approximately 300,000 cases and 1,200 acres of North Coast vineyards to Foley Family Wines' portfolio, further solidifying its position as one of the dominant luxury wine companies in the industry. Owner Bill Foley's distribution company, Epic Wines and Spirits, has been similarly amassing a formidable presence within the mid-sized distributor landscape.

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The California distributor, which represents Foley Family Wines brands as well as those of a number of independent wineries, completed two acquisitions during the year. Epic acquired the California trucking company Pacific Wine Distributors, as well as Pacific Northwest-based distributor Vehrs Distributing. Foley's vertically integrated business model serves as a valuable countermeasure against the outsized influence commanded by large wine companies over the industry's ever-consolidating middle tier.

In August, Sojourn Cellars was acquired by Sonoma's Best Hospitality Group, a collective of Sonoma, CA-based businesses owned by real estate developers Ken and Stacy Mattson. The Pinot Noir-focused brand produces roughly 11,000 cases annually and sells most of its wines via mailing list and at its downtown Sonoma tasting room. The Mattsons previously acquired the former Ravenswood winery and intend to use the renovated facility as a home for both Sojourn and startup brand Harrow Cellars, a collaboration with winemaker Angelina Mondavi.

In September, Heitz Cellar owner Gaylon Lawrence Jr., along with Heitz CEO Carlton McCoy Jr., announced their acquisition of Burgess Cellars in Napa's Howell Mountain region. Lawrence, who purchased Heitz just two years ago, has become one of Napa's more active buyers in recent years, also picking up Haynes Vineyard in Coombsville and Wildwood Vineyard in Rutherford in 2019. Sadly, just a few weeks following the sale, Burgess' 19th century winery and barrel house buildings were destroyed in the Glass Fire. Thankfully, the company's historical old-growth vineyards were spared, and the Lawrence family has indicated that it intends to rebuild the winery.

Growing Role of E-Commerce

Online wine sales soared during the initial months of the pandemic as millions of people developed and reinforced online shopping habits. While e-commerce sales are likely to wane from current levels in a post-pandemic world, the rapid increases in consumer awareness and familiarity with online shopping have undoubtedly accelerated its relevance in the minds of wine companies.

Following its acquisition of Booker, Constellation Brands placed another bet on DTC in July with the purchase of Empathy Wines. Founded by media personality Gary Vaynerchuk in 2019, Empathy is a direct-to-consumer wine brand which produces approximately 15,000 cases annually. The brand's wines are line-priced at \$20 per bottle and sold exclusively through the company's e-commerce platform either as one-time purchases or via subscription. As part of the deal, Empathy's employees will join Constellation and assist in refining the company's DTC strategy across its broader wine and spirits portfolio.

Institutional Buyers Pick Up Vineyards

Vineyard acquisitions were dominated by financial investors in 2020, largely due to an oversupply of grapes that diminished interest among winery buyers. Many wineries in 2019 did not renew grape contracts, relying instead on a robust bulk wine market to meet their production needs. With wide availability of grapes and bulk wine, wineries were less incentivized to lock up supply via acquisitions, and in some cases sought to shed some of their own non-core vineyards. Burned by low interest rates and stock market volatility, institutional investors such as insurance companies and pension funds have been increasingly turning to permanent plantings as long-term, stable investments.

Top M&A Deals

Overall the pace of vineyard acquisitions was slow compared to the past few years, but the average deal size was significant. In the Central Coast alone, more than 6,000 acres of planted vineyards changed hands in 2020, the vast majority of which ended up in the hands of financial buyers. Investors have flocked to the region in recent years because of its growing role as a key grape source for \$15 and above wine brands. One of the more high-profile entrants in recent years, the Harvard University endowment, appeared to divest a significant portion of its vineyard holdings in June to Canada's Public Sector Pension Investment Board (PSP Investments). Several veteran investment groups, including Silverado Investment Management Company and Homestead Capital, also added to their vineyard portfolios in 2020.

The second half of 2020 looks much different from a supply standpoint. Throughout the entire west coast, wineries faced unprecedented concerns over widespread smoke taint from a devastating wildfire season. The resulting run on 2019 vintage bulk wine, coupled with an expected significant loss of the 2020 crop, has dramatically changed the supply/demand dynamic in many areas. Additionally, the channel shift brought on by the coronavirus pandemic is likely to impact demand for grapes in certain regions more than others, at least for the coming vintage. The degree to which these changes resonate through buying habits of wineries and financial buyers remains to be seen, however it will likely look much different from this year.

Outlook for 2021

Looking toward 2021, standalone brand acquisitions are likely to see a rise in popularity as wine companies look to increase their clout with a consolidating distributor and retailer landscape. In addition to exacerbating a longer-term trend of large wine companies having outsized influence over distributors, the forced shift to off-premise channels resulted in uneven growth among various brands and wine companies. Brands which had less exposure in on-premise channels, or were able to pivot quickly, will be attractive targets for acquisition.

In terms of buyers, the largest wine companies, which already over-indexed to off-premise channels and maintained healthy cash flows in 2020, will be in the best position to reinvest in growth, including M&A where appropriate. Financial investors, still sitting on near record levels of dry powder, will also likely take note of beverage alcohol's relative strong performance compared to many other consumer-facing industries and re-engage with the market in a meaningful way.

Despite a year of extreme uncertainty, the industry has proven to be resilient in its ability to adapt. Toward the latter half of 2020 we have already seen indications of a much more active buyer pool as companies gain a handle on the new market realities and now look beyond their existing business for opportunities to grow. Additionally, mid-year concerns regarding access to capital and sustained economic volatility have been assuaged to a large degree. Based on these factors, we expect 2021 to be a particularly active year as buyers look to use acquisitions as a means to capitalize on this year's market disruptions. **WBM**

Zepponi & Company is a leading global mergers and acquisitions advisory firm that is dedicated to the beverage alcohol industry, and has been the most active advisor in the North American wine sector. The firm has served as the financial advisor on numerous transactions involving ultra-premium and luxury wine brands, estates and vineyards, such as Diamond Creek Vineyard, Pahlmeyer, Ransom Wine & Spirits, Orin Swift, Meiomi, Patz & Hall, Kenwood Vineyards, Penner-Ash, Siduri, WillaKenzie Estate and Stagecoach Vineyard. Zepponi & Company has advised some of the industry's largest beverage alcohol companies, including Constellation Brands, Ste. Michelle Wine Estates, Diageo, Jackson Family Wines, F. Korb & Bros. and King Estate. The firm has offices in Santa Rosa, California and Portland, Oregon. For more information, please visit www.zepponi.com.

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