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ECONOMIC IMPACT OF WINE AND WINEGRAPES IN THE PASO ROBLES AVA AND GREATER SAN LUIS OBISPO COUNTY 2007

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HIGHLIGHTS

FULL ECONOMIC IMPACT OF WINEGRAPES AND WINE IN THE PASO ROBLES AVA AND GREATER SAN LUIS OBISPO COUNTY

$ 1.785 Billion[1]

PASO ROBLES AVA + GREATER SAN LUIS OBISPO WINE	ECONOMIC IMPACT
Full-time Equivalent Jobs	8114
Wages Paid	$241 million
Retail Value of Paso Robles AVA Wine	$657 million
Retail Value of Greater San Luis Obispo County Wine	$803 million
Number of Bonded Wineries	217
Wine Produced (9 liter cases)	3.2 million
Winegrape Bearing Acres	29,000
Value of Winegrape Crop	$151 million
Allied Industry Revenues	$51 million
Tourism Expenditures	$113 million
Winery Tourists Visits	1.2 million
Charitable Contributions	$1.1 million
Taxes Paid (State and Local)	$86 million

[1] See **Table1** below.

Table 1

Total Economic Impact of Wine and Grapes in the Paso Robles AVA and Greater San Luis Obispo County

Revenue:	**$ million**
Winery Sales	372.0
Retail revenues	338.4
Distributors Sales	93.0
Winegrapes Sales	151.0
Tourism	112.8
Suppliers	39.3
Services	11.8
Tax Revenues - State & Local	85.9
Charitable Contributions	1.1
Education and Research	1.2
Indirect (IMPLAN)	203.7
Induced (IMPLAN)	134.0
Total Revenue	**$1,544.1**
Wages (annual):	
Winery Employees	44.3
Vineyard Employees	30.6
Tourism	38.1
Retail	0.3
Distribution	0.9
Suppliers	7.9
services	2.6
Education	0.9
Indirect (IMPLAN)	70.5
Induced (IMPLAN)	45.0
Total Wages	**241.3**
TOTAL	**$1,785.3**

Source: MKF Research LLC

EXECUTIVE SUMMARY

The wine and grape industry in San Luis Obispo County has been transformed over the last decade, a transformation that has enabled growth in employment and incomes in the county while preserving agriculture in an astonishingly beautiful rural environment.

Over this period,

- ✓ The number of wineries in the county increased from 51 to 217;
- ✓ The number of wineries in the Paso Robles American Viticultural Area (AVA) increased from 35 to 181;
- ✓ The number of vineyards in the county increased by 72%, with winegrape bearing acres growing by more than 190%;
- ✓ Winegrapes, now the county's highest value crop, represents one third of San Luis Obispo County's total agricultural production value.

Winegrapes surpassed vegetables as the county's leading agricultural crop by value in 2000. Vegetable production had led San Luis Obispo County agriculture for the previous 75 years.

Wine, vineyards and related industries and services generate $1.785 billion in economic value in San Luis Obispo County, including more than $86 million in state and local taxes.

San Luis Obispo's wineries, vineyards and allied industries and services account for 8,114 jobs in the county, generating a payroll of more than $240 million per year. These jobs represent 7.5% of total county employment, 9.2% of private sector employment and a major share of the jobs created in the county in recent years[2].

The county's wine industry is largely concentrated in North County, which is primarily the Paso Robles AVA. The Paso Robles AVA accounts for more than 90% of the number of wineries in the county, about 82.4% of the county's winery revenue and 82.5% of county wine production. Nearly 90% of the county's reported 29,000 vineyard acreage is within the Paso Robles AVA. Consequently, the economic impact of wine and grapes in the Paso Robles AVA is estimated at $ 1.467 billion, employing 7,000 persons with a total payroll of $182 million.

Despite the acceleration in winery construction over the past decade, the production capacity of wineries within the AVA and of wineries, wherever located, producing wine with the Paso Robles AVA designation has still not caught up with the region's growth in

[2] Available data indicates that Health and Education Services together represent the largest single employment sector in the county, with 17% of total reported employment. The next largest sector appears to be Leisure and Hospitality, with 14% of the county's total employment, a significant share of which is wine related.

grape production, although significant progress has been made. Whereas several years ago, 85% of Paso Robles grapes were sold out of the county, today 58% of these grapes are sold outside of the county. More than two thirds of the grapes produced in the Paso Robles AVA go into wines designated for the lower priced California and Central Coast AVAs.

The major value added from producing wine grapes is derived from processing grapes into wine, which includes the sales and marketing of that wine. Moreover, grape prices reflect in large part the price of the wine they produce – grapes processed for lower value AVAs thus depress the returns of their growers.

To both improve the incomes of winegrape growers in the county and to capture more of the value added of its vineyards, more of these winegrapes need to be made into wine within the county – and that wine should carry the higher priced Paso Robles, Arroyo Grande or Edna Valley AVAs.

A key question is whether Paso Robles can stimulate sufficient growth in demand for wine with its AVA to attract sufficient new brands, as well as the growth in existing brands, to absorb a substantial share of these grapes.

Paso Robles and greater San Luis Obispo County have clearly shown the ability to produce high quality wines at reasonable prices. The Paso Robles Wine Alliance has made major strides in building the reputation of the region's wines in recent years. However, even with significant continuing growth of existing brands and the several new high end wineries in development, major new initiatives are required. To attract the needed investors, the region needs to further expand its promotional efforts, with strong support by the city and county and by the region's economic development organizations.

The crucial missing ingredient to realizing the potential of the County's winegrape investment is thus the development of additional brands to speak for the county's distinctive combination of quality and value. The core of such brand creation will be the growth of brick and mortar wineries – smaller, higher end wineries -- offering visitors memorable experiences, reinforcing the county's image as the source of quality wines and turning tourists into "brand ambassadors". Generally, smaller high end wineries refer to wineries producing up to 100,000 cases of wine priced above $15 to $20 per bottle.

It cannot be overemphasized how important these winery visit and tasting room experiences are to the growth of brand and the development of brand loyalty in today's wine market. Ample research has shown that word of mouth based on personal experience is the ultimate driver of wine selection for today's wine consumers. This development will also drive high end tourism to San Luis Obispo County.

The estimated 57,600 tons of grapes which could eventually be shifted into local AVA wine, as discussed on pages 18-19 below, would be equal to the production of about 3.6 million cases of wine. Developing new "brand evocative" wineries for about one third of this wine would enable the full economic potential of the AVA to be realized. The remaining grapes could be processed in crush facilities already existing in the county. Thus, only a limited expansion of the winery footprint in the county would be needed to substantially enhance the value of the county's wine and winegrape industry.

Concerns about grape quality apparently can be resolved by reasonable adjustments in viticultural practices in some vineyards.

The economic benefits of realizing this goal[3] would be considerable, including increased economic impact estimated at $1.43 billion, the creation of more than 5,600 new and primarily higher level professional jobs along with a payroll of nearly $188 million, as shown in Tables 8 and 9. These benefits can be achieved from the existing vineyard footprint and have the potential to ensure the long term stability of the County's agricultural base and enhance its environment and quality of life.

San Luis Obispo County in California's Central Coast

[3] This calculation assumes 80% of the grapes currently processed out of county and in AVAs other than those of Paso Robles or San Luis Obispo County remained in the county and became wine using one of these AVAs, as discussed on pages 17-19.

THE ECONOMIC IMPACT OF WINE AND GRAPES IN GREATER SAN LUIS OBISPO COUNTY

Wine, vineyards and related industries, products and services generate nearly $1.8 billion in economic value in San Luis Obispo County, including wages of more than $240 million and more than $86 million in state and local taxes.

In San Luis Obispo County, as in many wine producing regions, wineries are tourist magnets, attracting over 1.2 million visits by tourists spending more than $113 million and creating more than 1,800 jobs.

With more than 29,000[4] acres planted into wine grapes, San Luis Obispo County produced an estimated 148,000 tons of winegrapes with an estimated total value of $151 million in 2006.

The county's wineries produced wine with an estimated total retail value of $803 million, of which wineries' share of revenues exceeded $340 million, with the balance representing distributor, restaurant and retailer margins.

In a very conservative estimate, charitable contributions by the industry exceed $1 million, not including many of the individual winery cash and in-kind contributions or many of the events in which wine becomes a vehicle for raising funds for community organizations.

Wineries, vineyards and related industries pay $86 million in state and local taxes, including $10.5 million in property taxes on wineries and vineyards. Wineries and vineyards in the county have a total assessed value of more than $1 billion, reflecting the very high capital requirements of this industry.

Allied Industries

San Luis Obispo's wine industry is still in the early stage of development and has impressive potential for growth as the quality of its wines is recognized. Similarly, the support infrastructure for winemaking is still early stages of development. The majority of winemaking supplies and equipment for the county's wineries are still acquired in the North Coast wine region, although vineyard supplies are acquired in the County's well developed agricultural services sector. New local winery suppliers are, however, emerging rapidly, as are local service providers.

[4] County Department of Agriculture and California Agricultural Statistics Service (CASS) crush report estimates of acreage and production differ significantly. To be conservative, this report uses the lower CASS estimates.

Overall, service and supply providers to the industry currently generate more than $51 million in revenue, nearly $10 million in wages and 305 jobs in a variety of rapidly growing small businesses.

With nearly twenty wineries of varying size reportedly in planning stages, the region is likely to attract a growing number of suppliers of both goods and services as well as growing opportunities for skilled employment in winemaking, marketing, sales, public relations, finance and accounting and general management.

Employment

San Luis Obispo's wineries, vineyards and allied industries and services account for 8,114 jobs in the county, generating a payroll of more than $240 million per year.

Table 2
Total Employment Greater San Luis Obispo County, 2006
Wine, Winegrape and Related Industries

Winery	1,393
Vineyard	1,002
Distribution	15
Retail	24
Tourism	1,782
Suppliers	281
Service Providers	24
Education	8
Indirect	2,062
Induced	1,523
Total	**8,114**

Source: MKF Research, California EDD and California Tourism Board

San Luis Obispo County as a whole employed 108,559[5] people at the end of the second quarter of 2006, 87,999 of whom worked in the private sector. In the preceding five years, total jobs in the county increased by 6,277. Thus, employment driven by the wine and grape sector represents 7.5% of total county employment[6], 9.2% of private sector employment and a major share of the jobs created in the county in recent years.

Most importantly, wineries and vineyards are, by their nature, long term commitments to the community.

[5] According to the Quarterly Report of Employment and Wages of the Bureau of Labor Statistics of the U.S. Department of Labor

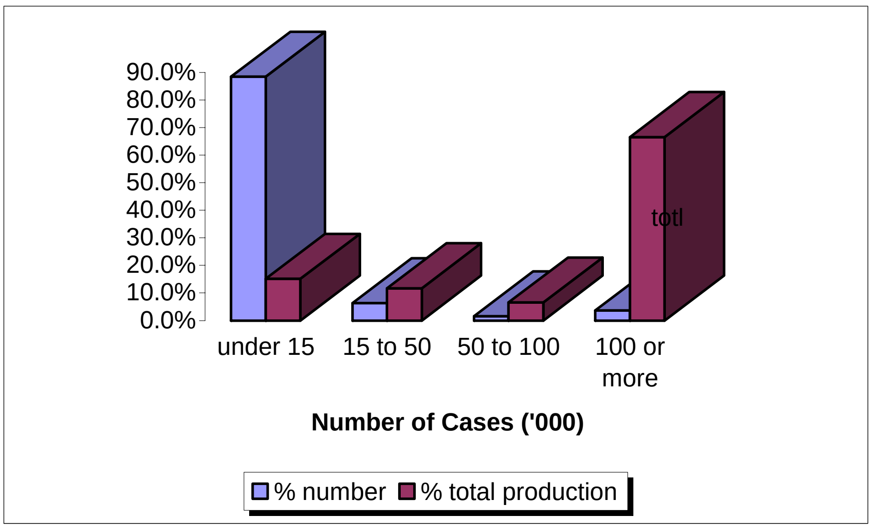
[6] For comparison, the available data indicates that the largest sector for employment in the county is Education and Health Services, which provide 16% of the county's reported jobs, followed by leisure and hospitality, which provide more than 14% of the county's jobs – a sizable share of which are of course driven by wine tourism.

Wine and winegrapes are inherently long-term investments and long-term employers: newly planted vineyards need four years to produce a harvest at a cost of at least $30,000 per acre. Another one to three years are needed to turn those grapes into wine, along with major capital commitments to develop winemaking facilities. Not only are these long-term investments, but they are inherently tied to "place." Unlike manufacturing or service enterprises, San Luis Obispo's vineyards and wineries, once planted, cannot simply relocate to another state which might offer a better business climate or tax incentives.

Wineries in San Luis Obispo County

Of the 217 bonded wineries reported in the county at the end of 2006, 90% of the *number* of wineries is in the Paso Robles AVA, as is 82.5% of wine production, with the balance in South County AVAs such as Edna Valley and Arroyo Grande.

Table 3
Size Distribution of Wineries in Greater San Luis Obispo County



Source: MKF Research

Across the county, 89% of the wineries each produce less than 15,000 cases of wine, representing slightly more than 15% of the county's total production. Conversely, 3.7% of the wineries by number produce more than 100,000 cases each, representing two thirds of the county's wine production.

In most of California, large wineries (defined as wineries producing more than one million cases) and large winery groups have been merging into even larger units. At the same time, the number of very small wineries – wineries producing less than 20,000 cases and even less than 5,000 cases – has multiplied.

However, San Luis Obispo is notable for the emergence of relatively new, fast growing wineries which have quickly passed the 100,000 case level by successfully targeting the consumer demand for quality mid-priced wines. Such entrepreneurial success in this dynamic wine segment offers significant opportunity for the county's wine industry.

The county is also home to several custom crush facilities, ranging from very large operations, created to service the volume producers who established Central Coast brands in the last decade, to smaller entities designed to support higher end boutique brands. With the consolidation of the large winery groups, these large scale custom crush operations are operating with significant excess capacity. New custom crush facilities are being planned for San Luis Obispo County. Moreover, some of the larger winery facilities designed for volume brands are also opening their facilities to custom crush services to utilize excess capacity.

Expanded use of custom crush facilities for new production or production expansion is a major trend across California. The rising costs and permit constraints of building new "brick and mortar' wineries make these facilities a cost effective alternative for many producers.

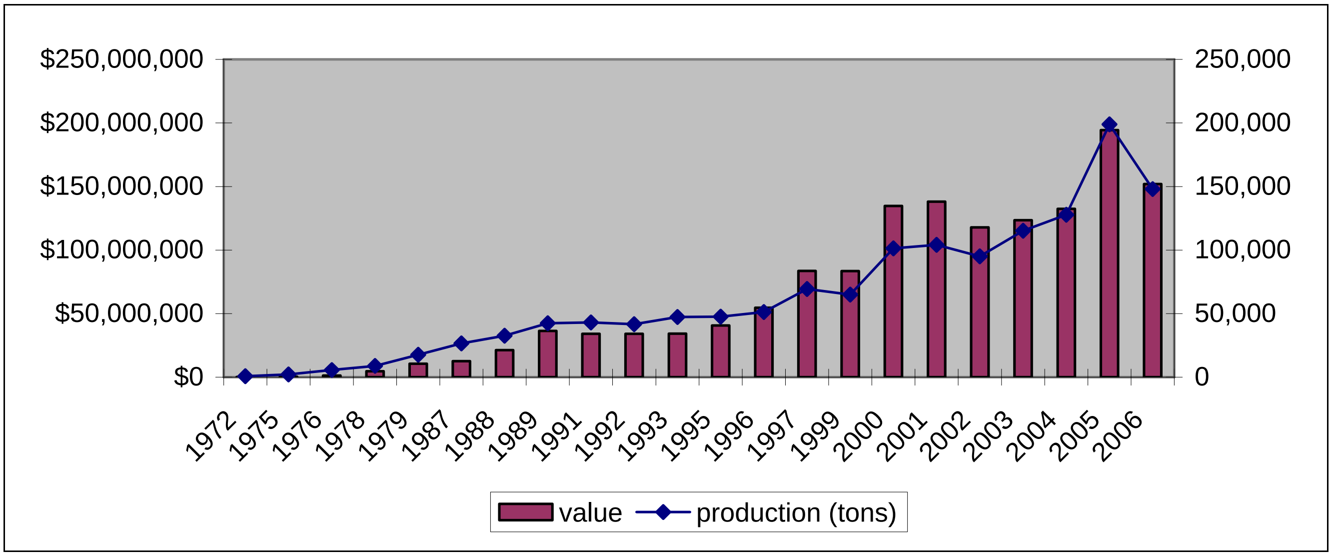
Grape Growing in San Luis Obispo County

Winegrape planting in the county had been negligible until the late 1970s, with growth accelerating first in the mid-1980s and then again, a decade later[7]. The county reports that winegrape bearing acreage rose from 540 acres in 1972 to 7,649 acres in 1989 to 11,897 in 1998 to 34,662 acres in 2006[8]. Winegrape production grew from barely 750 tons in 1972 to more than 148,000 tons in 2006.

As reported by the industry today, approximately 29,000 acres of winegrapes are planted in the county, of which 3,000 are planted in the cooler South County, producing primarily Pinot Noir and Chardonnay for local wineries. The remaining 26,000 acres of winegrapes are planted in the north county, in the Paso Robles AVA, with production focused on Cabernet Sauvignon, Merlot, Zinfandel and Rhône varietals.

[7] This chart reports, as the county did for many years, just harvest from bearing acreage: grapes require up to four years to produce a full crop. Thus, bearing acreage harvested in 1999 was initially planted in 1995.
[8] The industry reports a more conservative 29,000 bearing acres, which is the number used for this report.

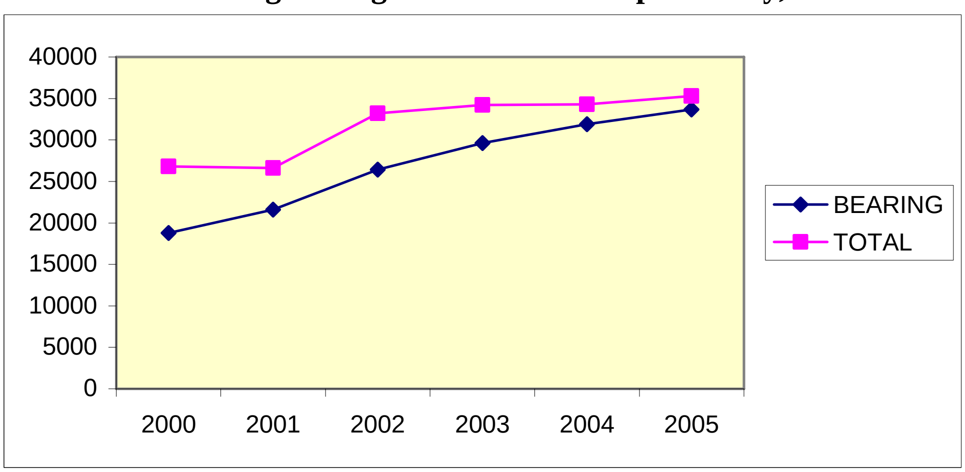
Table 4
Development of San Luis Obispo County's Winegrape Production



Source: San Luis Obispo County Department of Agriculture and Weights and Measures

Crop value surged in the late 1990s, inducing a vineyard expansion which began to bear fruit just as an overall surplus of winegrapes emerged in California in 2001 through 2004.

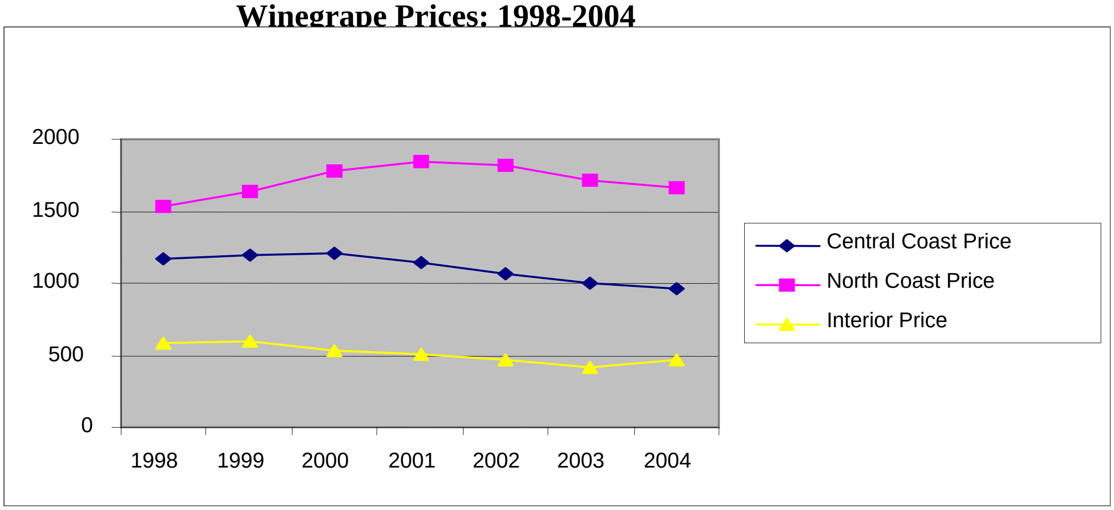
Table 5
Total and Bearing Acreage in San Luis Obispo County, 2000-2005



Source: MKF Research *Grape Trends*

The Central Coast winegrape region experienced severe winegrape price declines during this period. Declining prices discouraged additional planting in these years, although wine demand continued to grow. The industry therefore expected the California winegrape market to come into balance in 2005. However, an unprecedented surge in yields in 2005, producing a record grape crop, has delayed recovery in grape prices. Concern is now emerging that the extended slowdown in grape planting is leading to a shortfall in grape supply in the rapidly growing higher price/quality segments.

Table 6
Winegrape Prices: 1998-2004



Source: MKF Research *Grape Trends*

A cyclical imbalance in winegrape demand and supply is inherent in grape production, with its four year delay between planting and a full harvest, which makes it difficult for growers to gain a clear picture of market prospects.

As a result, the growth in the value of the winegrape crop in the county has not kept pace with the growth of planted acreage. Thus, despite an 84% increase in winegrape planted acreage since 2000 and a 46% growth in production, the value of the 2006 crop was only 13% greater than the value of the 2000 crop. While 2000 marked a peak in overall wine sales, which slowed significantly in the years immediately following, sales of California wine have now recovered – a recovery only somewhat shared by San Luis Obispo's winegrape growers.

THE ECONOMIC IMPACT OF WINE AND GRAPES IN THE PASO ROBLES AVA

The county's wine industry is largely concentrated in north county, in the Paso Robles AVA.

Approximately 2.6 million cases of wine are produced in the Paso Robles AVA, representing estimated winery revenue of $306 million, which includes winery direct sales. The total retail value of this wine is $657 million, including distributor, retailer and restaurant markups.

The Paso Robles AVA accounts for more than 90% of the number of wineries in the county, representing about 82.4% of the county's winery revenue and 82.5% of county wine production.

Table 7
Size Distribution of Paso Robles AVA Wineries

Number of Cases ('000)	% number in AVA	% AVA production	% SLO production
under 15	89.02%	15.25%	12.58%
15-25	3.47%	4.80%	3.96%
25-50	2.31%	6.60%	5.44%
50-100	1.73%	7.97%	6.57%
100 or more	3.47%	65.38%	53.94%
	100.00%	100.00%	82.50%

Source: MKF Research LLC and Paso Robles Wine Alliance

The Paso Robles AVA attracts about 87% of the wine related visitors to the county. The region is home to a large number of the county's winery suppliers. Agricultural suppliers are spread throughout the county. Education and research resources are concentrated in South County, with Cal Poly[9] and Cuesta College.

Nearly 90% of the county's reported 29,000 vineyard acres are within the Paso Robles AVA[10]. Prices for winegrapes in Paso Robles range from over $3,000/ton to as low as $200/ton, because of variations in soil, climate, geology, the availability of land suitable for large-scale, mechanized farming, yield management practices and contracting situations.

The total economic impact of wine and grapes in the Paso Robles AVA is estimated at $1.785 billion, employing 8,114 persons with a total payroll of $241 million.

[9] California Polytechnic State University, San Luis Obispo
[10] The larger county estimate of 34,662 planted acres (with the difference apparently falling in South County) would suggest that Paso Robles share of total acreage could be closer to 75%.

WINEGRAPE CULTIVATION IN THE PASO ROBLES AVA

In the north county Paso Robles AVA, about 26,000 acres are planted, 90% of which are planted in East Paso Robles.

Much of the new planting in Paso Robles was developed by independent growers to support large wine producers developing Central Coast AVA brands in the late 1990s. The slowdown in the wine market from 2000 to 2003 led some of these producers to reduce prices towards the lower end of the market (under $8 per 750ml bottle) or to cut production, weakening demand for grapes, already pressured by the state's winegrape surplus.

Wine demand revived strongly from 2004 – but shifted increasingly towards the higher end of the market, further weakening sales of these discounted and lower end wines. Today, the largest segment of the wine market is the $8-$15 segment, and particularly the $12-$15 segment, with rapid growth in demand for wines above $15. In the heavily surplus environment, wine producers often ceased to offer contracts to growers, forcing more production into the weak spot market.

Much of this large scale planting was also for varietals, particularly Cabernet Sauvignon and Syrah, which remain in surplus in the state, particularly at the lower price segments.

Despite the acceleration in winery construction over the last past decade, the production capacity of wineries within the AVA and of wineries, wherever located, producing wine with the Paso Robles AVA designation has still not caught up with the growth in grape production in the region, although significant progress has been made. Whereas several years ago, 85% of Paso Robles grapes were sold out of the county, today 58% of these grapes are sold outside of the county and 67% of the grapes produced in the Paso Robles AVA go into wines designated for the lower priced California and Central Coast AVAs. Another share of this wine is used as a lower cost, good quality, blending wine for more expensive North Coast wines.

The major part of the value added from producing wine grapes is derived from their processing into wine and the sales and marketing of that wine. Moreover, grape prices reflect in large part the price of the wine they produce.

Consequently, Paso Robles' independent grape growers' incomes have experienced little of the recovery seen in other segments of the wine industry. While grape prices of close to $1,000 per ton would be needed by most vineyards to be profitable, especially those vineyards planted in recent years, prices for some grapes in the area have fallen as low as $200 per ton and pricing of $500 per ton is not uncommon.

The circumstances have also deprived the county of a major part of the potential value added from grape production, that of the processing of wine grapes into wine and then marketing that wine to consumers, with all its ancillary benefits, from skilled professional employment to development of local suppliers to growth in the particularly attractive wine tourism demographic.

CHALLENGES AND OPPORTUNITIES

CAPTURING ADDED VALUE FROM PASO ROBLES' VINEYARDS

The county faces the dual challenge of improving the returns to winegrape growers in the county, particularly in Paso Robles, and capturing within the county more of the value added from winegrape production. These are, in fact, much the same issue with a common solution: to still more aggressively grow the production of Paso Robles and San Luis Obispo AVA wine with locally based brands and facilities.

What actions are needed to achieve this objective and what obstacles are presented? What would be the economic and other benefits generated if this objective were achieved?

Three issues need to be addressed to reach these objectives:

- Does a grape quality concern underlie the weak pricing of the grapes leaving the county?
- Does the county require a massive increase in the number of wineries to absorb these grapes?
- Are there sufficient brands with the Paso Robles AVA to absorb these grapes? If not, what is needed to generate these brands?

Grape Quality

Discussion with a broad cross section of winegrape growers, vineyard developers, grape and bulk wine brokers and winemakers showed a consensus that the vineyards developed in the recent vineyard expansion in Paso Robles vineyards were well planted. Therefore, desired improvements in grape quality, where needed, could be achieved through reasonable modifications in viticultural practices, particularly improved yield management.

Improved practices would aim to reduce yields on about 40% of the planted acreage (about 9,400 acres) in Paso Robles from about 7 tons per acre or more to closer to 5 tons per acre. The increase in farming costs from such adjustments is estimated at about $200 per acre per year, primarily in additional labor for handwork on these otherwise mechanized vineyards.

If 80% of the relevant acreage were to implement these practices, total winegrape production in the county would decline from its 2006 total of 149,000 tons to about 134,000 tons. However, the resulting grapes would achieve a higher price. A $300 per ton increase in the price of the grapes produced on this acreage would add $11 million to total grower revenue despite the reduction in yield per acre.

Wine Making Capacity

Pursuing this quality improvement strategy would reduce the estimated[11] total of grapes sold out of county from 90,000 tons to about 72,000 tons. These 72,000 tons, however, represent a potential 4.7 million cases of wine – almost 140% of the county's current wine production. Would the winemaking capacity required to produce this wine in San Luis Obispo County lead to a flood of winery construction, undermining the rural environment?

Wineries will certainly continue to be developed in the county, as in the rest of California and for that matter all 50 states. Most of this development in San Luis Obispo, as in other regions, will likely be for small, high-end wineries – wineries producing under 100,000 cases and usually less than 50,000 cases, of wine to be sold at prices well above $20 per 750 ml bottle. The economics of winery construction, and the demographics of the population pursuing the winery dream, largely dictate such behavior. Such development is more likely to enhance the county's quality of life rather than undermine it, by attracting higher end tourism, quality consumer services and retail and hospitality facilities, while creating demand for highly skilled winery professionals in such areas as sales, marketing, finance, winemaking and general management.

However, these small wineries will only absorb a small share of the grapes under consideration.

The principle wine market these grapes would feed would be the $12 to $20 per bottle price segment, the strongest segment of today's wine market. Competition in this segment requires production at a sizable scale with maximum flexibility, as indicated by the successful brands already in this segment in the county, such as J Lohr, Treanna, Edna Valley, Rabbit Ridge and EOS. Moreover, the leading trend in this wine segment is to contract for winemaking with independent custom crush facilities, to minimize asset investment and branding delays, with the brand owner concentrating on sales, marketing and general management of the brand.

The county has substantial winemaking capacity available for such production. Over the last decade, several large independent production facilities were developed, often to service the same volume producers the vineyards were developed to supply. With the consolidation among the large wine companies, several such producers have shifted their processing capacity out of the county, leaving available capacity at these independent production facilities. Moreover, some existing large producers have excess capacity and some new independent facilities are being planned. Finally, several of the county's existing large producers are growing rapidly in this market segment and would absorb much of this fruit into their facilities, especially if any remaining quality concerns were resolved.

[11] Obviously, the actual amount of grapes involved depends on annual harvest conditions.

To be conservative, we assume that no more than 80% of the grapes currently sold out of county, or approximately 57,600 tons of grapes[12], might be absorbed by local production, especially as some of these grapes are grown by wineries which will continue to require them for California or Central Coast brands or for blending. 57,600 tons of grapes represent about 3.6 million cases of additional wine to be processed in the county. MKF Research's analysis of available and planned winemaking facilities in San Luis Obispo County indicates that existing and planned large scale winemaking capacity in the county should be adequate to process this additional fruit, in parallel with the development of new small, high end "brand evocative' destination wineries, as discussed below and on pages 6-7.

Paso Robles AVA Brands

Developing new large mid-priced Paso Robles AVA *brands* to absorb these grapes is the key concern in this scenario.

Paso Robles already has several extremely strong and rapidly growing brands in this segment, as noted above. However, creating demand and brand recognition for an additional 3.6 million cases of wine is a substantial undertaking. Even with significant continuing growth of existing brands and the several new high end wineries in development, major new initiatives are required. Building such large wine brands in the crowded U.S. wine market is expensive, demanding major investments in sales and marketing, packaging, promotion, research among other activities, in addition to winemaking and the creation of additional destination winery facilities. Considering that there are well over 200,000 wine labels registered in the United States, this is a daunting challenge.

Paso Robles has clearly shown the ability to produce high quality wines at reasonable prices. The Paso Robles Wine Alliance has made major strides in building the reputation of the region's wines in recent years – but Paso Robles was still described recently as a 'hidden jewel' by a major distributor. To attract the needed investors, the region needs to further expand its promotional efforts, with strong support by the city and county and by the regions economic development organizations. The rewards to the region for these efforts would be substantial, as discussed below.

Potential Benefits from Making Wine in Paso Robles from Paso Robles Grapes

Producing an additional 3.6 million cases of wine in the Paso Robles AVA would increase San Luis Obispo County's share of California's wine production from 2.9% to 7.5%. In addition, as shown in Tables 8 and 9:

- Winegrape grower income would increase by at least $11 million;

[12] 72,000 tons would be the estimated county production after yield management techniques were applied to some of the acreage, as discussed above. 57,600 tons is 80% of these 72,000 tons.

- Winery revenue from wine sales would increase by $353 million;
- State and local tax revenues would increase by more than $60 million.

The additional economic impact of this development would total $1.43 billion

Capturing this added value for San Luis Obispo County would create more than 5,600 jobs, including an estimated increase of 1,100 winery jobs, three quarters of which would be skilled jobs in marketing, sales, management and finance.

Table 8

Potential Total Economic Impact of Wine and Grapes in the Paso Robles AVA and Greater San Luis Obispo County: Capturing Added Value of Vineyards

Revenue:	$ millions
Winery Sales	353.0
Retail revenues	336.0
Distributors Sales	90.0
Winegrapes Sales	12.0
Tourism	112.8
Tax Revenues - State & Local	61.5
Charitable Contributions	0.8
Suppliers	21.9
Services	4.8
Education and Research	0.4
Indirect (IMPLAN)	151.9
Induced (IMPLAN)	98.2
Total Revenue	**1,243.3**
Wages	
Winery Employees	58.0
Vineyard Employees	1.4
Tourism	38.0
Suppliers	5.4
Services	1.1
Education	0.3
Indirect (IMPLAN)	50.8
Induced (IMPLAN)	33.0
Total Wages	187.9
Total	**1,431.2**
Source: MKF Research and IMPLAN	

Table 9
Total Employment Potential: Wine, Winegrape and Related Industries
Capturing Added Value of Paso Robles Vineyards

Winery	1,100
Vineyard	50
Tourism	1,782
Suppliers	176
Service Providers	7
Education and Research	3
Indirect	1,397
Induced	1,116
Total	**5,631**

Source: MKF Research and IMPLAN

Currently, most wineries in the county acquire their wine related supplies from out of the county, although several rapidly growing small businesses have emerged recently to service the sector. A doubling of wine production should accelerate this trend. In our model, we assume (modest) expansion in supplies of winery services of various types and in supply of tanks, equipment, bottling, trucking, warehousing and packaging, among other industries. Thus, more than 180 jobs would be created from the growth of suppliers and service providers to the industry.

OTHER CHALLENGES

Tourism Impact

The relatively small percentage of San Luis Obispo County's leisure visitors who visit wineries remains a puzzle. In most regions of the country, tourists who patronize wineries tend to visit two or three wineries per trip. On this basis, MKF Research estimates that today about 12% of the county's tourists visit wineries. If such tourists are assumed to visit only one winery per visit, this percentage only rises to about 21% of total visitors. To put these numbers in perspective, Sonoma County assumed that 27% of its visitors visit county wineries and has recently substantially increased this estimate. San Francisco estimates that more than 23% of the visitors to that city also visit Northern California wine country. Napa County, where of course wine dominates the county economy, reports that 77% of visitors visit wineries.

Moreover, research indicates that the demographic of wine related tourists is comparable to that of wine consumers: well educated, high income (typically over $100,000 per year), likely to patronize quality restaurants and lodgings and to buy high end products. The Napa Tourism study[13] also indicated an unusually high rate of return visits by these visitors. Thus, wine tourists are a particularly attractive tourist demographic.

[13] www.destinationstrategy.com The Napa County Destination Strategy Project

If the continuing growth of promotion efforts for Paso Robles wine, along with new investments in wineries and wine brands, can attract twice the number of wine-related visitors as are received today – and the necessary hospitality (hotels, bed and breakfasts, restaurants, shops) facilities are developed to welcome these visitors − nearly 2,000 additional jobs could be created.

Scarce Skilled Labor for the Wine Industry

The wine industry across the U.S. faces a growing shortage of well-trained talent to support its burgeoning growth, with the industry still largely dependent on a small number of degree granting institutions. Potential immigration constraints further complicate the situation. New degree programs are being developed in several states, although faculty are difficult to locate.

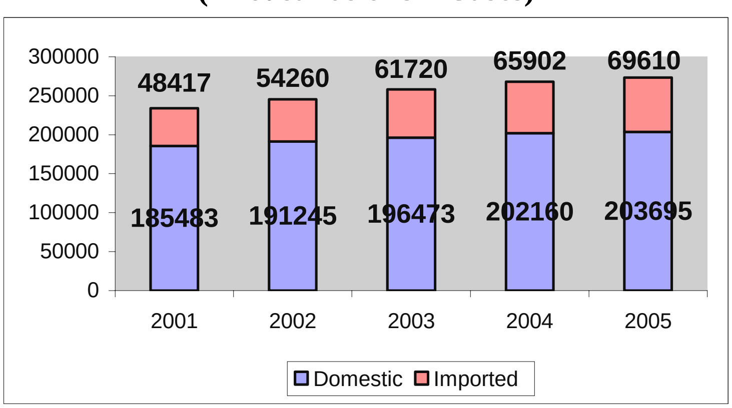
Winemakers and growers in the county are already reporting a scarcity of skilled labor in viticulture and enology, from skilled farm workers for the handwork envisioned to professionals in winemaking and vineyard management and in viticulture and enology research.

Cal Poly's respected programs in viticulture, enology and agribusiness will be an important asset to the region's efforts.

THE OPPORTUNITY: THE DEMAND FOR WINE

An underlying question in this analysis is whether overall consumer demand for wine is likely to be adequate to absorb this increased production, assuming successful brand development. Fortunately, the U.S. wine market has been growing strongly – and increased wine production proposed for Paso Robles would represent a little more than 1% of total current U.S. consumption of wine, shifted from the slow growth lower price segment to the strong mid-price wine segment.

Table 10
U.S. Wine Consumption 2001-2005
(Thousands of 9L Cases)



Source: MKF Research and Adams Wine Handbook, 2005

The U.S. wine market has grown by 13.7% since 2002 in volume and by more than 15% in dollars. With 25% of U.S. households having incomes over $75,000, wine is that most sought-after consumer good of this era: an affordable luxury.

Growing demand for wine is driven by multiple factors:

- One of wine's key attractions is that it tends to be consumed in moderation, as part of a meal, as socializing at home or in restaurants with food has been a key consumer trend this decade.
- 25% of U.S. households now have incomes in excess of $75,000 and increasingly seek premium products of good value. Wine is seen by this large group of consumers as an "affordable luxury," a modest expenditure for a quality experience.
- The post-9/11 consumer is looking for special "experiences," rather than just collecting "things." Wine is associated with food, sharing experiences in small groups and personal connection, closely corresponding to the priorities of today's consumer.
- Wine's connection to the land has a special relevance for today's environmentally sensitive consumer.
- Demographic changes have also favored wine consumption:
  - While Baby Boomers have long led wine consumption's growth, their interest in wine is echoed in the tastes of the adult cohort of the millennial generation – the children of the boomers who are the largest generation in American history. This group has increasingly switched from beer to spirits and wine, as reflected in Gallup's 2004 finding.
  - Women make the majority of wine purchases. The preference of the millennial woman for wine over beer has also led to increased wine consumption among the 21-30 male cohort, as they consume wine increasingly in social situations.

Not only are American consumers buying more wine, but they are also buying more expensive wine, as they seek higher quality products. The largest segment of the wine market today is wine priced between $8 and $15 per 750ml bottle, with the fastest growing segment being wines priced over $15 and especially wines over $30 per bottle.

Thus, the potential expansion of Paso Robles and Greater San Luis Obispo wine production would be targeting the 'sweet spot' of the U.S. wine industry

METHODOLOGY

DATA COLLECTION

Data for this study was collected from a variety of public sources supplemented by primary research with wineries, suppliers, growers and other economic entities and supported by a variety of studies undertaken by industry and professional organizations. Where judgments were required about the selection of data, the most conservative data was included.

DIRECT, INDIRECT AND INDUCED EFFECTS (IMPLAN)

All economic activities have "ripple" effects: employment of one person creates economic activity for others, whether the salesman who sells the employee a car or the restaurant where she eats lunch. Economic impact studies endeavor to measure those "ripples" as well as the direct activity, to help assess the impact of the potential gain or loss of an industry.

Economic impact studies estimate the impact of an industry in a defined geographic region by identifying and measuring specific concrete and economic events, such as the number of jobs, the wages, taxes and output generated by each job.

IMPLAN[14] is the acronym for "**IM**pact analysis for **PLAN**ing." IMPLAN is a economic model that uses input-output analyses and tables for over 500 industries to estimate the regional and industry-specific economic impacts of a specific industry. The IMPLAN model and methodology classifies these effects into three categories, Direct Effects, Indirect Effects and Induced Effects.

Direct Effects are economic changes in industries *directly* associated with the product's final demand. Thus, direct effects consider the direct employment and spending of wineries, vineyards, distributors and immediately allied industries.

Indirect effects are economic changes – income created through job creation in industries that supply goods and services to the directly affected industries noted above. For example, the purchases of electricity and gasoline by wineries and of cash registers purchased for a tasting room are considered indirect effects. Induced effects are the effects of these new workers spending their new incomes, creating a still further flow of income in their communities and a flow of new jobs and services. Examples are spending in grocery and retail stores, medical offices, insurance companies, and other non-wine and grape related industries.

[14] IMPLAN (www.implan.com) is the standard economic model for economic impact studies, developed by the University of Minnesota and the U.S. Forestry Service in the 1980s and currently used by over 1,500 organizations, including most federal, state and local organizations.

ABOUT MKF RESEARCH

MKF Research is the leading research source on the U.S. wine industry. We continue to strive to raise the bar on the quality of information and analysis available to the wine industry.

MKF Research provides business advisory services to the wine industry, conducts original research on the business of wine and wine market trends and publishes a number of industry studies. MKF Research also conducts a number of industry seminars on its research work including the annual invitation-only MKF Research Executive Wine Summit and various open workshops on key industry issues. Further information on MKF Research projects, studies, events and publications is available on our website, www.mkfresearch.com.

MKF RESEARCH CUSTOM PROJECTS

MKF Research's primary business is providing confidential custom consulting to wine industry enterprises, investors and suppliers. Recent, MKF Research consulting projects have included:

- Feasibility and market studies for new wine industry related businesses, products and investments;
- Strategic and market analyses and market, brand and financial benchmarking;
- Economic impact studies for a variety of wine and vineyard related businesses and public and private organizations in the industry.

MKF Research is also the leader in Winery Direct Sales research and the benchmarking of winery direct activities and has expanded its consumer and trade research capabilities to among the best in the industry.

MKF RESEARCH PUBLICATIONS

MKF Grape Trends (annual)

By combining the crush and acreage reports into one easy-to-use quick reference guide in electronic form, MKF Research's ***Grape Trends*** allows readers to examine the interaction of supply, price, varietal and region for California's wine grape industry. It includes a complete summary of current, past (since 1991) and projected tons, prices, and bearing acres for all major grape growing regions and counties for seven major varietals: *Chardonnay, Sauvignon Blanc, Cabernet Sauvignon, Merlot, Syrah, Zinfandel,* and *Pinot Noir*.

Economic Impact Reports

Economic Impact Studies published by MKF Research LLC include the following, all available for purchase from MKF Research LLC:

- ***Impact of Wine, Grapes and Grape Products on the American Economy, 2007,*** sponsored by Wine America, the Wine Institute, Winegrape Growers of America and the National Grape and Wine Initiative,
- ***Economic Impact of California Wine - Update 2006***
- ***Economic Impact of Wine and Winegrapes in Texas, 2006***
- ***Economic Impact of Wine and Winegrapes in Michigan 2005***
- ***Economic Impact of Wine and Winegrapes in North Carolina 2005***
- ***Economic Impact of Wine and Winegrapes in Illinois 2005***
- ***Economic Impact of Pennsylvania Wine and Winegrapes 2005***
- ***Economic Impact of Michigan Grapes, Grape Juice and Wine 2005***
- ***Economic Impact of New York Grapes, Grape Juice and Wine 2005***
- ***Economic Impact of Wine and Vineyards in Sonoma County 2005***
- ***Economic Impact of Wine and Vineyards in Napa County 2005***
- ***Economic Impact of California Wine 2004***
- ***Economic Impact of the Washington State Wine and Winegrape Industries***

Studies for Virginia, Tennessee and Missouri will be available shortly.

MKF RESEARCH OWNERSHIP

MKF Research LLC is a division of Frank, Rimerman + Co. LLP, CPAs.

Frank, Rimerman + Co., LLP, founded in 1949, is the largest, locally-owned provider of accounting and consulting services in northern California. With offices in San Jose, Palo Alto, San Francisco and St. Helena and over 180 professionals, Frank, Rimerman + Co., offers strategic business and information consulting services, tax consulting and planning, audit and financial reporting, accounting services, litigation and valuation services.

Frank, Rimerman + Co. is affiliated with Baker Tilly International, an international network of high quality, independent accountancy and business services firms, all of whom are committed to providing the best possible service to their clients, in their own marketplaces, and across the world, wherever the client needs help.

Frank, Rimerman + Co. continues to build its wine industry practice, based in St Helena (formerly the CPA practice of Motto, Kryla and Fisher), committing the full resources of this major professional services firm to the industry.

PASO ROBLES WINE COUNTRY ALLIANCE

The Paso Robles Wine Country Alliance – www.pasowine.com – is responsible for marketing and promotional programs designed to strengthen awareness locally, regionally and nationally and attract wine enthusiasts to Paso Robles Wine Country. Focusing on both grower and vintner interests, the Wine Country Alliance generates educational and research programs to ensure quality wine grape growing and wine production, and monitors legislative activities to support Alliance members. Membership categories include Winery, Wine Grape Grower and Associate (patron, business, corporate and major corporate). The organization produces an Annual Membership Directory, The Wine Country News, The Cluster Times-Herald (a quarterly newsletter for the Wine Country Alliance's new ambassador program), Buy Paso (an online tool to buy and sell wine grapes and bulk juice), the Quality Alliance educational series, and three annual consumer events to showcase the region. In 2005, the Wine Country Alliance initiated a national market tour to promote Paso Robles Wine Country. These National Grand Tastings target trade and media in top tier U.S. markets -- Atlanta, Austin, Boston, Chicago, Dallas, Denver, Ft. Lauderdale, Los Angeles, New York, San Francisco, Seattle, Tampa and Washington, D.C. -- with an average of 35 participating wineries who showcased quality wines of the region.

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ECONOMIC VITALITY CORPORATION

Established in 1994, the Economic Vitality Corporation is the primary provider of economic development services and business resources in San Luis Obispo County and each of its seven cities. As a non-profit corporation, the EVC's mission is to stimulate the economy of San Luis Obispo County, help generate jobs, increase investment in the community, and promote the start-up, growth and attraction of businesses. The organization assists in analyzing local business trends and implementing economic strategies. Covering a wide geographic region on the beautiful California central coast, the EVC assists local companies and entrepreneurs with a range of resources including business loan programs, workshops and seminars, site selection services, international trade consultation, Angel Investor & Venture Capital Network, business connections, and a publication about the local business community called the *Central Coast Business Watch*. Visit www.sloevc.org.

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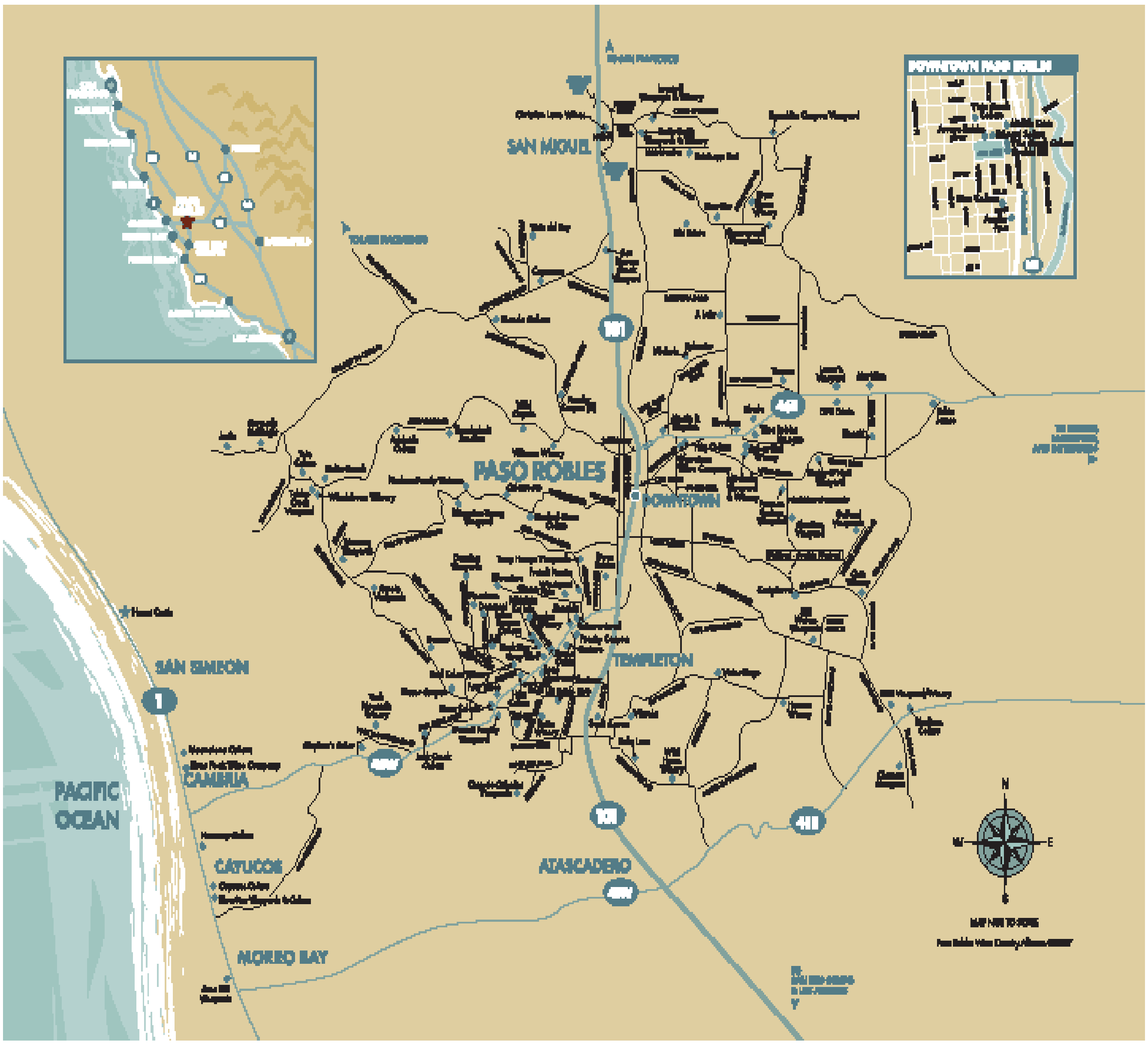
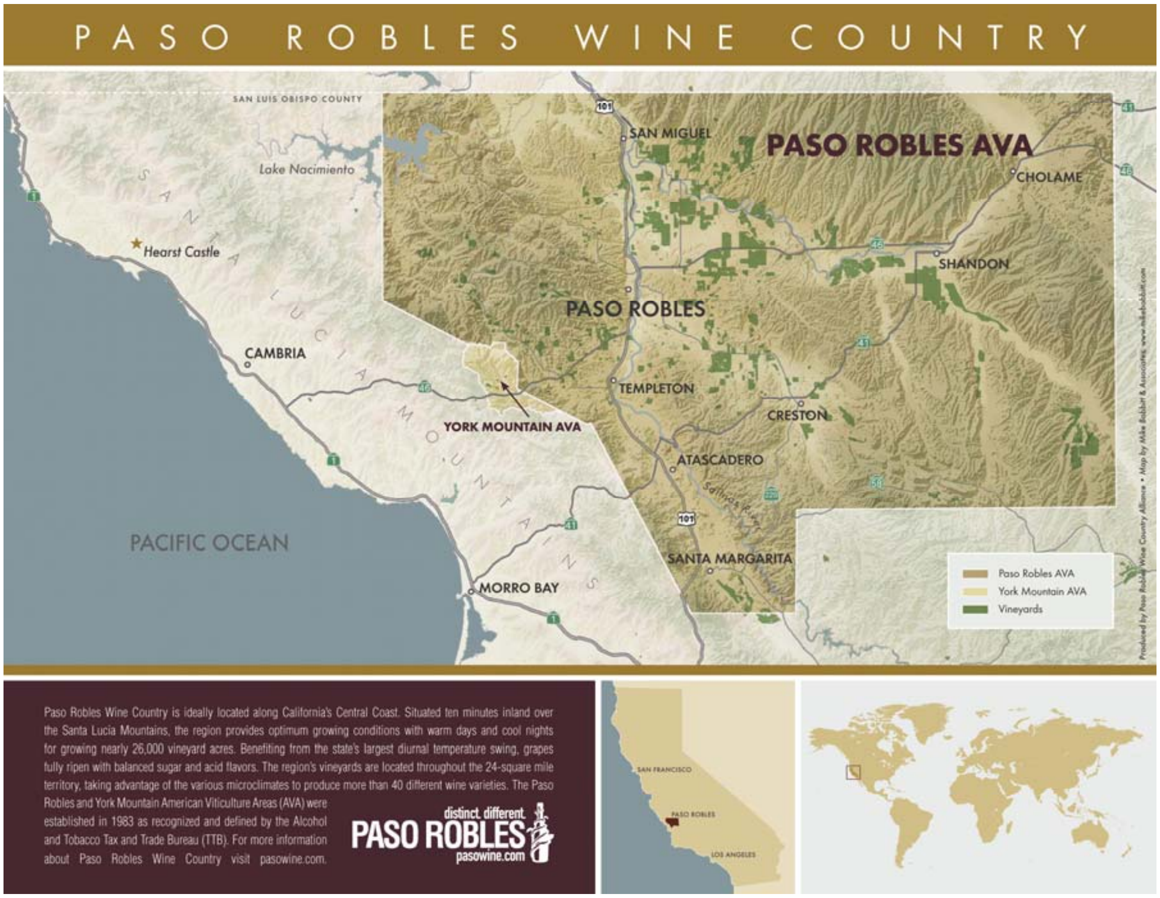
Winery Map of San Luis Obispo – South County

PASO ROBLES WINE COUNTRY ALLIANCE MEMBERS




PASO ROBLES WINE COUNTRY
SAN LUIS OBISPO COUNTY
Lake Nacimiento
SAN MIGUEL
PASO ROBLES AVA
CHOLAME
SHANDON
Hearst Castle
PASO ROBLES
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TEMPLETON
CRESTON
YORK MOUNTAIN AVA
ATASCADERO
PACIFIC OCEAN
SANTA MARGARITA
MORRO BAY
Paso Robles AVA
York Mountain AVA
Vineyards
Paso Robles Wine Country is ideally located along California's Central Coast. Situated ten minutes inland over the Santa Lucia Mountains, the region provides optimum growing conditions with warm days and cool nights for growing nearly 26,000 vineyard acres. Benefiting from the state's largest diurnal temperature swing, grapes fully ripen with balanced sugar and acid flavors. The region's vineyards are located throughout the 24-square mile territory, taking advantage of the various microclimates to produce more than 40 different wine varieties. The Paso Robles and York Mountain American Viticulture Areas (AVA) were established in 1983 as recognized and defined by the Alcohol and Tobacco Tax and Trade Bureau (TTB). For more information about Paso Robles Wine Country visit pasowine.com.
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