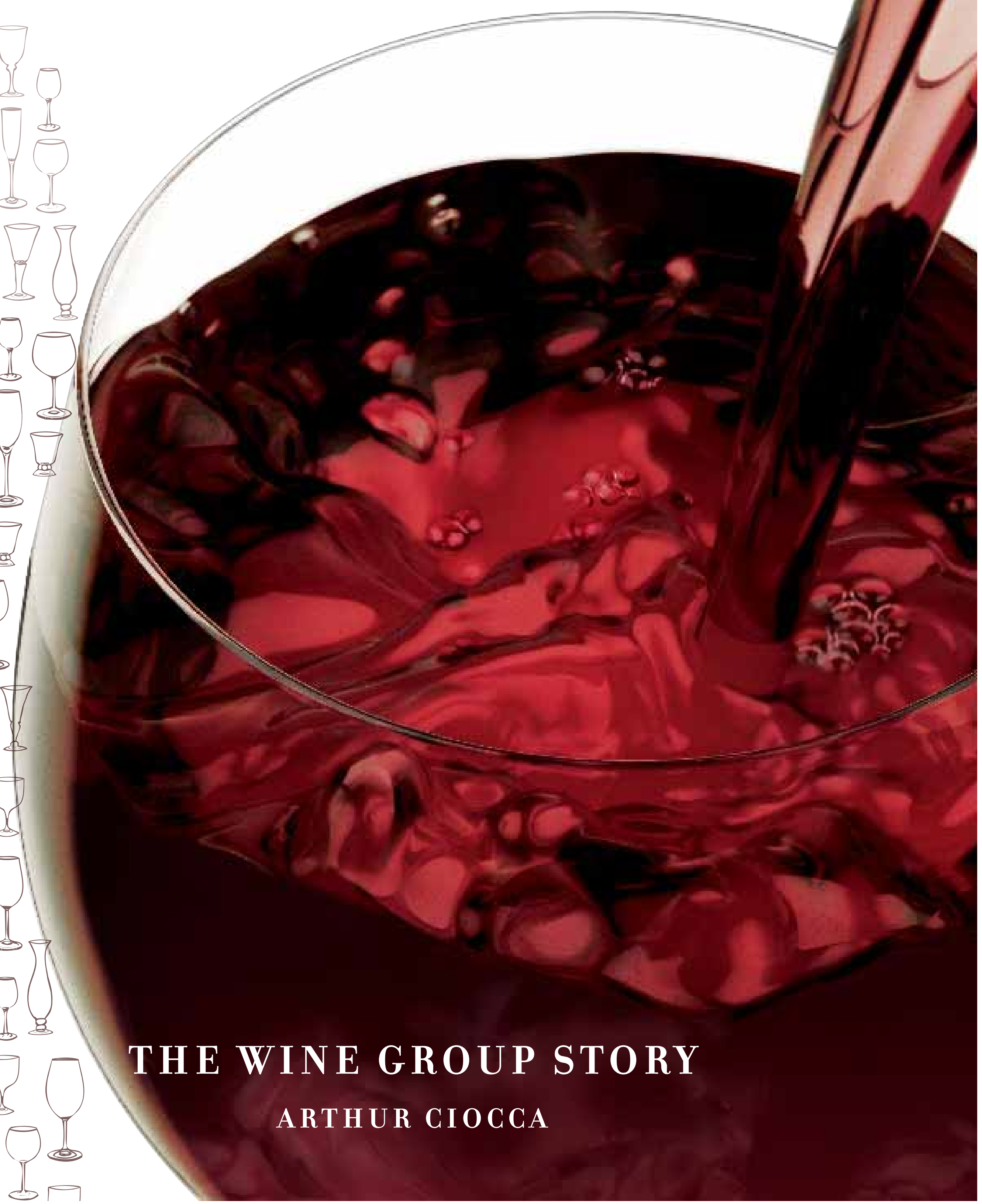
THINKING OUTSIDE THE BOX



THE WINE GROUP STORY

ARTHUR CIOCCA

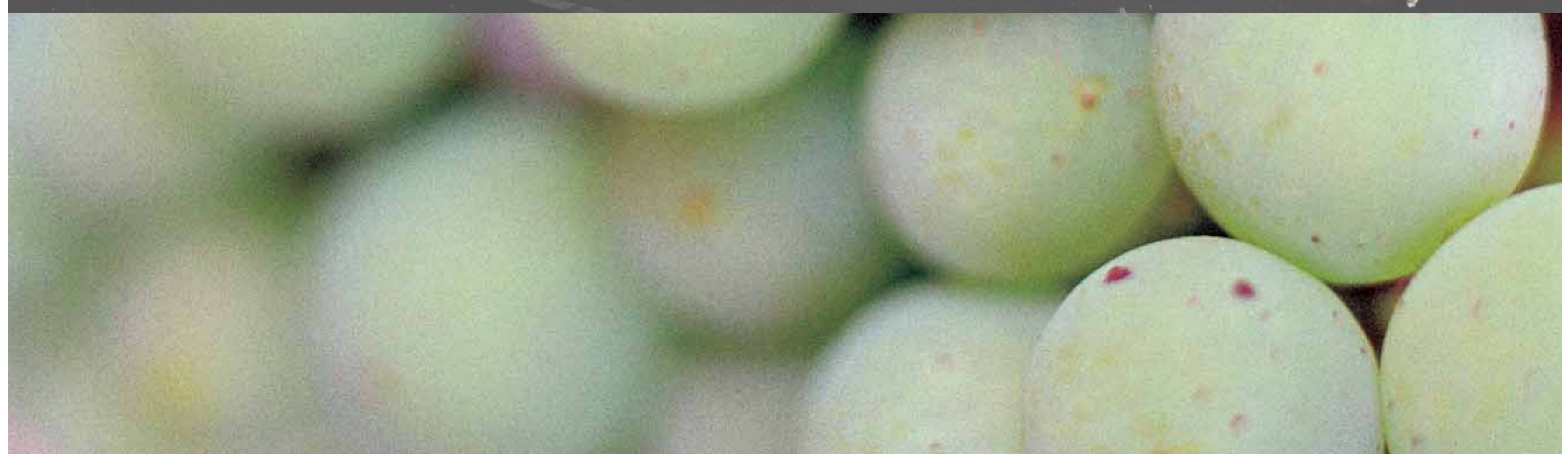
THINKING OUTSIDE THE BOX
THE WINE GROUP STORY

ARTHUR CIOCCA

Editorial and Design: Casey Fisher

DEDICATION

This book is dedicated to all the people who made our story possible as well as to those who will continue the company's tradition for generations to come. This book is the first chapter of what I hope will be many more chapters in The Wine Group's long and successful future.



PROLOGUE

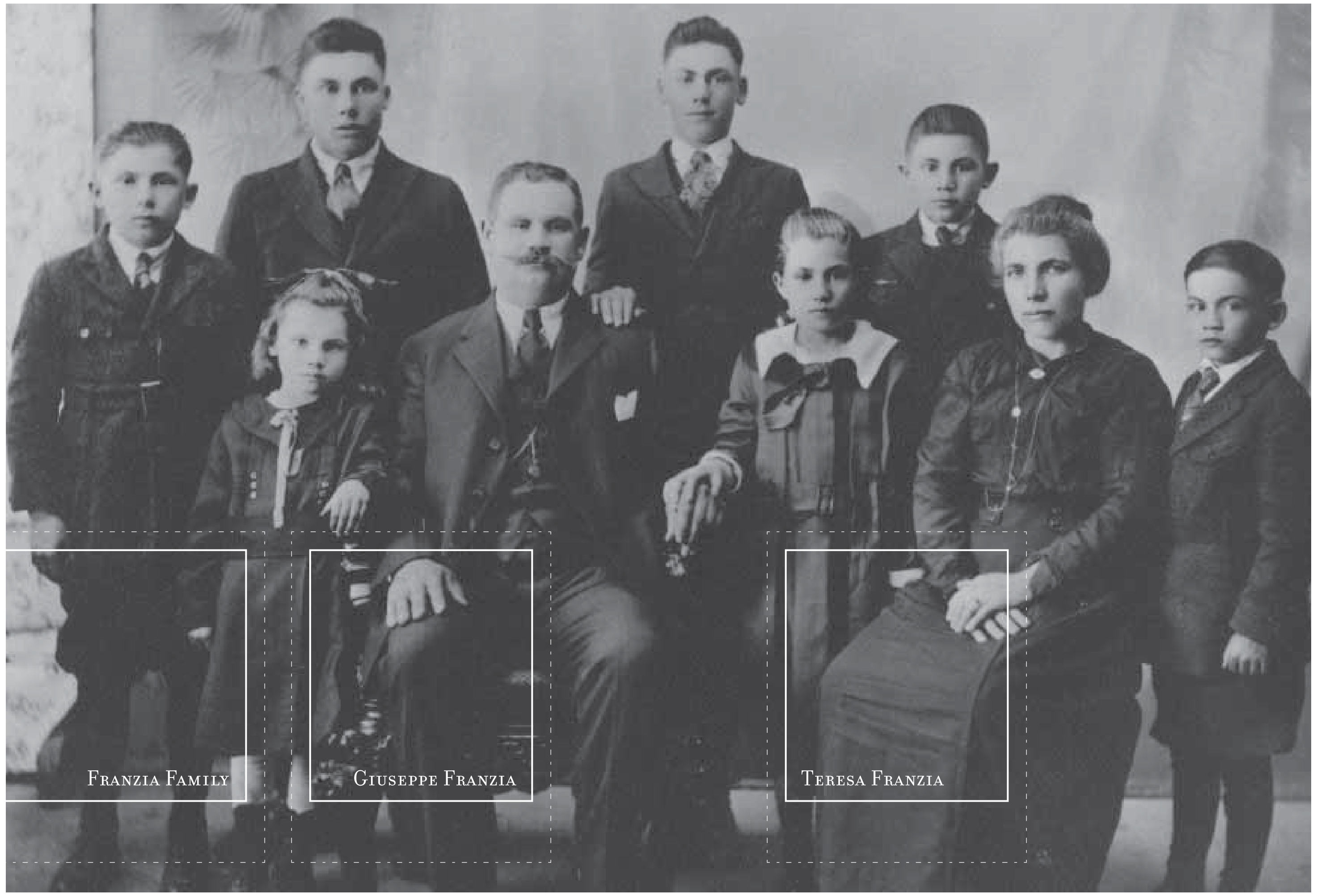
The worldwide wine industry spans many centuries. Italian wine merchants established family-owned wineries such as Ricasoli in 1141, Antinori in 1200 and Frescobaldi in 1206. Those companies have endured floods and droughts, wars and political strife. Despite internal and external challenges, they have been able to grow and change with the times.

The Wine Group, Inc.'s story over the past 26 years is one brief part of what I hope will be a long and rewarding future. The Franzia brand began over 100 years ago in the San Joaquin farmlands with Teresa and Giuseppe Franzia planting grapes and making wine.

At the turn of the century, an Italian immigrant named Giuseppe Franzia sent word to Italy that he needed a wife. It was a few years after the Gold Rush and Giuseppe, who had made a stake working as a truck farmer, wanted to settle down as a grape farmer in the Central Valley.

The girl who was supposed to set sail for San Francisco backed out at the last minute and sent her friend, Teresa Carrera, in her place. Teresa stood all of 4 feet, 10 inches tall. She arrived in California and stepped off the ship ready to marry Giuseppe on the spot. Giuseppe bribed the local priest to marry them that day instead of waiting the required three weeks to post the bonds of matrimony. So they married and set off via horse and buggy for Giuseppe's farm.

Giuseppe had an eye for agriculturally rich land. Over the years, he managed to save enough money to buy 80 acres of incredibly fertile property in Ripon, California. Teresa and Giuseppe grew grapes there. She cooked three meals a day, bartered with neighbors, usually chickens in exchange for what she needed, and raised her five sons and two daughters.



Franzia Family

Giuseppe Franzia

Teresa Franzia

Over the years, the family home in Ripon had become a favorite gathering place for many of the area's prominent Italian businessmen and early wine industry pioneers. They were drawn there by Teresa's fabulous pasta dishes, fresh home-grown vegetables and delicious homemade wines. (During Prohibition, limited amounts of wine could be made for home consumption.) Among them were Ernest and Julio Gallo, Charlie Rossi, Abe Buchman and the head of the Bank of Italy (which soon became Bank of America) A.P. Giannini.

In 1933, while Giuseppe was away in Italy, Prohibition was coming to an end. Teresa saw an opportunity to lessen the dependence of their family on the risks of shipping and selling their perishable grape crop each fall in Eastern and Midwestern markets. She knew that if she could build a winery to make and bottle wine, the family would have all year to sell it and bring in more money. With her vision for a family wine business clearly in mind, Teresa knew just where to go. She traveled by horse and buggy directly to A.P. Giannini's office in San Francisco and asked for a $10,000 loan, pledging the family farm as collateral.

With $10,000 in hand, she gave $5,000 to her five sons to start the Franzia Winery, and the other $5,000 she loaned to her son-in-law, Ernest Gallo. His venture became Ernest & Julio Gallo Winery.

When Giuseppe returned from Italy and learned what his wife had done, he threw a fit. He believed it was too risky and much too perilous for his family to sustain. He was a simple farmer whose goals started and ended with growing grapes. Little did he know that Teresa's entrepreneurial venture would have such a monumental impact.

This petite mail order bride from Italy started two of America's largest wine companies, all while her husband was away in Italy. What began as Franzia Vineyards at the turn of the century turned into a thriving company that has grown and evolved as a result of the hard work of everyone invested in its future.

I feel lucky to have been a part of The Wine Group, along with my incredible associate who, now, span three generations. Together we built something that has the potential to endure with the same tenacity as have the Ricasoli, Antinori and Frescobaldi wineries for the last eight centuries.

CHAPTER I

INTRODUCTION

As I drove to the Ripon Winery in the San Joaquin Valley for one of my last visits, I couldn't help reflecting on the very first drive I made there 36 years before. I was visiting the E&J Gallo Winery for an interview that would change the course of my life.

There was no way I could have known that this first job in the wine business would lead me into a company that would have a profound impact on contemporary wine history. Little did I know that I would be a part of turning a small division of the Coca Cola Bottling Company of New York into the third and sometimes second largest wine company in the U.S., or that we would develop the largest wine brand in the world, Franzia.

In 1969, the population sign on the outskirts of Modesto read 38,000. The path was a rough two lane road traveled by few cars. The drive was quiet and pastoral with farmland on both sides. In order to cross the narrow, single-lane trestle bridge that spanned the Stanislaus River outside of Modesto, eastbound cars were forced to stop until the westbound ones cleared the bridge. It was "the country" and its potential was still largely untapped. Three decades later, the one-lane road has been developed into a four-lane freeway filled with heavy traffic for 70 miles in each direction. Sparse land has been built up with massive shopping centers and hulking super stores. Times have changed.

The industry back then was just as different as the drive. It was called "a cottage industry still in its infancy." It was immature and highly formative, just waiting to be shaped by good ideas. Wineries and distributors were mostly owned and operated by families. It was a personable business where friends, family and relationships mattered. There were a lot of small retailers. Remarkably enough, dessert wine outsold table wines because table wines were little known outside of European communities. Wine was a new frontier in the U.S. with intense challenges and huge opportunities.

The industry is very different today. It's well developed and much more professional than personal. Markets are analyzed primarily from behind a desk by reading computer summaries of cash register receipts instead of visiting stores and talking to retailers. Technology and reports have replaced relationships and surveys. Because the business is more developed, it is harder to influence. It was a lot easier to try to leave a mark on the seminal industry of yesterday than the established one of today, but this is still one of the best industries in the world. It has all the challenges of business but it also has the ultimate wild card, Mother Nature. The wine industry is capital, distribution and image-intensive, but the most exciting and humbling aspect is the cyclical, agricultural element of having to live by Nature's whims.

I'm proud and thankful for what we've accomplished. I feel blessed that we had the opportunity to build a company and contribute to the development of this extraordinary industry. I feel lucky to have been in the right place at the right time with exactly the skill set that was needed. I was a young marketing guy in a production-driven industry that was trying to become market-driven. This was the perfect opportunity for a young entrepreneur who was looking for a place to make a mark.

In hindsight, it is still difficult to imagine that I would team up with five partners and build a company which we would eventually own, and play a role in shaping an industry. I am grateful to my extraordinary original partners, Lynn McShane, VP of Sales, Lou Quaccia, VP of Winery Operations, Morris Ball, VP of Vineyards and Grower Relations, Steve Hughes, who held every imaginable position in the early stages, and to Lynn Bates, CFO and later, VP of Operations.

Lynn Bates kept us out of a lot of trouble. I was the arsonist who started all the fires. He was the fireman who knew exactly which ones to extinguish and which ones to continue to let burn. We had a wonderful, complementary relationship. Nothing would have worked without him. Today, Lynn and I have the same relationship, but as partners on the golf course. I hit the ball into trouble and he bails me out.

Together, as a team, the six of us accomplished far more than we ever imagined, and we had an extraordinary growth experience in the process.

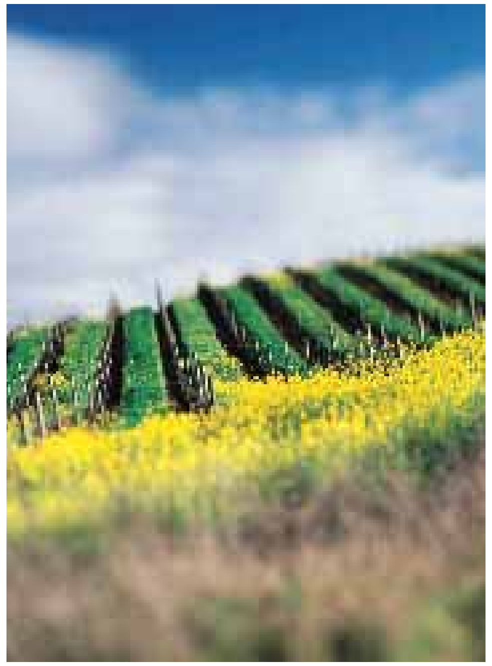
Over the 26-year period from 1974 to 2001, the company that eventually became The Wine Group, Inc., grew from a failing commodity business into an industry leader with strong brands and a significant share-of-market. Of the top 25 companies in the California Wine Industry in 1974, only five remain today. The others failed or were acquired. Industry leaders who knew the company and were familiar with the acutely hostile market conditions at the time believe The Wine Group, Inc. has prevailed against extraordinary odds.

The challenges came fast and without warning. Each was a learning experience that helped shape our thinking. Sometimes we got lucky and learned what worked the first time around. More often than not we learned what didn't work and had to try again. It wasn't long before we had a good sense of our strengths and weaknesses and were able to begin charting strategies and plans.

Our beliefs and behavior grew as an integral part of these strategies and plans. They evolved into a company culture which shaped and guided the behavior of the organization over the years.

THE WINE GROUP'S 10 CORE CULTURAL VALUES

1. OFFERING THE BEST CONSUMER VALUE
2. PUTTING PERFORMANCE FIRST AND ELIMINATING POLITICS
3. ENCOURAGING EVERYONE TO TAKE A PROPRIETARY INTEREST IN THEIR WORK
4. KEEPING IT SIMPLE – CONTINUALLY REDUCING COMPLEX PROBLEMS TO SIMPLE SOLUTIONS
5. MAINTAINING FLEXIBILITY TO DEAL WITH AGRICULTURAL EVENTS AND TO CAPITALIZE ON CHANGING MARKETPLACE OPPORTUNITIES
6. EXERCISING ENTREPRENEURIAL RISK-TAKING
7. THINKING OUTSIDE THE BOX TO INNOVATE AND TO SOLVE PROBLEMS
8. OPERATING WITH THE HIGHEST INTEGRITY BECAUSE GOOD ETHICS ARE GOOD BUSINESS
9. BEING PROUD BUT NEVER ARROGANT
10. BEING GOOD STEWARDS OF THE GIFTS GIVEN



Our management team never set out deliberately to develop a style of operating or a set of cultural values. These evolved as we wrestled with difficult issues and learned to work together as a team. They took shape like a piece of wet clay in the center of a conference room table being pushed, pounded and pulled from each direction until agreement was reached on a final shape which was then baked into place. The final shape was never the result of a compromise that diluted the effectiveness of the final outcome.

We learned about one another's strengths, weaknesses and values as we climbed the steep part of the learning curve together in those early years. We found that the best plans and solutions to problems came as a result of dialogue and debate. And as long as we argued openly with no personal prerogatives, pride of authorship or hidden agendas, we could usually coax a winning solution onto the table. We didn't always see eye to eye, but we were always respectful of one another. In the final analysis, our focus was always overall company performance.

There was nothing earth-shattering, flashy or revolutionary about what we did. We weren't interested in winning awards or seeing our names in lights. The only popularity contest we wanted to win was with consumers who voted for or against our products with their pocketbooks. When they voted for us more than they voted for our competitors, our share of market grew and our organization took great satisfaction in that victory.

These values also enabled us to keep our organization lean and optimize performance at the same time. Our people had broader responsibilities and more authority than their counterparts in other companies and were held accountable for adding value. We didn't have the time or inclination for much administration, reporting or other formalities.

As a result, our culture enabled us to get the best performance from our people. We had very solid, driven, competent, hard-working people, and we all had flaws and shortcomings which we came to understand through years of facing challenges together. We had failures, but we didn't dwell on them enough to have a negative impact. We learned and moved on.

We had a fundamental strategy that was different from other winemakers in the world. We believed we could create increasing value for our consumers by keeping our organization lean, stable and cost-efficient. We believed this gave us sharper and more efficient decision-making abilities which allowed us to be more responsive to the grape and retail marketplaces.

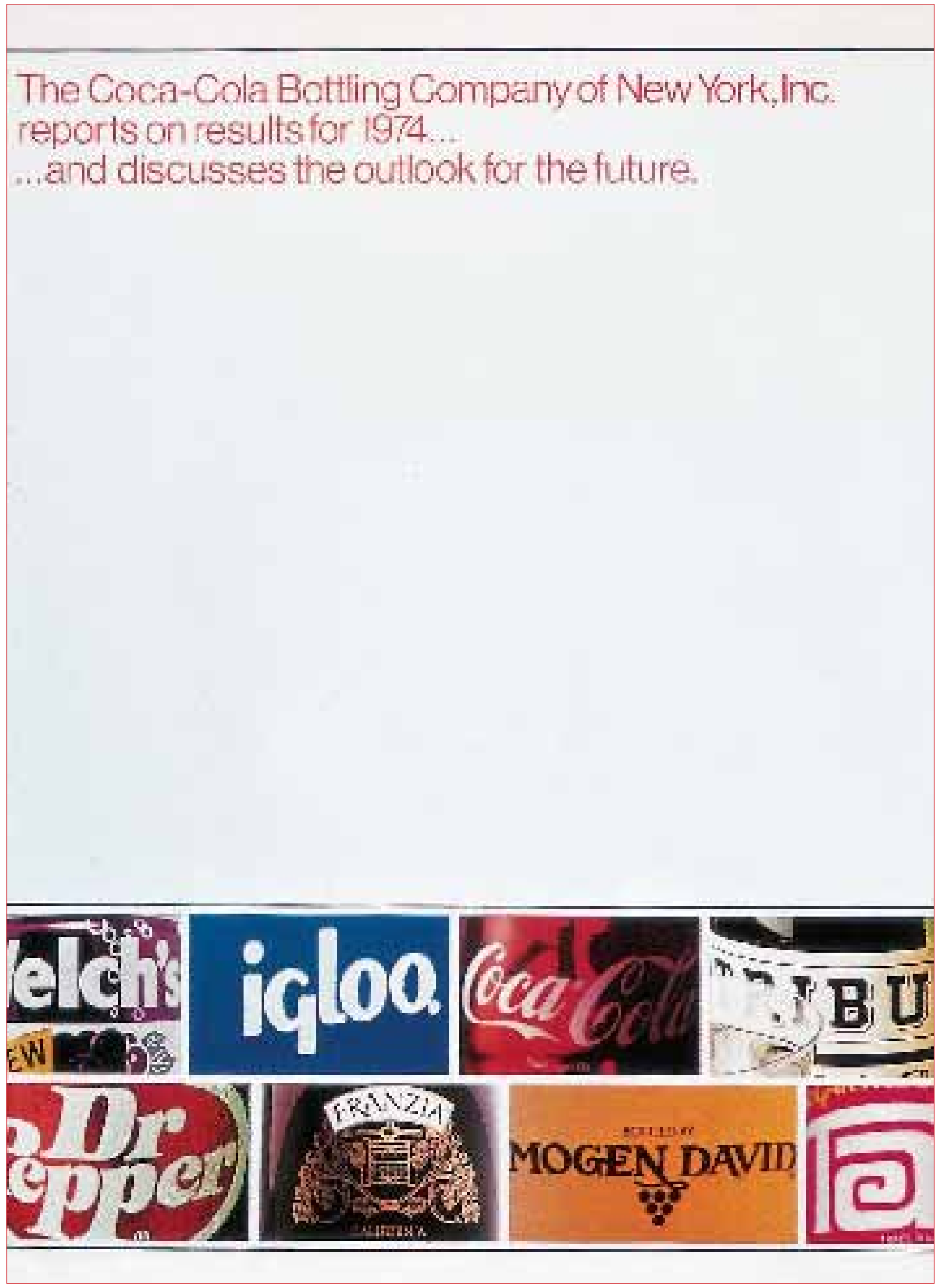
Fortunately for us, there weren't any best-selling books on management to lead us astray. Today, well-regarded CEOs like Jack Welch boast that G.E. used performance reviews to eliminate the bottom 10% of its employees every year. Before it went bankrupt, Enron did the same thing. In Enron's case, it was done by a peer review process which was the perfect way to enhance its already arrogant, greedy and corrupt culture. The painful results are self-evident.

Our approach was totally different. We screened out employees who didn't fit with our culture early on. But once they "made the cut," chances were they would be with us for a long time. They became Wine Group family and we saw this as a competitive advantage.

This story is about the decisions, strategies, people and values that made that possible. In essence it's about values, values that drove those decisions, strategies and people. Some of these cultural values developed in the early years as we battled for survival. Others evolved later as we struggled to carve out an identity for the company and unique niches for our brands. And still others evolved as we faced the decisions about management succession, stewardship and stock valuation so as to leave the company in a stronger position than when we began. Ultimately, this story is about building a company we hope is positioned to endure for centuries to come.

CHAPTER II

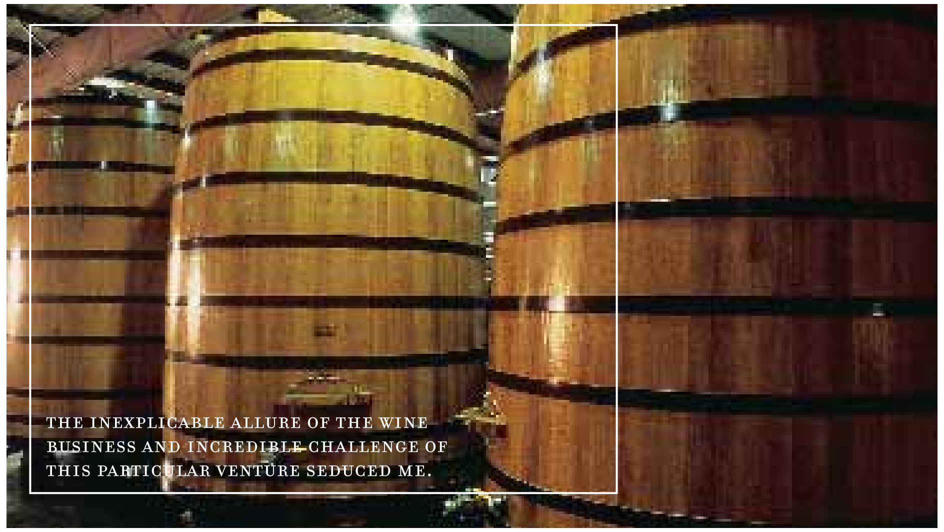
THE TURNAROUND



A GLAMOUR INDUSTRY

By 1970, the stature of wine was growing in the United States. Consumers and business people were intrigued by the industry. The Bank of America had just written a glowing industry report which had been broadly circulated. Sales had been increasing at a double-digit pace with no end in sight. Behind the numbers, low-alcohol, flavored wines were pacing this growth and introducing new, younger consumers to wine. Banks and insurance companies were falling all over themselves to give out loans. Money was cheap and credit policies were lax and irresponsible. Real interest rates were negative and inflation was higher than interest rates which meant vineyard and winery assets would likely appreciate. Competition was benign. The dollar was weak so there were few imports. Most of the California wine companies had a production mentality. They were only focused on making wine, not marketing it. Seven of the top 10 major wineries were cooperatives owned by grape growers whose vision extended only to the price they were paid for their grapes. The wine industry looked like an attractive place to be.

One of the first companies to identify this opportunity was the Coca Cola Bottling Company of New York (or Coke-NY). Coke-NY saw itself as a consumer beverage marketing company with a broad portfolio ranging from soft drinks to adult beverages. In the early 1970s, it purchased the Mogen David Wine Company and in 1973, it acquired Tribuno Vermouth and Franzia Wines.



FROM SOFT DRINKS TO HARD KNOCKS

Shortly after the Franzia, Tribuno and Mogen David acquisitions, Bill Sullivan, Executive Vice President of Coke-NY, invited me to dinner. He wanted to meet me because I had experience in the business as a result of my time at Gallo as a Group Product Manager. He also knew that I had great insight into Franzia because it was one of Gallo's competitors. I told him from the outset that I loved my job as General Manager of the Grocery Products division of Oroweat in San Francisco and wasn't interested in going back into the wine industry. Nevertheless, I agreed to meet with him because he was an incredibly personable guy and I liked him a lot.

I told him exactly what I thought over dinner. Not all of it was positive; in fact, most of it was brutally honest. He listened carefully and by the end simply said, "Thank you very much for your time." I left and expected never to hear from him again. I later learned that he went back and told Coke-NY's other executives about my analysis. That's when they decided to meet with me first-hand.

When the meeting got underway, I tried to help them understand what they were up against in the wine business. Coke-NY was a successful beverage company, but its executives recognized the company's blind spots when it came to wine and spirits. It had headed into uncharted territory without a compass and needed an industry insider to get it on track.

I told them that the long-term prospects for the company were excellent, but the short-term would be a challenge because it did not have brand strength or pricing power. Combined with the impending oversupply of grapes, that meant depressed prices and margins. I suggested distribution channels be strengthened and operations streamlined.

I didn't hold back and the more I told them, the more they wanted to know. I was getting even more deeply involved and the more I tried to extricate myself, the more they wanted me. The last thing I wanted to do was disrupt my well-balanced life in San Francisco and go into competition with the man I admired and feared most, Ernest Gallo.

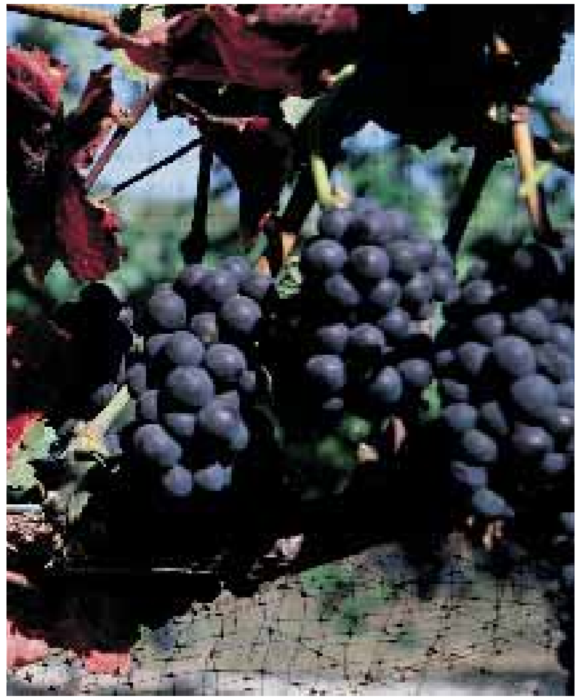
Yet somehow the inexplicable allure of the wine business and the incredible challenge of this particular venture seduced me. Before I knew it, I was Vice President of Marketing for Franzia Wines, slated to be CEO.

MORE THAN I BARGAINED FOR

I thought I had the perfect background and experience for this job. After completing my MBA degree, I held positions of increasing sales and marketing responsibility at General Foods, Spice Islands and Gallo, where I managed brands much bigger than Franzia and actually competed directly against it. I had leadership experience in the Navy where I was responsible for commanding over 1,000 men. I'd also learned a great deal as a result of a failed entrepreneurial venture which left me jobless and penniless at age 32. The culmination of these experiences led me to believe I had a firm grasp of what I was getting into. The situation I described to Coke-NY was accurate, but as I soon realized, it was only the tip of the iceberg.

Conditions in the industry and at Franzia had deteriorated since my exposure at Gallo a few years earlier. Although my experience suited me well to run an established wine company, there was nothing in my background to prepare me for the huge turnaround challenge I faced. It was so dire that several industry veterans told me years later they thought our management team would undoubtedly fail because the company was unsalvageable.

A good barometer of the severity of the situation was the telephone. I would sit in my office and nine out of every 10 phone calls were bad news. Not just bad news, but extremely bad news. One call would say, "We just lost distribution in Safeway." That meant a huge loss that would cost us a lot of money we couldn't afford to lose. Another would announce, "Our best sales manager just resigned." Or, "Our biggest customer can't pay us any more." Things just kept getting worse. We were losing business across the country which exacerbated our already excessive wine and grape supply and further idled our huge underused production facility, driving costs upward.



A MORTGAGED FUTURE

Coke-NY had acquired Franzia for top dollar at the top of the cycle, practically guaranteeing lower future returns. In 1972 and 1973, Franzia had record sales and profit levels because the company was able to capitalize on the 1972 crop failure. Unfortunately, that temporary success came at a very high price. When the crop shortage developed in 1972, Franzia's grape buyer, striking at night before any meaningful long-term plan could be developed, recklessly committed the company to nearly 1,000,000 tons of grapes over a 20-year period at disadvantageous pricing.

When the grape supply corrected in 1974, grape prices plummeted, leaving Franzia's grape cost higher than its competitors'. Franzia had no choice but to adhere to its contractual obligations and refrain from purchasing better quality grapes at lower prices. As competitors regained their footing in the marketplace, Franzia's selling prices were forced down by competitive pressures and profit margins evaporated.

It's unclear what motivated Franzia to enter into those long-term and onerous grape contracts. The only thing we know for certain is the contracts locked Franzia into being uncompetitive. Coke-NY, like most other public companies outside the wine industry, failed to appreciate the volatility of a cyclical agricultural business. It didn't grasp the liability of long-term contractual grape obligations entered into at the top of the market during a short crop and high prices. It didn't understand the relationship between grape prices, market prices and profitability at various stages of the cycle.

Coke-NY probably assumed the past growth and profit trend would continue uninterrupted. This temporary profit aberration influenced Coke-NY's decision to increase its sales organization and invest over $20 million in capital expenditures to expand the winery. This stretched the balance sheet and set the stage for the dominos to come crashing down.

MOTHER NATURE'S REVENGE

Prior Franzia ownership had leveraged the supply shortage to the absolute maximum and now it was time for the absolute maximum correction. Coke-NY and my management team were about to bear the full brunt of the multiple mistakes and excesses of the past: the over-expansion of facilities, entering into onerous long term grape supply contracts, ill-timed S.G.&A. additions and blatant market miscalculations. These mistakes were compounded by the deteriorating market conditions at the time. It was going to be a blood bath.

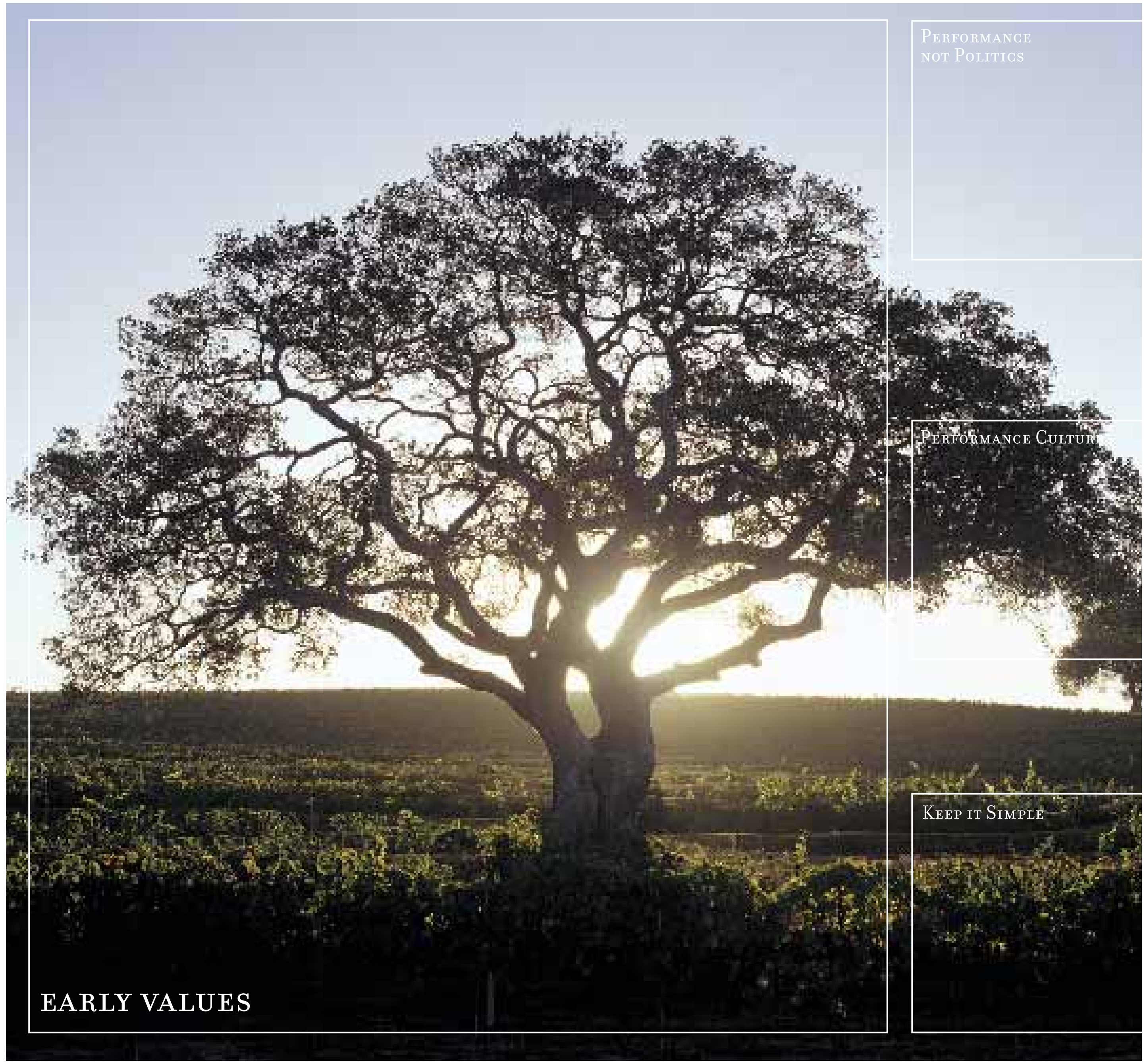
We recognized that throughout history, short crops have usually been followed by long crops because during a shortage the vines conserve energy and are stronger going into the next season. The shorter the crop, the bigger the next one usually is. In the wine business it's like Mother Nature's revenge against man's indulgence – indulgence in taking advantage of a short crop and raising prices. As a result, the pendulum of supply corrects in proportion to the excess. Franzia's decisions had been indulgent and my team was challenged with picking up the pieces.

BUILDING THE ORGANIZATION: EARLY VALUES

Before we could even deal with the grape supply issue, my first challenge as CEO was to assess the organization and its people. In many respects, the job was easy because the Franzia environment was rudderless. As a result of the new public ownership under Coke-NY, people were stunned by the dramatic changes to a stable, old line, family business and by the dramatic shifts taking place in the market.

What worked in our favor was that most people were craving direction and leadership. Only a few were looking for a place to hide. Most of them genuinely wanted to help and eagerly accepted new challenges. Others, although well-meaning, simply didn't fit in. They were either victims of the old family system where someone else did the thinking for them, or they were historians and photographers of the glorious past unable to relate to the art of the possible. They were the ones who had to leave so we could move forward.

I tried not to make personnel judgments too early, but some were unavoidable. Decisions had to be made early to set the right tone, whether they were perfect or not. We were in survival mode, rapidly approaching a crisis. I was reminded of the line in "The Godfather" where Michael looked at Hagen and said, "I love you like a brother but I need a wartime *consigliere*" I needed a wartime *consigliere* too, but I didn't have one. There was no one else to execute the tough decisions I had to make or to buffer me from their consequences.



The best personnel decisions are not ones made about people. They are decisions about performance. The first and most important thing I ever did at Franzia was to institute a Performance Culture. We made it clear from the outset that the measure of a person's worth in this new company was performance, performance and nothing but performance. We set high standards and evaluated people regularly. People who performed well were rewarded. Those who didn't moved on, usually by their own choices. The most difficult and inefficient individuals to deal with were the politicians, the people who put their own agendas and self-interests ahead of the company goals. They were time-consuming and difficult to deal with because, like politicians, they talked a good line, lobbied effectively to accomplish broad support and would go to convoluted extremes to promote their schemes. I had no use for those people. I had met more than my share at General Foods where I'd witnessed marketing program after marketing program compromised by risk-adverse individuals who took the uncreative, safe route to protect their self-interests.

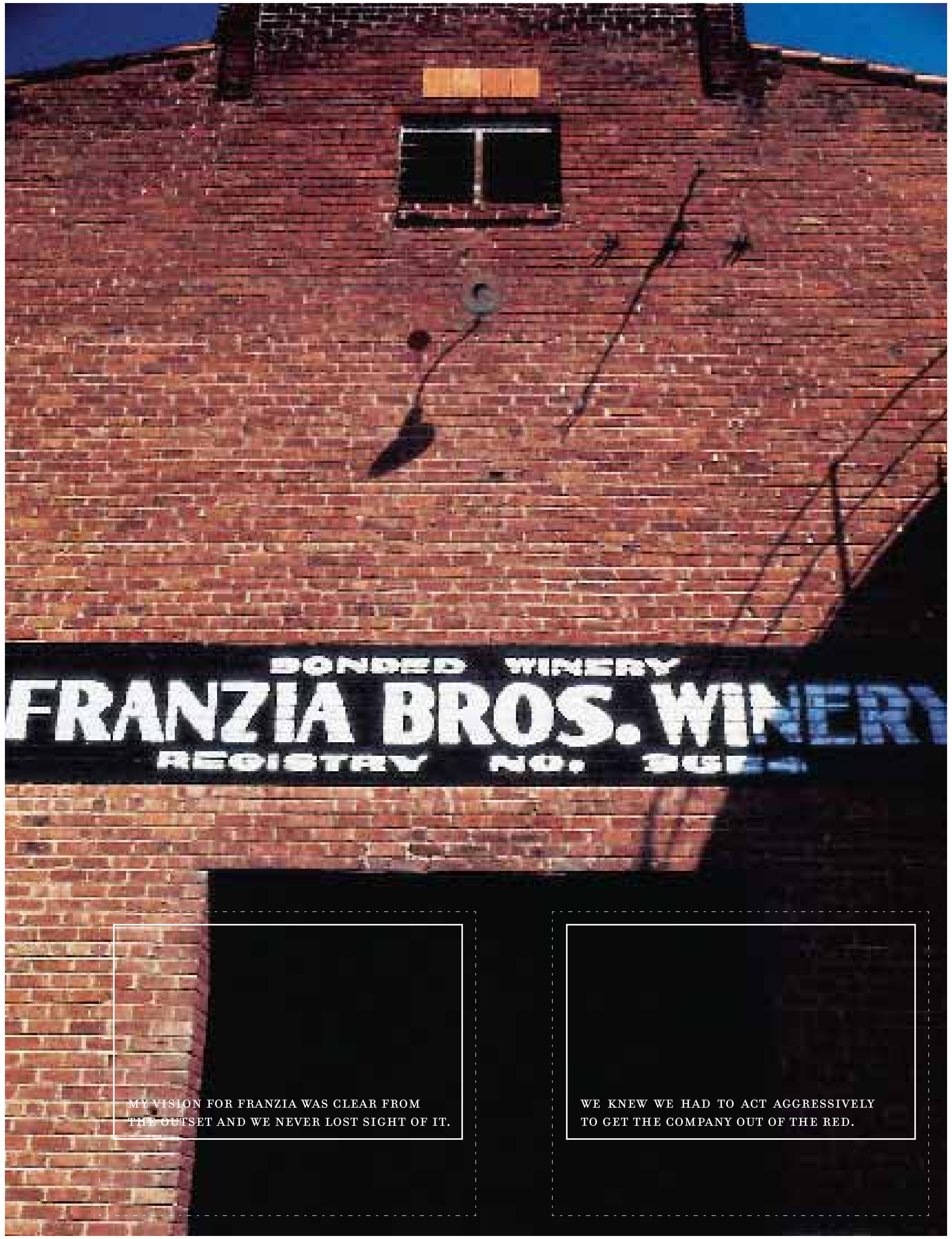
I made it clear from the outset that Franzia would be an apolitical company. The way we articulated this cultural value was through "Performance not Politics." I explained that performance and politics were as juxtaposed as the opposite ends of a seesaw. Performance could only be up if politics were down. Everyone got it and within months everyone knew which end was up.

This was a pivotal value early on even when the organization was small. It is even more critical now as the company increases in size, and through acquisitions, is forced to integrate people from politicized cultures who are trying to make their marks.

There was a lot to learn and a lot to do. The mission seemed overwhelming. I found that people were getting lost in the details. Sometimes the solution to a problem was worse than the problem itself. I found myself getting bogged down with long complex memos from subordinates. When I accepted these undeveloped ideas, they became my problem. Since I couldn't afford to get lost in the details, I would simply scribble across the top of long, rambling letters: "If you can't express this idea in a paragraph or two, it probably isn't thought-through enough to consider."

It wasn't long before I was being brought more solutions than problems. Our second cultural value was born: "Keep it Simple." By keeping it simple, I was able to avoid continually being in a reactionary mode and was able to spend more time actively building the organization, focusing on strategic issues and charting the course for the organization.

Clearing away politics and unnecessary complexity enabled us to identify real issues and make crisp, straight-forward decisions particularly in response to rapidly changing market conditions. It was liberating for the organization to be moving forward. We continued this momentum by keeping it simple and encouraging performance not politics, values the organization still embraces today.



EYE ON THE BALL: A LONG-TERM VISION ALWAYS IN FOCUS

My vision for Franzia was clear from the outset and we never lost sight of it. I was a marketing guy. I was hired because I was a marketing guy. My goal for the company was to eventually become a marketing company by building strong brands capable of sustaining high margins in good times and bad.

Bill Sullivan, Coke-NY's Executive VP and I were on the same page. He used to say not so facetiously, "Anyone can make the stuff. The trick is selling it at a profit." We envisioned gradually converting 100% of the winery's capacity from commodity goods to branded case goods.

Marketing and brand-building were relatively new concepts to this very young California industry. Wine was not held in high regard by the consuming public. Cheap dessert wine outsold table wines in the early 1970s. The few table wines that were available were generic and sold at low prices to immigrant communities. The industry was splintered into over 500 small wineries, while grower cooperatives accounted for more than half the business. The markets were underdeveloped and there were no mass-marketed, national brands. As a result, per capita consumption was less than one gallon compared to nearly three times that amount today. Wine had not entered the mainstream.

By the '70s, only one company, Gallo, was making marketing inroads and beginning to develop markets and brands. They had an enormous lead because they had built a solid foundation over the years with a strong organization, state-of-the-art facilities, a reliable grape supply and a strong sales and distribution network. Ernest Gallo was a visionary, leader, ferocious competitor and problem-solving genius. He had a natural understanding of markets and marketing.

By contrast, Franzia, which looked like a progressive company because of its new ownership and public persona, was actually light years behind. Before we could even think about building a branded company, we needed an efficient facility, a sound distribution network and a strong organization. We also needed to get our financial house in order. Under ideal industry conditions, this would have been a monumental task. But industry conditions had never been more hostile than they were at this time.

Our immediate concern was getting control of the grape supply and the commodity aspects of the business. Grape supply was a challenging issue for the entire industry and it was even more of a challenge for Franzia because of our onerous grape contracts. We knew we had to act aggressively to get the company out of the red.

CHAPTER III

LAYING THE FOUNDATION

FRANZIA BRAND REPOSITIONING — A GOOD IDEA BEFORE ITS TIME

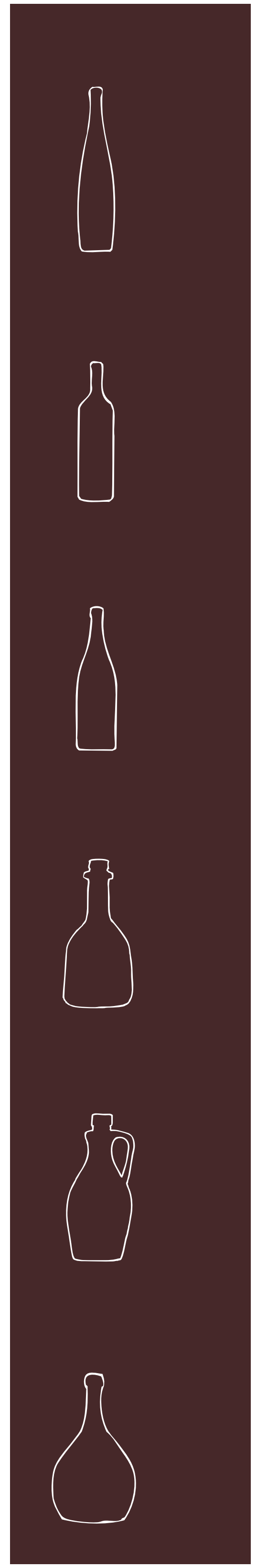
Frequently in business, one is forced to deal with acute issues at less than ideal times. Such was the case when it came to the subject of marketing and brand building in the ’70s at Franzia.

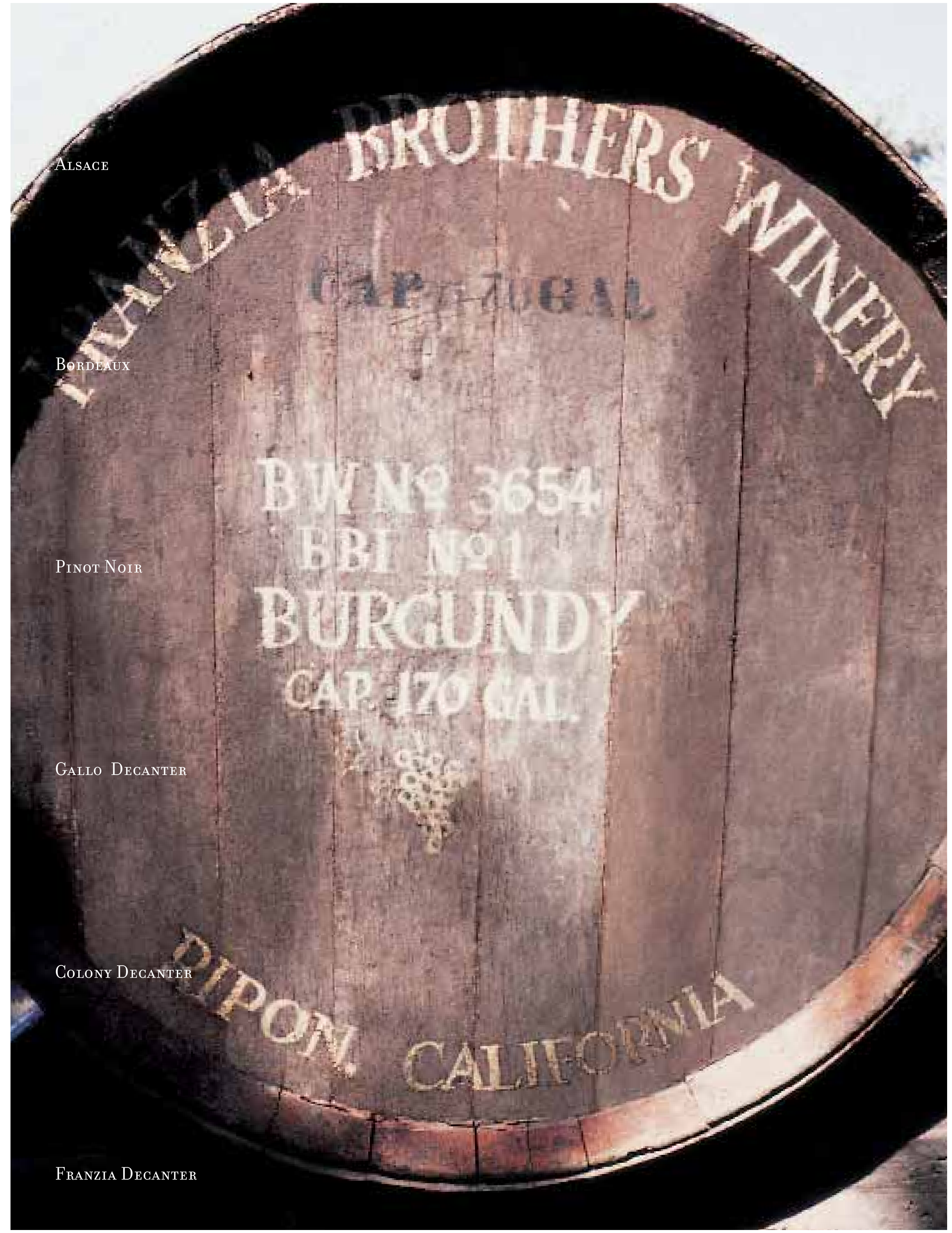
The situation at Coke-NY was dire both financially and politically. In 1975, during my first year as President and CEO, Franzia lost $4 million on revenues of $20 million. Wall Street was asking tough questions and Coke-NY’s management was under pressure to put a good face on Franzia’s brand potential and growth prospects, and to stop the bleeding.

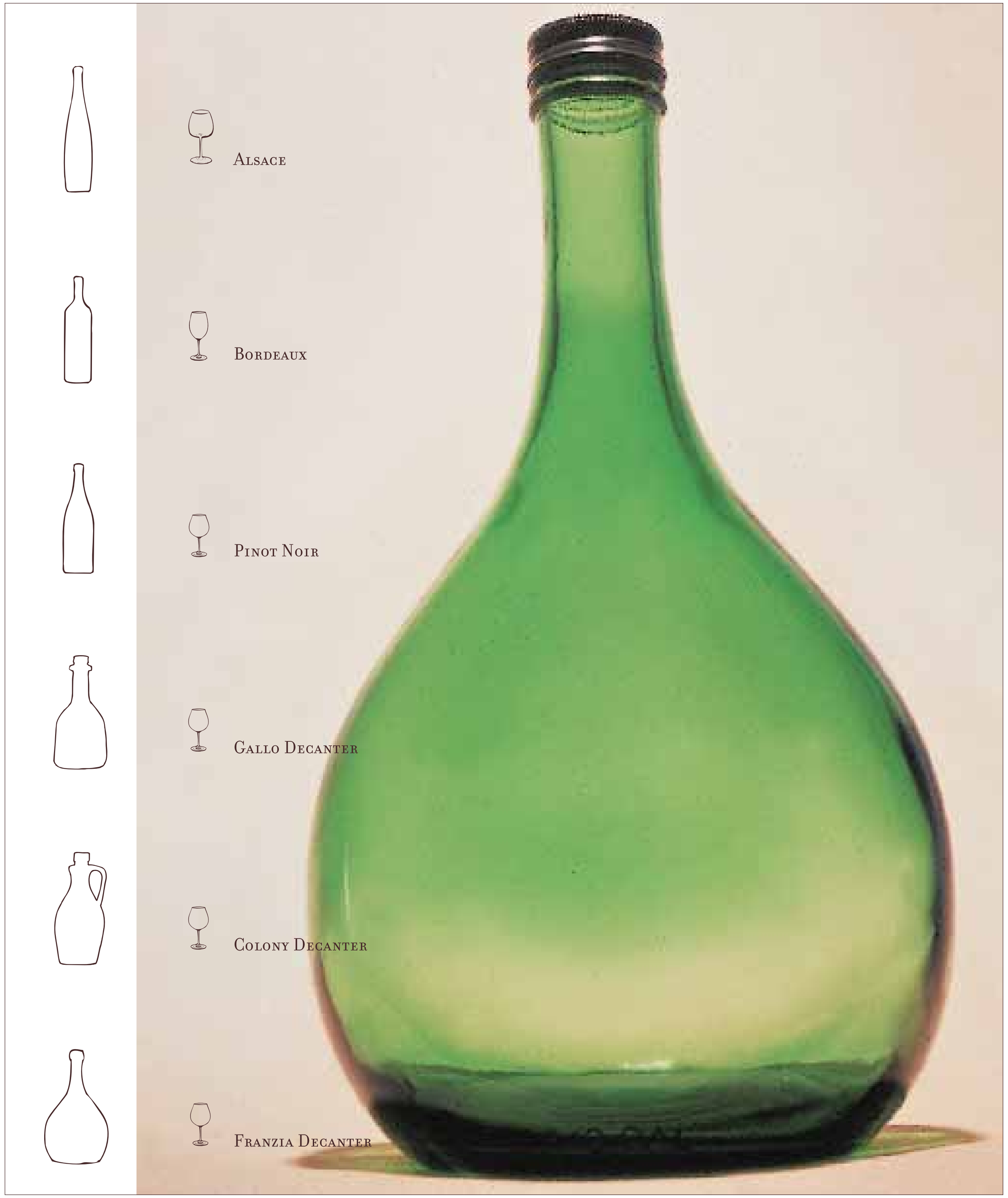
To complicate matters even more, marketplace trends on the Franzia brand were deteriorating rapidly. The brand was in danger of losing shelf space and potentially being discontinued from retail stores. Our team would have been much better off if we had focused exclusively on internal operational problems for the first few years, but it was just not realistic. We couldn’t ignore a brand that was languishing in the marketplace.

We needed something drastic. We decided to develop and implement a total repositioning of the Franzia brand and take our chances that we just might make it stick. We were being forced to deal with problems that were not of our own making, problems that originated from the naïve decisions made by management several years earlier and were exacerbated by hostile market conditions.

During its heyday in the early ‘70s, Franzia management launched a half gallon package to compete in the rapidly growing Decanter Category against Gallo and Italian Swiss Colony. These two brands had their own distinctively shaped, proprietary decanter. When they both came up short of grapes after the 1972 harvest, their only recourse was to curtail promotional expenditures and raise shelf prices, thereby vacating the important $1.99 shelf price to avoid completely running out of stock and losing shelf space in retail stores.







To capitalize on the situation, prior Franzia management had copied the exact shape of the Gallo decanter and raised its price (thereby extending margins) to the recently vacated $1.99 price point, now 20¢ to 30¢ below Gallo's. The retail trade, anxious to hold consumer prices down, brought the new Franzia decanter into broad distribution. Sales soared.

In 1975, when Gallo and Italian Swiss Colony inventory was restored to normal, they reduced shelf prices back to $1.99 and doubled-down on promotion. Meanwhile, Franzia, whose wine cost had risen, had to roll back prices too in order to preserve a relative price advantage. As a result, it suffered a margin reduction to nearly zero. The Franzia supply advantage disappeared and consumers perceived the new Franzia decanter as a cheap imitation. Sales slowed to a crawl.

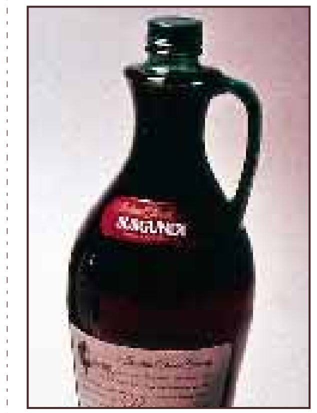
Our only hope of restoring sales involved a total repositioning of the brand, complete with improving wine quality and overhauling the packaging. We knew we had to abandon the copycat bottle that emulated Gallo and made us look like an inferior knock-off. We thought that if we could develop a superior package that looked more expensive, we could induce new consumer trial of our improved wines and restore sales.

The new package we developed was an elegant, teardrop-shaped decanter that had a larger size impression than its competitors. Our research told us consumers thought it looked more expensive than our competition and perceived it as a better value.

The plan worked right from the start. The retail trade loved it and supported it with advertisements and displays. Consumer sales picked up smartly which was good news. Unfortunately it was also bad news. Sales were so strong that they were negatively impacting competitive volume. This attracted the competition's immediate attention and brought a strong counterattack.

Both Gallo and Italian Swiss Colony knew our Achilles' heel was that our high cost structure left us with minimal money for retail promotion and no way to add manpower to a frail sales organization. Their counteroffense focused on these two major weaknesses. They used deep promotional spending to dominate retailer


GALLO DECANTER


ITALIAN SWISS COLONY


FRANZIA DECANTER

ads and in store display space. At the same time, they used their armies of sales personnel to subordinate Franzia on the shelves (unlike the above photo which portrays the ideal shelf set for Franzia). Most consumers were overwhelmed and never even got a chance to see the new Franzia package or taste the new wine. Our competitors' offense worked.

The repositioning, which could have worked under other circumstances on a more level playing field, failed. We weren't ready and it was simply a good idea before its time. But it was still a bitter pill to swallow to see it languish when we knew it could have worked if our cost structure had been efficient and our organization had been prepared.

This experience caused us to realize the only way Franzia could compete successfully was to offer consumers a better value than our competition did. The marketplace told us that Franzia only sold well when our prices were lower or our wines were better. Our mission was clear. We had to improve wine quality and lower costs. In order to do so effectively, we had to get everyone in all corners of the organization to understand this mission so they could apply their own expertise and imagination. We chose to communicate this through a device that became known as our value equation. It was:

VALUE = QUALITY – PRICE

We explained to the organization that Value was enhanced when Quality improved and Price was lowered. The only way to accomplish the latter was to get costs down in order to pass the savings to consumers in the form of a lower Price.

The priority for the company for the next three years became balancing inventories, improving wine quality and improving logistical efficiency.

BALANCING INVENTORIES, UPGRADING QUALITY

In 1975, just about everything was wrong with our inventory and the grape contracts which would become inventory over the next several years. The tens of millions of dollars of grapes to which we were contractually obligated for several years were substantially more than we could sell or store even under the best conditions. These contracts included undesirable varieties of overpriced grapes with lax and ambiguous language as to the quality standards the grapes must meet. Fixing this problem was a tall order for a new management team inexperienced with grape growers and the commodity aspects of buying and selling grapes and bulk wine. We were either going to learn fast or drown in the overflow of poor quality grapes.

We decided the way to solve a multimillion dollar problem was $10,000...$20,000...$50,000 at a time. We formed a task force, spelled out the issues and laid out a plan.

Everyone pitched in and did their part. Morris Ball and Stan Gajarian worked with the grower community and identified problems and opportunities. Lou Quaccia took on the responsibility of working with other winemakers and facilitated numerous bulk wine sales and swaps. Lou and I both worked the wine broker community to solicit their help. Jim Walls made the winemaking run smoothly. He made significant quality improvements and lowered costs. I strapped on my selling shoes and wore out the soles cultivating and calling upon winery principals to negotiate and transact deals. Lynn Bates, working behind the scenes at the winery, kept us all honest by clearly identifying which financial transactions made sense and which did not. We met often and adjusted our strategy to fit changing market conditions in this volatile marketplace of grapes and bulk wine. The instant we sensed a new sales opportunity, we pounced on it with a creative and attractively priced offer, frequently beating our competitors to the punch with only minutes to spare.

It's impossible to reconstruct the thousands of transactions it took to whip our grape supply and inventory into shape. But some are fun to reflect upon. The very first thing we did was toughen our grape quality standards. Since we

$10,000....

$20,000....

$50,000....

were already paying top dollar, we demanded top quality. We refused to take grapes that didn't meet reasonable quality standards. Growers complained and in some cases took us to court. In the end, we usually prevailed. Eventually our high standards prevented growers from overcropping, so quality improved and quantity decreased.

The next thing we did was to work with our contracted growers to understand their longer-term goals so we could identify and evaluate all the options and make our long-term goals congruent. In the beginning, the market was so oversupplied with grapes there weren't many practical options for growers without disadvantaging the winery even more. Nevertheless the exercise was constructive because it enabled us to size up our growers and determine who we could work with over the long run.

Unfortunately three of the more troublesome contracts were in the hands of growers who were from the Win/Lose school of relationships. These three were in it for every last nickel. They had been lured into these contracts by prior management solely for maximizing their dollar signs. It took us a few years to find out that they lived by the exact letter of the contract only when it advantaged them and circumvented the contract by over-or under-delivering when the contract didn't suit their needs. It took us several years until we caught the biggest one of these three cheating and were able to void the contract. Apparently we weren't the only ones he had cheated. Shortly after our run-in with him, he was convicted of fraudulent business dealings and sentenced to time in prison.

Most of the growers we met during this difficult period were "salt of the earth" farmers who simply wanted a fair price for their grapes and a strong long-term relationship with a strong winery. When the hostile market conditions eased, we were able to work with them to deal off surplus grapes to other wineries in a way that was not disadvantageous to them. This not only helped reduce our grape imbalances, but it identified growers we could work with over the long term.

We became very creative in dealing with our excess grape commitments. We did everything from paying growers a bonus to sell them to someone else to selling them ourselves. If we couldn't sell unneeded grapes, we made them into bulk wine and sold it. At times we sold bulk wine for a loss and replaced it with material purchased at a much lower cost, thereby converting a loss into a profit.

Our winemakers were the most innovative of all. Jim Walls and his team developed a technique to convert less desirable red grapes, which were in long supply and commanded low prices, into highly desirable white wine with a distinctive character that commanded a much higher price. Their ingenuity mitigated a huge problem.

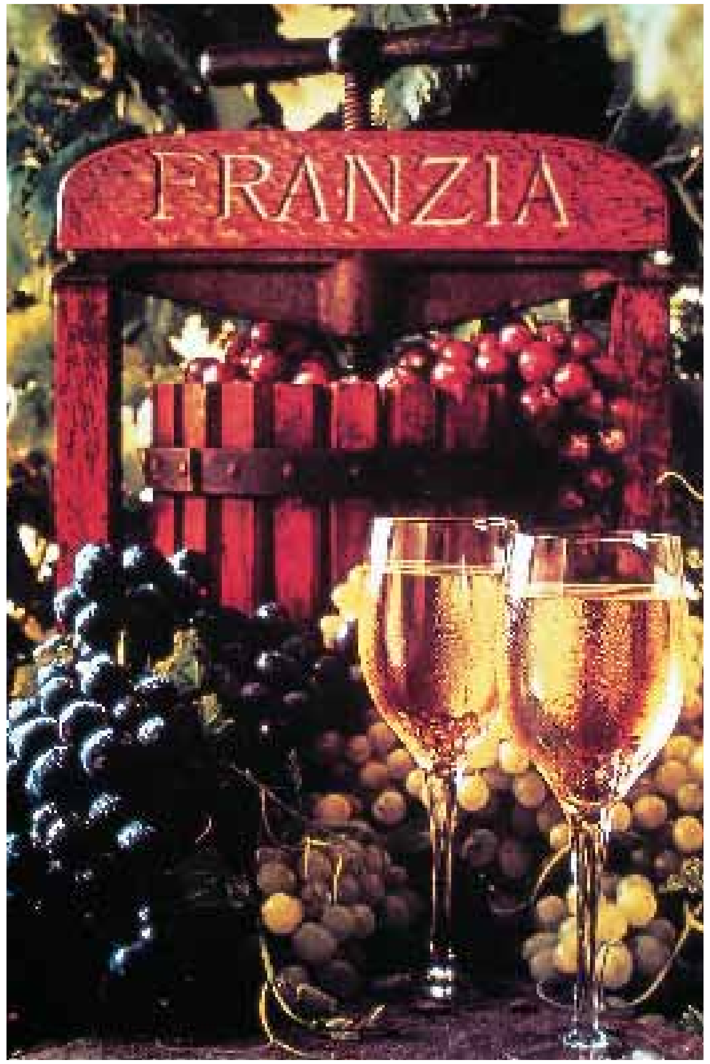
When we finally stopped the inflow of unneeded grapes and matched the supply with demand, we found we had excess winemaking capacity. Rather than purchasing the extra grapes to cover that overhead in hopes of selling bulk wine later in the season, we took the safe route. We decided to lease our winemaking capacity at a profit. This enabled us to start a new contractual relationship with a customer who would become very important to us in the long term – Harry Teasley of Taylor California Cellars, which was owned by the Coca Cola Company (Coke-NY was a separate company that bottled under the Coca Cola brand.)

Over the three years it took to get our inventories in balance, we negotiated hundreds of transactions. The grapes and wine that we sold were pure commodities in a grossly oversupplied market. The market conditions couldn't have been worse, but the lessons we learned could not have been better. They left us in good stead in the ever volatile and cyclical grape and bulk wine markets.

From that point forward, we never committed to long-term grape contracts to maximize easy profits at the top of the cycle when grapes were in short supply, because we didn't want to be saddled with those expensive grapes when the cycle turned. Instead, we preferred to maintain our flexibility to purchase less expensive better quality grapes when the market softened and there were more grapes to choose from. By doing so, we would be much more competitive and in a position to grow share of market at the bottom of the cycle when competitors were oversupplied, usually with lower quality grapes.

Any wine company can prosper at the top of the cycle, but not everyone can survive at the bottom of the cycle. It's much better to moderate profits at the top and be strong at the bottom than it is to maximize profits at the top and be marginally unprofitable or weak at the bottom. A good management team will try to maximize profits over the duration of the cycle which usually lasts eight to 10 years.

LOGISTICAL EFFICIENCY



In 1973, the year before I arrived, Coke-NY invested heavily in a major expansion of the facilities which left us with a lot of unused bottling, warehousing and shipping capacity. This large facility in Ripon was inefficient when it wasn't at full capacity because the overhead cost was the same whether it was fully or partially in use. Obviously, the way to lower unit costs was to fill the capacity as long as that didn't result in incurring more costs somewhere else or filling it with poor quality product.

Our first choice would have been to increase Franzia's sales to use up the extra wine. Unfortunately Franzia was such a weak brand that the promotional expenses required to do so would have been prohibitive.

A much less risky route was to lease this capacity just as we had done with surplus winemaking capacity. We had already built a relationship with Taylor California Cellars management as a reliable supplier for its bulk wine. Our arrangement was working and its brand was growing so much that it was contemplating expanding its facility. We convinced its management that using our facilities would be more efficient and would help them avoid capital expenditures. It was a win/win and within a year our winery was running like never before. Over the next several years we became even more efficient and bottled, warehoused and shipped over 10,000,000 cases of Taylor California Cellars, cases that contributed to efficiency and profitability for both companies.

As soon as we got the winery operating at what we thought was full capacity, we learned there was room for even more volume by running equipment, especially bottling equipment, faster and eliminating down time. It was time to optimize performance!

This required in-depth technical expertise about dozens of complex machines such as fillers, labelers and case packers. This is where it paid to have employees at the grassroots level who took a proprietary interest in their work and understood our culture, especially our value proposition and the importance of simplifying.

Throughout the 1970s, dozens of dedicated employees made hundreds of workplace production decisions that

contributed to continuous logistical improvements and millions of dollars of savings. Few, if any, were originated by top management and none were conceived in the front offices. They all came from the bottom up and were the result of a framework of values, some that were already in place and others that helped to shape our developing culture.

Tim Rocha, who managed the Ripon Bottling Pavilion, did the most to increase awareness and support for the value proposition throughout the company. He communicated well and set high standards within his department, but he also reached across departmental lines and top management to encourage a more coordinated effort to improve value by lowering cost, mainly bottling room cost. Through his excellent leadership, superb example and at times nagging rhetoric, he drove home the need to continually evaluate our value proposition, simplify our product line and apply innovative solutions to problems.

I'll never forget the day he cornered me as I was walking the bottling room floor. He told me the marketing department was making him crazy and his labeler operator on Line #8 was so upset, she was about to walk off the job.

When we talked to her, she showed us how a few hardly noticeable changes to the shape of the label would eliminate 15-20 minutes of down time per shift and result in the production of about 600,000 extra bottles annually at no extra cost. As soon as the marketing department understood the issue, they agreed that the production economics far outweighed the marketing considerations. A few weeks later, more ideas surfaced to improve line speed. Some were agreed upon in the interest of production efficiency and some were rejected in order to protect the integrity of the marketing programs. The walls between departments were down and communications were flowing. Decisions were being made in the best interest of the overall company. People felt good about this whether their department was at an advantage or not.

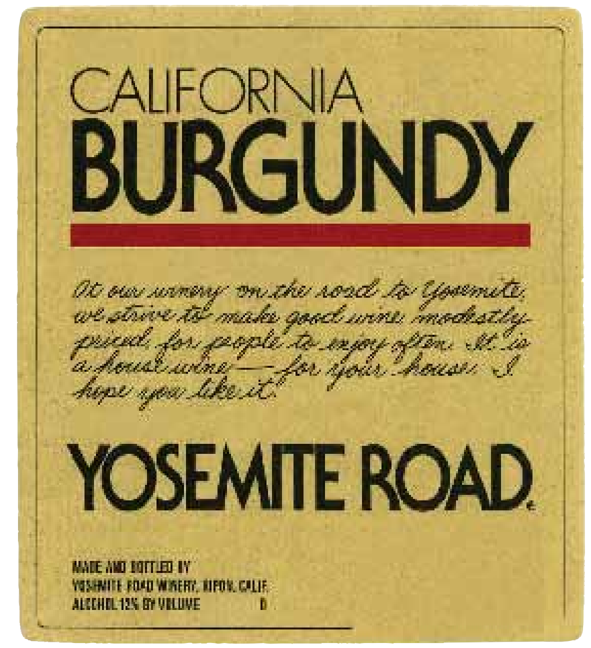
That's when we realized we could use a little more sophisticated value proposition to communicate effectively to employees that the value of a wine went beyond just cost/price and quantity. Consumers also considered a brand's reputation and its imagery in their perception of quality. Dino Cortopassi, a Young President's Organization (YPO) friend, who later became a Director of the company, suggested we add Perceived Quality to the value equation as follows:

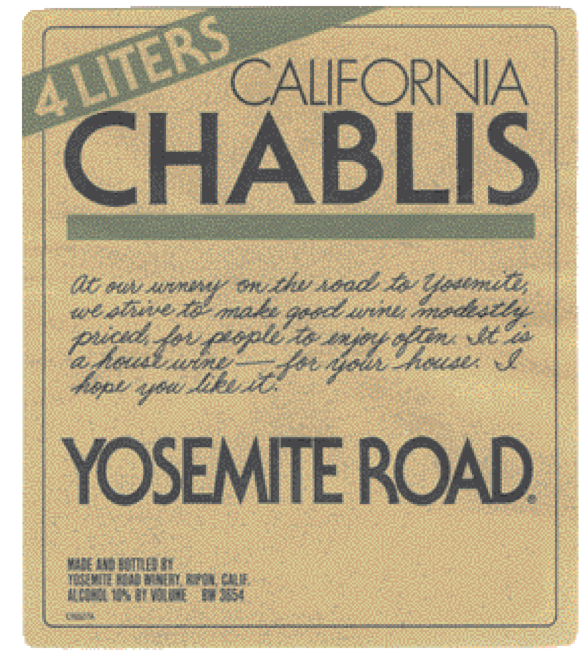
$$\textbf{Value} = \frac{\textbf{Demonstrable Quality + Perceived Quality}}{\textbf{Price}}$$

Demonstrable Quality meant that one could see, taste and smell the quality. Perceived Quality came from imagery such as reputation, label and advertising. Perceived Quality meant the imagery surrounding the product, such as package aesthetics, the brand's reputation, and especially price. For example, most people would think more of a $300 bottle of wine served at a Five-Star Parisian restaurant where it took six months to get reservations than they would think of the same wine if it was served blindly at their own kitchen table on a Tuesday night.

Tim Rocha made sure his people understood that some recommendations were turned down because the added value of the package's aesthetics more than offset the production efficiencies of a simplified package. He was careful not to stifle future recommendations and to ensure a continual dialogue. For years after that when I walked the bottling room floor, I would joke with Tim about the latest marketing conspiracy to slow down his bottling lines. He always kept a sense of humor but he never yielded any ground without a thorough explanation. As a result he sharpened our organization and strengthened our culture.

We also learned a lot more from this experience than how to drive bottling room efficiency. We learned that operational efficiencies are driven from the bottom up, not from the front office. We learned that cultural values can reach into the distant corners of the company to guide and motivate the best qualified people to perform their jobs better. All we had to do was set the right tone, follow up with good examples and hold people accountable.





It took three years, until 1977, before these inventory and logistical efficiencies were visible in the distributor community. The "enlightened" distributors realized we could offer high quality, low cost products capable of becoming a volume base for their distribution house that would fund delivery trucks and put sales feet on the street. Important new relationships started to fall into place – especially in the Northwest and Colorado.

Most of the case goods sold during 1975-77 were still purchased largely because of price but the realization was growing at least among distributors that our company could offer much more. Our challenge was to continue to build on this. I'm not talking about building a brand because we weren't ready for that. I'm talking about building a business, relationships and a franchise by leveraging our newfound cost efficiency and our excellent quality.

We learned a lot by trial and error during this three-year interval as we moved a lot of volume into the marketplace. It stuck in some markets and certain distributions, but not in others. The places where it caught on had a common theme: they were open, receptive, high consumption markets where promotion worked and where large customers were willing to push our products to market.

Our products were sold by distributors who recognized the importance of a low cost volume line to cover overhead, pay for delivery trucks and float their sales organization. They were customers who needed our product and were cost efficient themselves. They believed in aligning with us and would sometimes chip in part of their margin to enhance consumer value so we could both grow.

Three such wholesalers emerged in the late '70s. Gary Raden in Seattle was the best. Gary was a young entrepreneur who instinctively saw the value of our line. He was a hard worker just starting out. When I first met him he was operating out of a warehouse in the basement of his father's hotel.

He was delivering to stores on two leased trucks, one of which he drove himself. When you called his office and he was in the field, the receptionist answered, "Welcome to the Commodore Hotel." There were no cell phones, e-mail or BlackBerries. Gary needed a volume brand to be important to potential customers: without such a brand, he would never have been able to get started.

We struck an agreement to sell him a new brand which we jointly named Yosemite Road. We sold it to him at our cost for an extended period of time. At that price combined with his own highly efficient warehouse and delivery system, Yosemite Road was the best value in the market. Within a few years it was selling 300,000 cases annually in the state of Washington and became the best selling brand in the market. That meant little to us since we were selling it at breakeven, but it meant everything to Gary who used it as a foundation to build his business. As his business grew, he remembered who had brought him to the party and he was able to sell other Franzia products, which were profitable for us.

Before long, Yosemite Road became the locomotive that made Gary Raden the most important distributor in Seattle and pulled the Franzia brand into a position of prominence in the marketplace. As a result, Washington State became our most important market outside of California.

A few years later, we replicated this story in Oregon. When I first called on Chris Maletis, Sr., the Anheuser-Busch wholesaler in Portland, we were selling 2,000 cases of marginally profitable Safeway private label wine per year. Paralleling Gary Raden's story, we grew our line to over 350,000 cases per year over the next 20 years.

At the same time, the Colorado market developed identically because of a highly efficient, driven entrepreneur by the name of John Pearson, who owned and operated C&C Distributing. His office was a corner of the warehouse with only two chairs. We pulled up empty wooden crates to sit on when discussing plans. John was a cost-efficient operator who was close to the market and shared our values, which made for a fast relationship with us.

OUR CULTURAL VALUES REACHED OUTSIDE THE COMPANY TO GUIDE AND SHAPE THE PERFORMANCE OF OUR DISTRIBUTORS AND OUR RELATIONSHIPS WITH THEM

An unmistakable pattern had emerged. The wholesalers who shared our values and culture were our best performers. They were easy to motivate and a pleasure to work with. Our cultural values even reached outside of our company to guide and shape the performance of our distributors and our relationships with them. The high rolling, high cost liquor distributors were a total mismatch.

Distribution channels were developed one market at a time. It takes a long time to build a business through a wholesaler, so the process, which started in the mid to late '70s, continued across the U.S. for the next 20 years. Although it is still happening, today's world is much different. In the '70s, there were multiple wholesalers in each market, often as many as seven to 10. Today there are only two or

three. Gone are the days of hungry entrepreneurial wholesalers who had the time, motivation and incentive to work hard to help build brands. Instead, half the wine brands in the world are often divided between two wholesalers in a market.

Hungry is not how you would define most wholesalers today. As a result, there are as many as 250,000 stockkeeping units vying for space and position in a 40-foot long wine section in the average supermarket. Real estate on shelves is a precious commodity. The net effect is that these huge, muscle-bound wholesalers don't have the capability or interest in promoting anything other than the top brands. If smaller brands are not content with their low priority status they have to augment the distributors' selling effort, or they have to find alternate distribution channels such as e-commerce or direct-to-consumers.

Wineries have been driven to consolidate for aggregated volume and clout, to contend with these mega-wholesalers. At the retail end, mega-discounters such as Wal-Mart and Costco are forcing supermarket chains to consolidate. Although this has spawned the growth of specialty wholesalers notably Whole Foods and Trader Joe's, neither the specialty nor discount stores carry a broad enough selection of brands to ease the tightening distribution picture. As competition intensifies at the winery level and distribution channels constrict at the wholesale and retail levels, more consolidation is inevitable.

Interestingly enough, all three of the small, aggressive entrepreneurial wholesalers mentioned in this chapter, Raden, Maletis and Pierson, ultimately were wooed into selling out to regional mega-wholesalers. I suspect they might regret it today.

GOOD ETHICS ARE GOOD BUSINESS

We learned from our baptism of fire with grapes, wine, equipment and facilities that the company was uniquely positioned to become a low cost provider while at the same time making excellent wines that were a better value than anything in their category. We realized that there was no safe position on the totem pole of value and once superiority was achieved, we had to continually improve on all fronts to maintain or improve our position.

In the early years, our personal and corporate integrity was put to the test. When we were nearly drowning in the oversupply of low quality wine, it would have been easy to improve performance by reneging on oppressive grape contracts. There were loopholes in those contracts that our predecessors signed and a lot of tactics a winery could employ to negate them. In our desperation, we even tested a few, but quickly concluded we would have no future if our word and our contracts were no good. The short-term impact of the decision to play it straight was burdensome. But over the long term, we more than made up for it by developing strong loyalties with members of the grower community who demonstrated they would be honorable and loyal in return. Those allegiances paid off with extra high quality grapes when others were short.

We developed relationships with our growers based upon mutual trust. We learned that dealing with marginal growers, much like dealing with marginal people, wasn't worth our time. So, when we could help our loyal growers without disadvantaging the winery, we did and they reciprocated. Many of the growers who sold us grapes each year never signed long-term contracts with us. We considered them "our" growers and they considered our winery "home" for their grapes. We had a simple understanding based on handshakes and mutual trust.

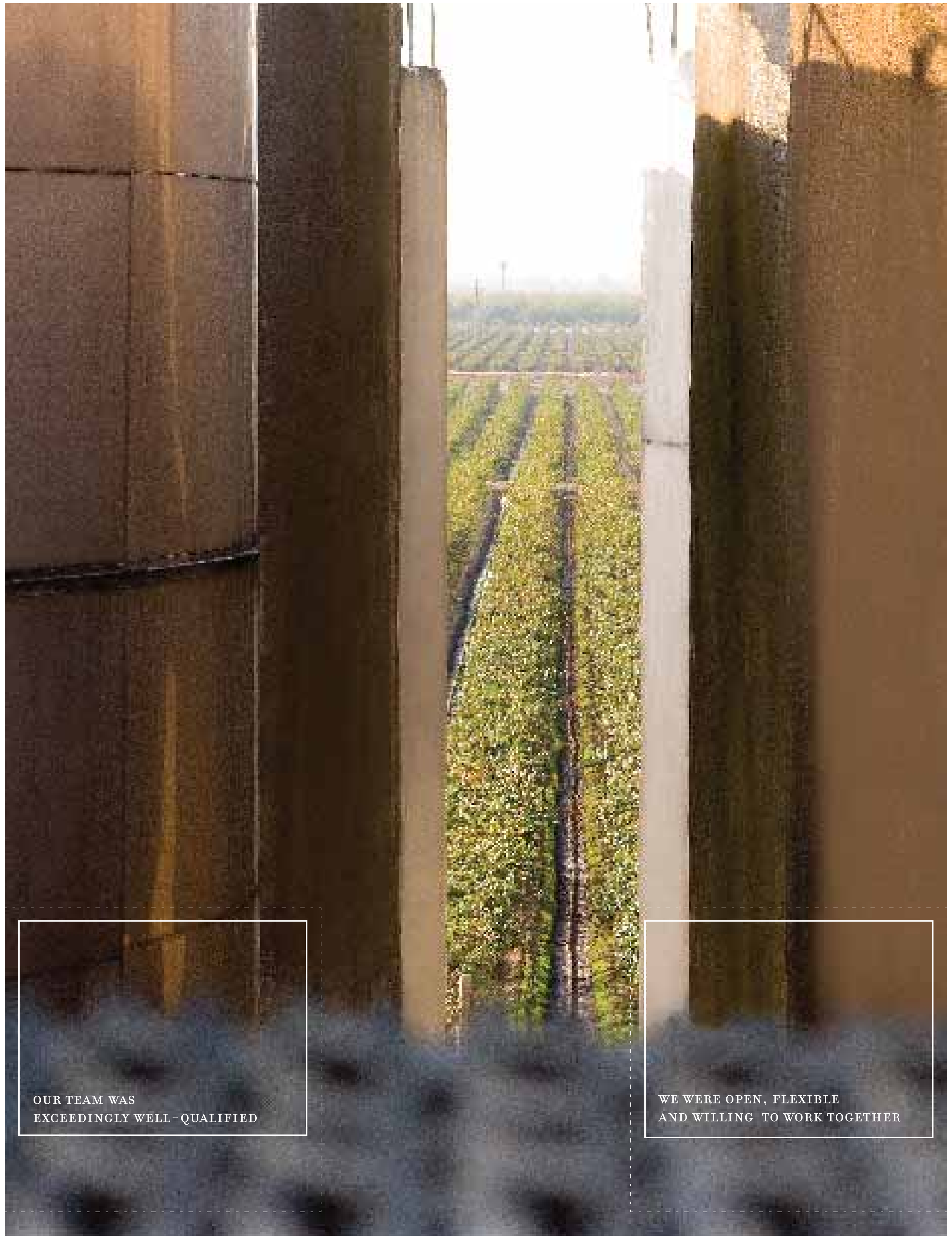
The more we got to know our farmers, the more we liked them. Our guys were simple, straightforward men of integrity and honor. In the early days of the rough-and-tumble world of alcohol distributing and retailing, this was not always the case. There were quite a few customers with their hands out and a number of illegal deals to be done worth tons of business. Just a few dozen of these deals would have helped us enormously. To make matters worse, others were doing them, making it more difficult for us to be competitive. There were a

lot of ways to cover your tracks, so the odds of getting caught were slim. We were seriously tempted in the beginning as our lean sales force lost out on sales.

I was lamenting this industry plague one day with my boss, Bill Sullivan, Coke-NY's Executive Vice President. He looked at me and said, "Art, I'll do anything in the world for this company except sit on my tail in jail." That was helpful perspective, but in the end it wasn't what influenced us. We concluded that we would not compromise our principles. We knew if we built our business supported by doing shady deals, we would attract shady customers who would be loyal only until a better deal came along. That was the very opposite of building long-term brand loyalty, which was our mission from the outset. We also knew anything short of living by the highest standards of integrity would corrupt our organization and drain resources, both of which we needed desperately for the long-term brand-building effort.

Years later, a new management team faced a complex dilemma regarding an acquisition. On the surface it was a perfect fit, but as they got into due diligence, they determined that a significant block of business was supported by highly questionable deals and would be lost as soon as the companies merged. At first, they rationalized that the acquisition plan still worked without this business, but quickly cooled on the deal when they realized the corrupting influence it would have on our organization. When they lost confidence in the integrity of people, they terminated negotiations. When this team pulled out, one of our competitors stepped in and purchased it. Within three years, this artificial volume vanished just as we had expected. It was a costly mistake for them.

It took us longer to build our brands and our business based on the merits that we believed were solid and enduring, but we did it. Building on a solid foundation enabled us to keep moving forward at an increasing rate. We didn't have to digress to fix problems or deal with shady customers or marginal people. Our organization was honorable, loyal and trustworthy. Our people knew what was expected of them. We were able to operate simply and efficiently toward our goal of creating real value for our customers. We were on the road!



EMERGENCE OF AN ORGANIZATIONAL STYLE

Our management team never set out to develop a style of working together. It evolved as we wrestled with difficult issues and learned to work together to achieve optimum results. As we climbed up the steep part of the learning curve in the early years, we developed an insight into one another's strengths, weaknesses and values. Everyone on our team was exceedingly well-qualified in their areas of expertise but open, flexible and willing to work together with other departments toward the common goal. There were no political agendas and no egos. Our only goal was to succeed in the marketplace.

Lynn McShane knew our distributors, customers and the marketplace. Morris Ball knew growers and the grape market. Lou Quaccia understood how to make, package and ship the product. No one had all the answers or could make good decisions single-handedly. We found that the really important decisions required evaluating input from different disciplines and constructing an integrated plan. We brainstormed and debated all-important strategies together and never compromised for the sake of saving time or making someone feel better. We were only interested in the strongest outcome for the company. We had already seen too many failures as a result of compromised solutions in our past experiences.

The most typical conflict was between production efficiency and sales or marketing effectiveness. We never let the cutting edge of a marketing program be dulled by the desire for production efficiency just as we never allowed marketing programs to render production inefficient. If that meant passing on an opportunity or two, we did it. We never compromised the integrity of a program.

Laying the foundation upon which to begin the process of brand-building was an all-consuming job for us in the early '70s. But we kept our heads down and paid little attention to what was going on back at Coke-NY headquarters. Within a short time, all of that changed.

CHAPTER IV

SIDETRACKED

INVESTOR VINEYARDS, THE FARM WORKERS AND JOE SANCHEZ

The first in a series of challenges arose in the form of two contentious relationships brewing at the same time on the same 4,000-acre plot of land. One was with the investors who owned the grapes and improvements on winery land and the other was with the workers who farmed those grapes. One had a happy ending, the other did not.

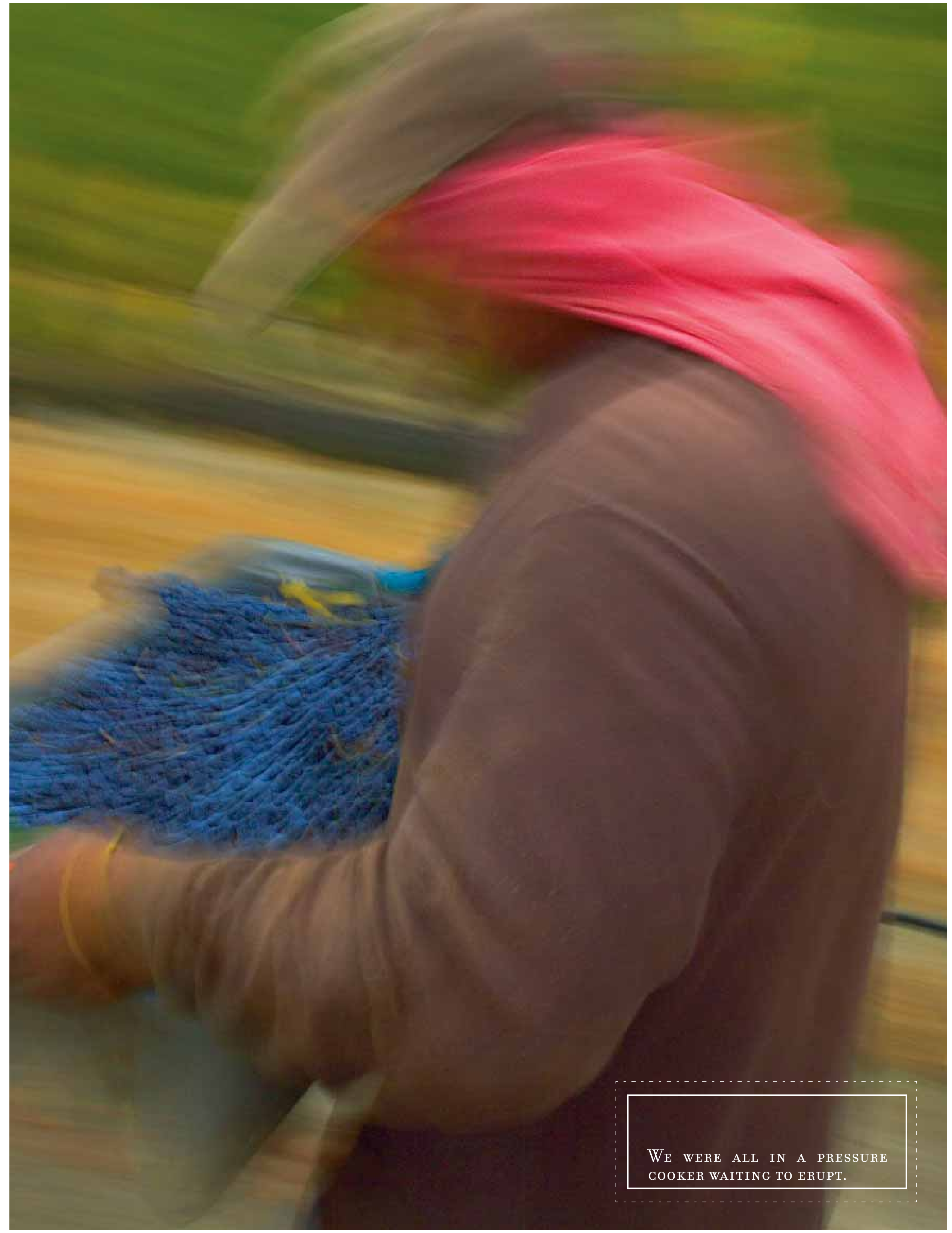
To begin with, everything that could be wrong with the vineyards was wrong. They were planted in 1973 and 1974 at the direction of Coke-NY for a group of investors, some of whom were insiders, to capitalize on a federal tax rule which allowed an investor in a newly planted vineyard to receive the entire investment back in tax breaks that same year. There was no risk to the investors and a high probability that the vineyards would appreciate because inflation was higher than interest rates. So if you bought an asset with borrowed money and the asset value rose only with inflation, you would make a lot of money. The concept of planting new vineyards made sense because investors got their money back in the first year and the winery would manage the vineyards for a fee and cultivate the grapes they needed.

In our company's case, in 1973 before my team came on board, a twenty-year grape and management contract was signed and there was a rush to get the plantings completed before the law changed. As a result, the planting was done on poor soil too late in the season to be assured that all the vines would "take" (survive the winter and be vigorous producers). Within a few years it was apparent these vineyards were low-yielding, inefficient to farm and produced poor quality expensive grapes.

None of this mattered to investors until they started getting cash calls to offset their operating losses. That's when it became apparent we were stuck in a relationship with speculators whose goals were diametrically opposed to our goals. They didn't understand agriculture and had disincentives for investing additional money to fix the problem from the same tax law that gave them the break. A politically charged, antagonistic relationship developed between the vineyard owners and management. It was exacerbated by two attorneys who were part of the ownership group. One was on the board of Coke-NY and the other was a high profile class action gunslinger. The farm workers were caught in the middle. We were all in a pressure cooker waiting to erupt.

That was when a complicated power struggle developed between ther Teamsters Union, which represented our farm workers and the United Farm Workers union, led by charismatic César Chavez. The United Farm Workers Union was somehow trying to takeover from the Teamsters and our workers were caught in the middle, uncertain which way to turn. Our management team had little experience in matters such as these so Morris Ball hired a consultant named Joe Sanchez. Joe had a lot of experience with field worker unions. He had been a worker himself and now acted as a consultant. Joe was a down-to-earth, smart, practical problem-solver who clearly understood all sides of our dilemma.

His strategy was straightforward and simple: eliminate the union middlemen, thereby enabling workers to keep the dues, and create a meritocracy where workers were rewarded in proportion to performance. After identifying his goal for the workers, he got management to buy into it. Once we did, he took Morris and me out to meet with various workers at their stations in the vineyards. We told our story, talked and answered questions with Joe interpreting from English to Spanish and back.



WE WERE ALL IN A PRESSURE COOKER WAITING TO ERUPT.

Within a few weeks, our workers voted the union down almost unanimously. Joe had orchestrated a true victory. The workers received higher pay and better benefits at no extra expense to the winery. This set the stage for subsequent productivity improvements and benefits which were shared, as promised.

Those laborers became among our hardest working and most loyal employees. My favorite party each year was the Mexican Fiesta we held on the front lawn of the winery. Our workers all came with their entire extended families, each decked out in their Sunday best, even young girls in their white Holy Communion dresses. We provided all the food, beverages and *mariachi* music, but they insisted on bringing homemade desserts. Those parties are among my fondest and most colorful memories.

Unfortunately, our affiliation with the investors in these vineyards didn't have such a happy ending. That contentious relationship dragged along acrimoniously for many years until the inevitable happened. The investors, unwilling to put up enough money to fix the problems, eventually ran out of tax benefits and abandoned the property. It became a burnt out tax shelter. It wasn't until much later that we were able to replace old and missing vines with new ones. Eventually yields and quality improved but the vineyard remained a below average performer.

We learned three more lessons. Just as we learned years earlier never to deal with marginal people, we learned never to deal with marginal soil. Secondly, don't do deals that rely on tricks like tax shelters to make them work: if the deal can't work on its own merit, then it's not worth signing. Finally, before entering into long-term relationships, ensure that both sides have congruent long-term interests.

OIL AND WATER DON'T MIX

Coke-NY purchased Mogen David Wine Corporation in 1970. Tribuno Vermouth and Franzia were bought in 1973. Within months, the Federal Trade Commission brought a suit, which we believe was instigated by Franzia's competition, alleging unfair monopoly practices. It was an antitrust suit filed to prevent Franzia and Mogen David from merging. From 1974 to 1979, before Coke-NY won the suit, the FTC issued a "Hold Separate" which meant the two companies had to be operated separately.

When the FTC suit was won in 1979, I was given the responsibility of merging the two organizations. In some respects, this was almost as big a challenge as turning Franzia around. It was an even bigger learning experience that would benefit us in the future when we were evaluating potential acquisition opportunities, then integrating them.

My mandate was to assimilate the two separate companies in a way that would result in getting the best of both worlds – the best people, best facilities and best distribution channels. I went into it with an open mind and a strong belief that there were important synergies to capitalize upon. Since the situation at Franzia was in good hands back in California, I threw myself into Mogen David and virtually moved into the plush and luxurious Chicago headquarters at the top of a Michigan Avenue high-rise building. Quite a change from agricultural Ripon.

Mogen David had three wineries, two in Chicago and one in upstate New York. One of the first tasks at hand was to examine some of the really difficult situations the company faced in Chicago. I was greeted warmly, entertained lavishly and invited into management's inner circle. I chose however, to keep my distance and be all eyes and ears for the first 90 days. I met and evaluated the extensive marketing staff and toured the two Chicago wineries and the satellite facility in Westfield, New York. I asked Lynn McShane, Franzia's VP of Sales, to move to Chicago with me and help integrate the two separate sales organizations and distributor networks. Whenever I could find the time, I attended Mogen David sales meetings, spent time with the sales managers and visited distributors and customers around the country.

What I learned shocked me. Mogen David was a mess. Their management was using the company and its resources to support personal lifestyles that were extravagant and counterproductive.

I was torn between my responsibility to do what I thought was right and trying to fulfill my mandate to achieve the best of both worlds. I decided not to do anything too precipitously, but from that moment forward I knew there was no hope of assimilating these two dramatically opposed cultures – a frugal, cost-effective Franzia with an over the top, extravagant Mogen David.

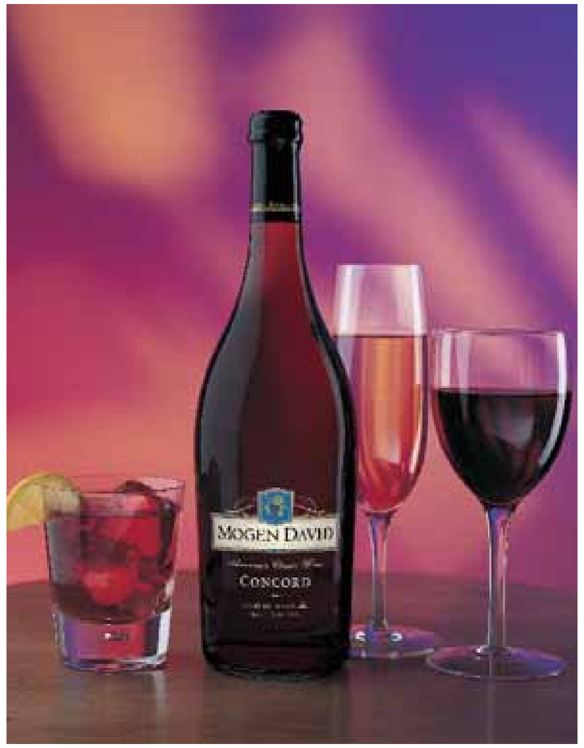
I was struck with the magnitude of this predicament. I simply did not have a management team in place that could tackle the integration assignment. Franzia managers had their hands full at Franzia and Mogen David management was not up to the task.

In the meantime, day-to-day operations at Mogen David demanded full, immediate attention. The financial picture was eroding rapidly, sales volume was declining and expenses were out of control. For the past two years, Mogen David's focus had been the development of new products such as Italian and Greek wine imports, a total departure from its main line of business and expertise. Not one new product initiative had succeeded in over three years, despite considerable expenditures, and my superiors at Coke-NY were getting restless. This was an all-out crisis!

I was in a tough spot and needed to build a team to help implement the integration. If I chose Franzia people, how would that impact the much bigger Mogen David organization? If I went the other way, I took the chance of corrupting an organization I had worked too hard to build.

By this time, the Chicago organization was starting to show signs of distress. People knew in their hearts that the life they had been leading for the last four years was empty, nonproductive and could not continue. This insight gave me the confidence to believe that some of them could rise to the occasion if we created an environment that encouraged integrity, initiative and good work. The situation was so volatile I had to move fast and hope for the best.

My first priority was to clean up the marketing department in Chicago. We had to get control of the situation but set a good example at the same time. I met with the president and we implemented a plan to cut several million dollars of unproductive expenses and reduce the staff to a few essential people.



Within a few months, the entire Michigan Avenue office was closed. Not only did it eliminate over $5 million in expenses, it eliminated a huge burden from the sales organization which had spent the last three years spinning wheels on one ill-conceived new product activity after another. Simply put, they had been ineffective and we were better off without them.

Not surprisingly, sharp sales declines stabilized. In some cases, sales of mature brands even increased as more time was devoted to them. The organization also responded favorably, especially the production people. The fact that I had taken a hard line polarized the organization into two distinct camps. Some rebelled. Others who were tired of the old ways and wanted something better rose to the occasion, ready and willing to accept more responsibility. In them, I had finally found people at Mogen David I could count on.

Now that marketing expenses were in check and the sales force was able to focus on core products, it was time to turn our attention to operations. In some respects, the two inefficient downtown Chicago wineries were in more of a crisis that than the marketing department had been.

The man who played the biggest role in charting a new course for Mogen David was Lou D'Ambrosio. At the time, Lou worked in the finance department. He was an inquisitive guy who always took a strong, proprietary interest in every assignment and had excellent perspective on the overall business. Lynn Bates asked Lou to go to Chicago to get a feel for the financial situation. As usual Lou did that, and much more. He evaluated actual production costs and output, efficiencies and capacities.

When he was finished in Chicago, he took it upon himself to go to the small satellite winery in Westfield, New York to do the same. What he found was transformational. With very little capital expansion, Westfield could outperform Chicago at a fraction of the cost. That not only meant unit costs could be lowered, it meant that we could unload all unproductive assets in Chicago to better align the balance sheet.

By thinking out of the box, Lou saved countless dollars and proved himself to be much more capable than we ever imagined. Lou's story was one of the first great examples of a cultural value that would manifest itself further in the company's development. Taking a proprietary interest in everything you do will serve you well in this company whether you are an owner or not. Today, Lou plays an important role as Senior Vice President of Production Services.

Most importantly, plant personnel in Westfield who had previously been treated as third class citizens, stepped up because of the leadership of Dick Alessi, who we promoted from Mogen David Winemaker to Winery General Manager. Dick dove in like a man possessed.

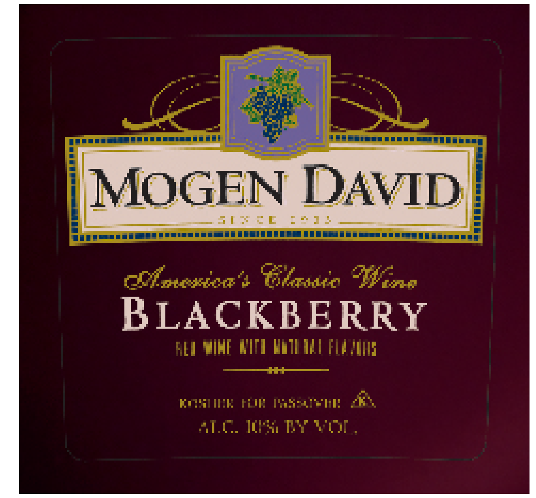
When I first met Dick, I was struck by his dedication to his job and his openness about his disdain for the frivolous ways of Chicago management. When I asked him what he would do differently, he gave me a list of suggestions off the top of his head that was so long I had to take notes! When I reviewed his ideas with our Ripon experts, they all agreed with him.

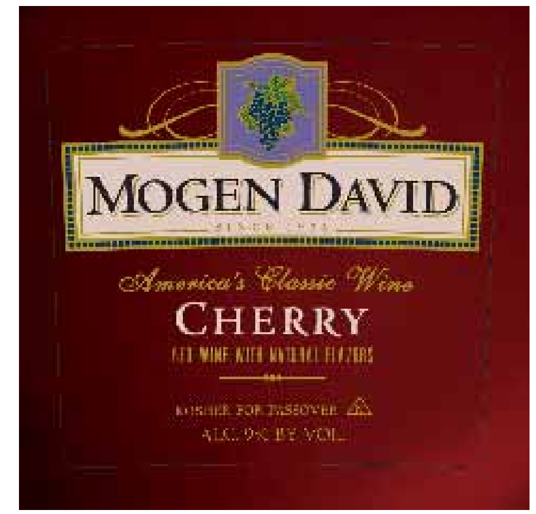
Although I spent a full week with Dick, by the end of the first day I knew he was a highly principled, straight-forward, no-nonsense guy. He gave new meaning to taking ownership of his job and he understood our Value Proposition as if he had written it himself. His personal values perfectly fit our culture and he had demonstrated leadership ability. I was convinced Dick was exactly the right person to be responsible for our most distant outpost.

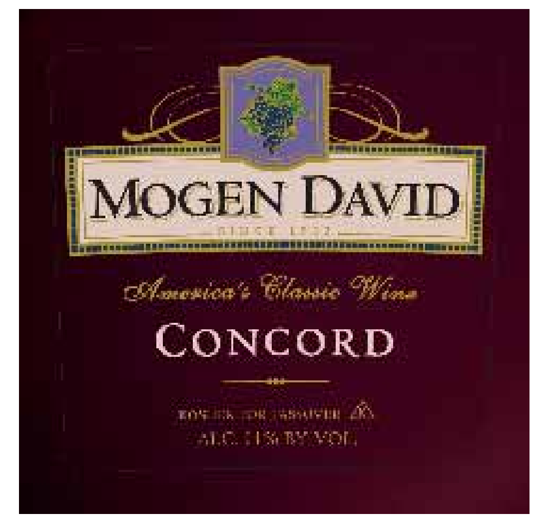
Within a short time, the Plant Manager retired and Dick was promoted to General Manager. He led a modest capital expansion program and integrated the entire production from the two Chicago wineries into Westfield. He generated a huge $2.00 per case cost reduction. The sales organization used this savings for promotion to bolster and solidify Mogen David brands. As a result, they were stabilized and would become true annuity brands that would serve the company well for years to come. Dick Alessi continued to run the Westfield winery autonomously and successfully for over 20 years.

Although we didn't realize it at the time, our reputation had preceded us to Chicago. We were viewed as highly principled, hard-nosed, hard-working and frugal. Their martini lunches and lavish lifestyles did not fit in with our culture and they knew it.

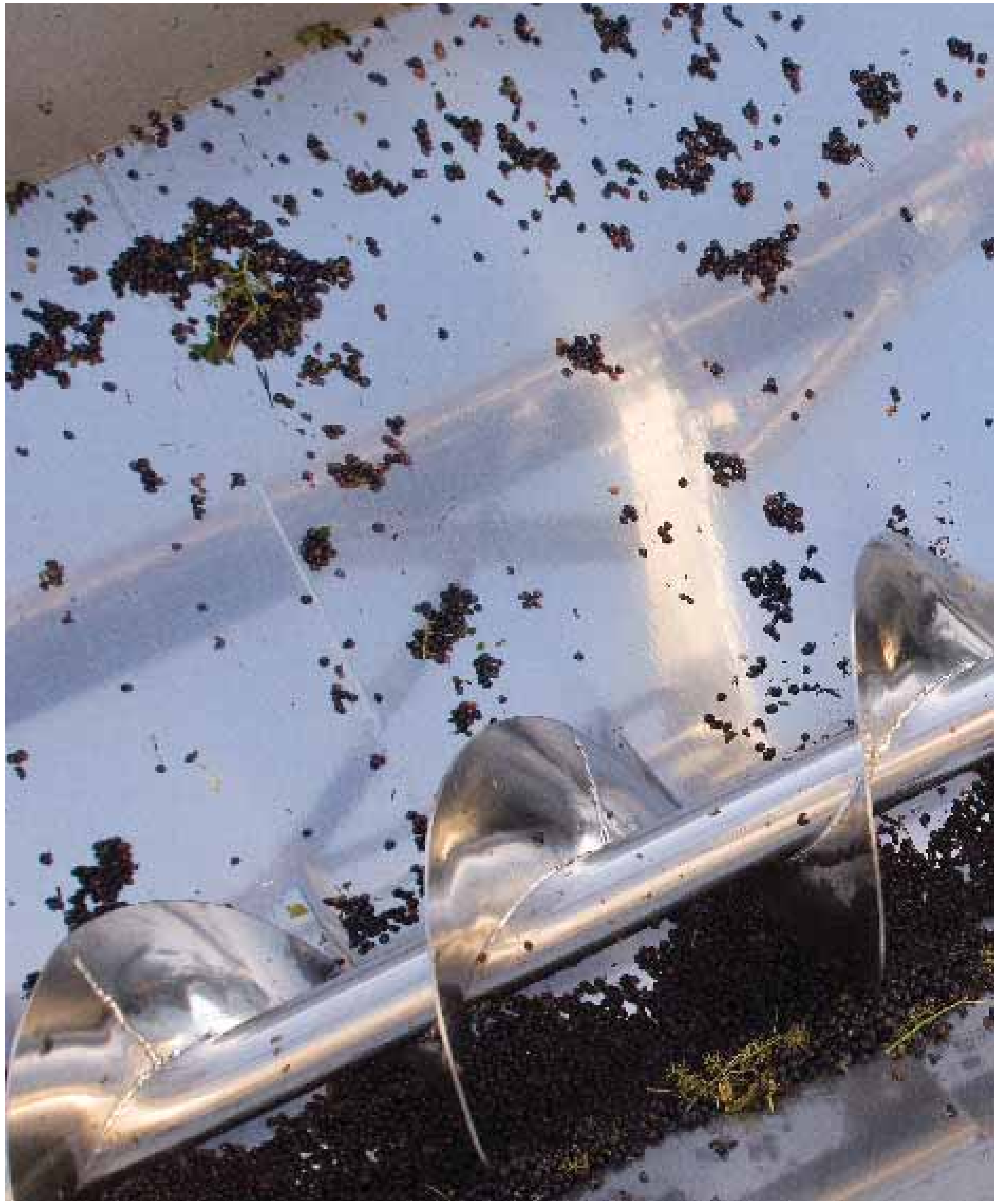
Our values spoke for themselves and it wasn't long before they realized they would never fit in. People tend to gravitate to a culture that is consistent with their own values and blossom in an environment that fits their beliefs, in the same way that they are apt to be less productive in an environment that is counter to their beliefs. Aside from the employees at Westfield, only two out of several hundred Mogen David salaried employees successfully integrated into our culture. The Mogen David/Franzia merger demonstrates the difficulty of integrating two dramatically different corporate cultures. Oil and water just don't mix.







THE UNION STRIKES OUT.



No sooner had we stabilized the Mogen David situation and finalized integration plans than another crisis erupted back in California. After we announced the decision to shutter the two Chicago Wineries, but before we were able to implement the closure, the unions decided to test us in two more ways. With our flanks exposed, they took us on in both Westfield and California. The Winery Workers Union was about to strike.

We were lucky in Westfield. We had managed to negotiate a contract where we made compromises with the confidence that the new opportunities we were offering our employees, combined with the work ethic in a small upstate NY town, would offset the nonsensical work rules the union was imposing. Over the long term, our work force proved us right.

California was a different story. The union struck right at the most vulnerable time, just a few weeks into the crush. It was a serious turning point and it could have made or broken this struggling company.

Our administrative staff and management in California were prepared to step in. The trouble was there weren't enough of them to fill all of the critical skills and technical posts that had been abandoned by skilled union workers. It was another crisis requiring all the help we could get. Some members of the management group in Chicago had the skills we desperately needed. They were winemakers, engineers, and qualified technicians capable of operating complex equipment and relieving some of the Franzia folks already working around the clock.

Since time was of the essence, I assembled the entire Mogen David operations staff and the president together on one conference call. I explained that we needed every available body at the Ripon Winery by the weekend, ready to work nonstop until the strike or the crush was over, whichever came first. It was a big demand and I knew it, but there was no alternative. This was yet another polarizing decision. Some people volunteered to come early and even suggested names of additional people they thought could help.

From that moment forward, everyone approached the strike with superhuman effort. The Mogen David crew came and did their part and some were integral to our success. Employees' families came from all over the state to help out, even working as general laborers.

Gary Raden, our Seattle distributor, showed his loyalty and support by sending us a team of experienced forklift drivers, a skill we needed desperately. Lynn McShane's wife, Susan, and Steve Hughes' wife, Cathy, showed up on the first day and didn't leave until the strike ended. They both played a key role in boosting morale and setting high standards. Both were in charge of bottling crews that were setting one new performance record after another after just two short weeks. We didn't keep those records a secret and word quickly reached striking workers outside the fence that they weren't as indispensable as they may have thought.

One success led to another and by mid-crush, the winery was running like a well-oiled machine. Grapes were coming in on an uninterrupted basis and case goods were flowing out to customers, right past picketing employees.

Things were certainly turning our way, but we weren't sure how far our burst of adrenaline would carry us. There were signs of stress everywhere. It was easy to see through the superficial smiles that they were tired, in some cases dog-tired. Safety was becoming a concern and costly mistakes were being made. One day, someone in the cellar misconnected a hose and pumped 300,000 gallons of red wine into a sewer system. Lost wine and lost profits were not the issue that concerned me. I was concerned about people. If they were pushing themselves too hard, we needed to alter our approach before someone got hurt.

Our dilemma was clear. The union was seriously hindering our performance as a company. Not only did they have counterproductive work rules, they also had some bad individuals who were hired when we had to staff a second shift to accommodate Taylor California Cellars' growth. Unfortunately they were not well-screened and were poorly trained. But most of the other union employees were solid workers, with good values and families that they had to feed. We needed those people. The organization as a whole had been through a lot during the strike and in the years leading up to it.

Despite being sidetracked by one challenge after another, our main priority was to keep moving the company forward. In order to do that, it was important to get our salaried employees back to their regular jobs and restore normalcy to our main production facility.

The day we agreed to let them come back to work was one of the most gut-wrenching days of my life. Not only did we have to accept the bad apples back, but we had to displace a lot of good ones to do it. It wasn't easy telling those temporary workers who hoped to become permanent, that their superhuman effort just wasn't good enough and they were back on the street. How did I explain

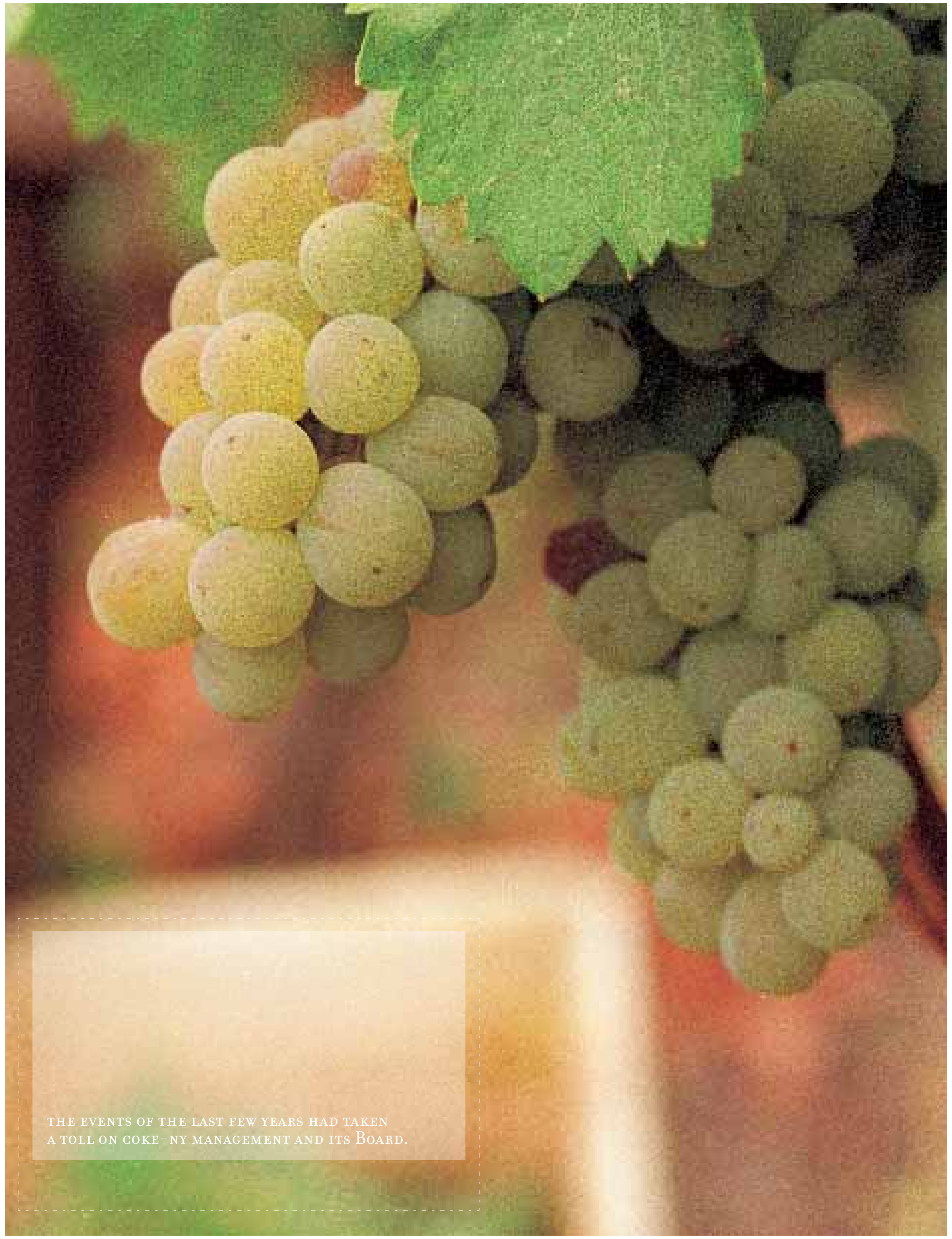
to our loyal salaried employees that they had won important concessions but still had to deal with some "bad apple" union employees and different work rules? Why was I so conflicted when I was supposed to be celebrating this "victory"?

I'm not sure taking those union employees back was the right decision even today. I suppose our consolation is that we did what we had to do. We could have broken the union, but the risks were high. The company needed to move forward. Franzia was back in operation, the changes made at Mogen David positioned it to be a profitable, contributing entity for the newly formed Wine Group, Inc. and Coke-NY. We had shored up and solidified the position of two vitally important brands, Franzia

and Mogen David, that could now be big contributors for years to come. Most of all, the decks were clear to get on with building the business.

What we learned from the strike was much more eye-opening than we ever could have imagined. Adversity and hands-on experience were good for us. It sharpened our understanding of the business, ourselves and our team. We learned through the school of hard knocks how to do a lot of jobs better. Jeff Hansen, our computer programmer, was assigned to driving a forklift in the warehouse. After driving around in circles looking for products for hours and hours, he determined we had a flawed system so he wrote a program for a locator system that made the company more efficient. Top managers and owners such as Lynn Bates and Lynn McShane set good examples by pitching in and doing manual labor just like everyone else – yet another effort that fostered team spirit.

There were numerous instances like this and they were significant. But they all paled in comparison to the sense of accomplishment, pride and bonding we experienced as a team that had overcome this adversity. That strike made us better and stronger in so many ways. From that moment forward, we never looked back or even believed there was a challenge we couldn't handle. We got this surge of confidence just in time to face an even more strenuous task.



"FOR SALE"

Despite the fact that the combined wine division had made reasonable progress and was even starting to make a significant return on investment, by 1980, the events of the last few years had taken a toll on Coke-NY management and its board. An FTC suit instigated by Franzia's competition was a costly, debilitating endeavor that left scars. The integration of the two companies, Franzia and Mogen David, was still not complete. Many Coke-NY directors wondered if there would be additional fallout or if the current level of profitability in this wildly cyclical wine business was a short-term aberration.

Wall Street was down on Coke-NY. The stock price was in the gutter, and management and the board were under intense pressure. Many analysts believed The Wine Group was a drag on earnings. Coke-NY had been badly criticized for making too many diverse acquisitions and for being unfocused. They had taken their eye off their main profit source, which was selling soft drinks in the New York metro market. Stockholders were in revolt and there was a cry to get back to basics.

Divesting itself of The Wine Group was probably a very good decision for a multitude of reasons. It wasn't a good acquisition to begin with and there were absolutely no synergies for Coke-NY's management. The trouble was the clumsy manner in which it was attempted.

The company was put on the block without my knowledge. When news that it was for sale reached our organization and threatened to undermine the morale of our people, my own personal integrity and everything we had built to date, I was outraged!

I'LL BUY IT

HIGH STAKES POKER

I had two choices. I could sit quietly and preside over the demise of our organization as rumors devastated morale and crumbled our outfit, or I could become part of the solution.

Before I knew it, I was on the next plane to New York for a confrontation with the Coke-NY board. It was February, 1981.

I told them that word had leaked out to the industry, spirits were low because our people felt betrayed and there was a good chance this could result in management defections and important losses of trade support. I described the compromising position it put me in and implored them to involve me in the sale process so that I could manage my organization and our customers.

Some directors were sympathetic, others were not. At one point, one of them suggested that wine was a lousy business and they should cut their losses and get out fast, irrespective of the fallout. I was dumfounded but determined to make my point.

From out of nowhere and without an ounce of preparation, I said, "This is a damned good business and a superb company and if you can't appreciate that, sell it to me. I'll buy it."

That stopped everyone in their tracks, especially me. On one hand, it was an empty offer because I had no money to back it up. On the other hand, they didn't know that and there was absolutely nothing empty about my conviction.

I can't remember how the meeting ended, but they took me seriously enough to invite me to become part of the sale process so I could help better manage it. The full impact of my action started to become clear. I was charged with my responsibilities as CEO of The Wine Group to assist with the sale of the company at the same time as I announced a conflicting plan to lead my own, not exactly friendly, takeover effort which no one said I couldn't do. Some directors even supported it (probably to see if there was actually any substance behind my words.)

As my plane raced back to San Francisco, my mind raced even faster. There was no turning around and no backing down. I had absolutely nothing to lose by testing the art of the possible. If I could raise some money and get lucky, I could save the company. If not, it would probably be sold to a large conglomerate that would integrate the brands and assets and dismantle the organization in the name of synergy. It was Do or Die!

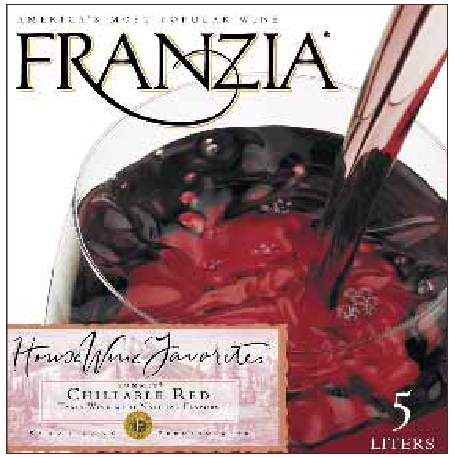
WHAT'S AN LBO?

Minutes after landing in San Francisco, my first call was to my good friend, Bob Smelick. Bob was Managing Director of the San Francisco office of the investment banking firm of First Boston Corporation. He agreed to meet with me for breakfast at his home in Sausalito early the next morning. As he opened the door in his bathrobe, the first words out of my mouth were, "What's a leveraged buyout?"

It took him more than one cup of coffee to explain the concept, but before I left he had arranged for me to meet with First Boston's buyout group in New York in less than a week. That left little time to cobble together a plan, but with a lot of help from my CFO, Lynn Bates, I was in New York on schedule.

Tom Cassidy, the First Boston manager in NY was meeting me as a courtesy to Bob. He was not eager to get into the wine business and said the proposed transaction was too small for them. He stated that they didn't have experience with leveraged buyouts, which were relatively new even to investment banks at the time. I sallied forth with the only counter-argument I could think of, "If you don't have much experience, wouldn't a small transaction like this be an excellent one for you to cut your teeth on?"

Since this was a small deal, it was given to a young analyst named Brian Young who wasn't more than 26 years old. Brian fell in love with it. It was probably the first deal he'd ever done and he took



it upon himself to make it work. He believed in us, loved the cash flow we could generate and was eager to make a name for himself at First Boston.

Brian was the catalyst in convincing each of the parties involved that the deal was going to be a success. At one point, with utter confidence, he marched into Tom Cassidy's office and said, "This deal is solid. I'll go ahead and get this guy Clark on board." He was referring to Jerry Clark, who was responsible for institutional lending at The Met. Eventually, Brian Young's logic prevailed and First Boston agreed to support us. It wouldn't have happened without his perseverance and conviction.*

At the same time across the river at the New Jersey headquarters, the Chairman of Coke-NY had gotten word I was in New York working on my deal instead of attending to business in California. I was summarily ordered to the headquarters where I was greeted by Fred Marcusa, the Coke-NY house attorney, who proceeded to outline my responsibilities in the multiple roles as Vice President of Coke-NY (a title I'd held only for a few months), CEO of TWG and leader of a potentially hostile offer for the company.

I was irritated about the way I was treated but also flattered that they gave so much credence to the possibility that I could actually succeed in buying the company. I quickly came to realize that the acquisition game was highly illusionary…Even the threat of having a powerful investment banker like First Boston on your side was often more important than actually having the money.

Now that I was being taken seriously, it was time to get serious. I rushed back to California to prepare the organization, address my ongoing responsibilities and assemble a team for the road show to raise money.

The next six months were chaotic. I prepared for our road show to raise money to buy the company while I was helping Coke-NY prepare for a road show to sell it. I flew to Europe to help pitch the company to a prospective foreign buyer. I conducted plant tours for other potential buyers. All the while, we had our hands full managing the business. It was a full-time job just keeping people calm, keeping the wholesale trade motivated to continue to support us and most importantly, keeping important retail customers from defecting.

* Brian Young went on to have a very successful career in investment banking, leading teams on dozens of deals. I wonder if he remembers ours.

The biggest challenge was our biggest customer, Harry Teasley, of Taylor California Cellars and the Coca Cola Company. Harry was a true friend and supporter, but there was no way that he could provide any assurances to us that the lucrative Taylor California Cellars processing and bottling contract could be part of our financial *pro forma*. This contract made a huge difference to the financials. Without its consumption of our excess grape inventory and reliable cash flow, some of the borrowing we relied on would not be possible. But he couldn't take the chance of a disruption to his business should there be a hostile change in ownership.

Harry Teasley was a highly ethical gentleman and a valued customer for whom we over-delivered on every commitment. We stretched the organization to the outer limits to meet the rapidly growing demand for his product, Taylor California Cellars, time and again. When the chips were down, Harry remembered and reciprocated by overdelivering on his commitment to us. Harry was facing a difficult choice. He could play it safe and move his business elsewhere, weakening our ability to buy the company. Or he could support us, thereby creating a risk to his own business. He decided to back us by making the continuation of the contract contingent upon "no change of control" in Franzia's Management. That was a courageous move. It gave us a tremendous leg up and enabled us to finalize our agreement with our investment banker and potential equity partner, but it also left him exposed if we couldn't consummate the LBO. Relationships are very important. The Wine Group values relationships and we especially valued this one. We went to the outer limits to do a good job for them and when the time came, they reciprocated. We are forever grateful to Harry. Without him, we may never have had the opportunity to purchase this company.

A WIN/WIN DEAL STRUCTURE

With the long-term processing contract in place, it was time to go to work on structure. Bill Jesse, our loyal friend and confidant, stepped in and his input was invaluable. We started by defining our objectives and identifying where we were willing to compromise and where we were not. Bill and I agreed that the one thing we wanted to insure against was a repeat of what was currently happening. We needed to protect against having the company sold out from under us before we could accomplish our goals. Bill said the only way to protect against that was to get CONTROL. I told him naively, "Good, write it down. Control is our #1 objective and everything else is secondary." Sometimes it pays not to know what you can't do.

In my due diligence, I had learned that management had to be concerned with losing control of the company, either through legal loopholes or 11th-hour power plays by clever and powerful money lenders. We were ardent when it came to control and made our position known to First Boston. The structure we presented served our objective perfectly. We considered them team members in this transaction, even though they would bring in and represent outside equity investors.

But before First Boston would agree to it, they tested our resolve by insisting we invest our entire personal net worth to purchase our stock. This was an easy decision for me because I had always seen myself as an entrepreneur and risk-taker. I had left the East Coast in my 20s in search of an opportunity to prove myself on a new frontier. The Wine Group LBO opportunity was a calculated risk with a huge upside. I had great confidence in our organization and our plan. I believed we could make it work as long as inflation* and interest rates didn't spiral out of control and the grape cycle didn't turn against us when our leverage was at its peak.

Our debt-to-equity ratio was going to be 26:1 so we didn't have much room for a hiccup that first year. If the agricultural cycle turned against us, we would be out of luck. That was a chance I was more than willing to take. I'd started with nothing, and my first ill-fated entrepreneurial venture left me that

* When Coke-NY bought the company in 1973, the prime rate ran around 7% and inflation was about 10%, for a 3% negative interest rate. In the summer of 1981, interest rates had soared and inflation had begun to drop. The prime reached 20.5% in July. The situation was so volatile that we prepared a worst case scenario plan that would enable us to squeak through if rates rose as high as 26%.

way again in the 1960s. It wasn't the end of the world. I had started from scratch twice and I was willing to do it again if I had to.

This must have been the vote of confidence First Boston was looking for because they agreed to the following equity split:

TWG, Inc. Management	50.1%
First Boston Corporation	9.9%
The Metropolitan Life Insurance	40.0%
	100.0%

The deal was structured so First Boston Corporation would serve as a buffer between management and The Metropolitan Life Insurance Company. This was designed to protect us against The Met squeezing management into a share of less than 50%. We crafted it so that if The Met decided to flex its muscles, share would come from First Boston until it was down to zero before management's position would be diluted. It worked. First Boston was the perfect buffer and the transaction was on track to close as planned.

Bill Jesse structured a voting trust so I had control of the management board. He did this as a defensive measure to preclude outside investors from even thinking they could gain control by enticing a member of management to throw in with them. With this structure in place, I invited the five top members of my management team to participate as equity owners. In our only meeting on the agreement itself, I told them of my control position and why it was so strictly structured. I told them I saw us all as partners and I would only exercise my prerogative in extreme circumstances where we failed to reach a consensus as a team. Based on my word, each of us put our entire net worth on the line, even mortgaging our homes (despite interest rates being at an all-time high). We had no choice. In the entire 20 years we worked together, we never once failed to reach a consensus as a team and I never once acted unilaterally on a single substantive issue. We didn't always agree with one another and nobody hesitated to argue their point, but we viewed controversy and debate as healthy. Brainstorming was one of our great strengths and we were usually able to coax a winning plan out of it time after time.

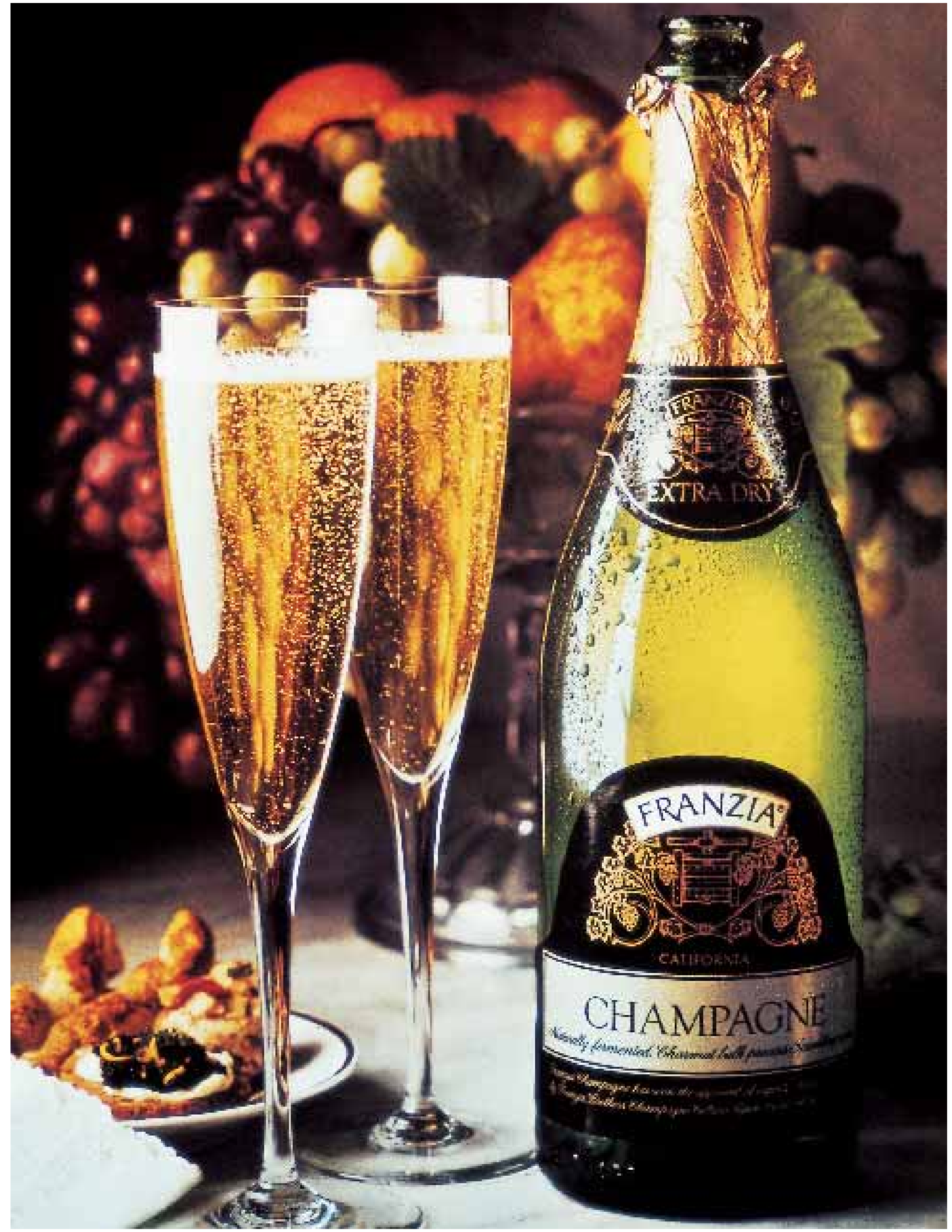
THE CLOSING

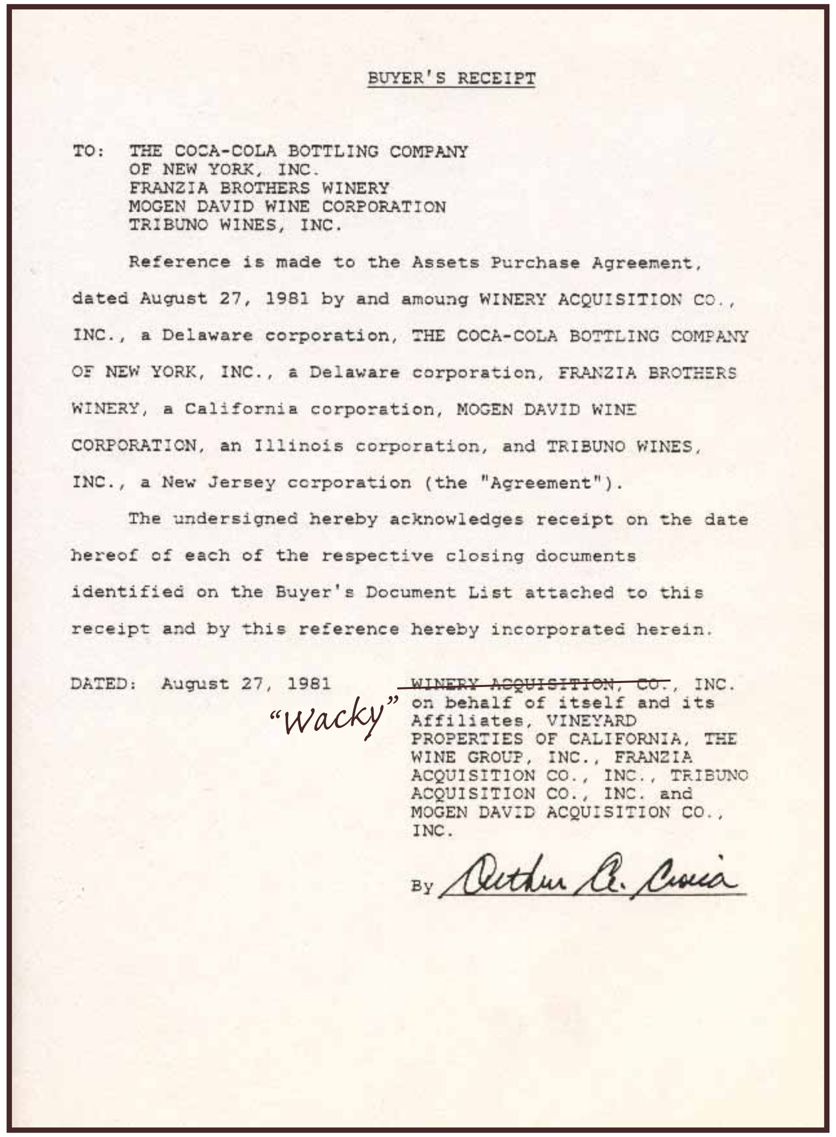
After six months of financial structuring, deal-making, negotiating, trying to sell the company, trying to buy the company, holding the organization together and discharging my responsibilities to Coke-NY shareholders, the deal closed on August 27, 1981.

It was a complicated three-way transaction that involved taking our public parent private and spinning off TWG in the process. At 11:00 pm, one hour before the deal was mandated to close, Jerry Clark from The Met looked up from the documents and said to me, "I don't see in these documents any assurance that we can get out." It was too late for a redraft so I promised him on my word that we would get The Met out at the end of five years.

The months prior to the close were intense. I often wonder how our team survived it. Lynn Bates worked around the clock crunching numbers and cranking out *pro forma* plans. This was before the era of personal computers so all of the models, *pro forma* and final plans for the investment bankers were done the hard way. Microsoft Excel and PowerPoint didn't exist, so we did everything by hand with noisy cumbersome calculators. Bill Jesse practically moved in with us. He was there to guide us through almost every part of this long drawn-out ordeal. In addition to being Chief Strategist, he helped with the financial plans, the road show and even legal documents and negotiations with First Boston and The Met. Somehow he managed to stay calm and collected. He was a wonderful, stabilizing influence on us all. At a few critical junctures when the project was getting off track, Bill was instrumental in straightening it out. Without Bill Jesse, the LBO would not have happened.

Almost everything that happened during the six-months running up to the LBO was stressful. None of us got much sleep or exercise, so we looked to humor for balance. After an exceptionally long day of reviewing document drafts with the attorneys, one of the many lawyers in the room looked up and asked me what the legal name of the holding com-





BUYER'S RECEIPT

TO: THE COCA-COLA BOTTLING COMPANY
OF NEW YORK, INC.
FRANZIA BROTHERS WINERY
MOGEN DAVID WINE CORPORATION
TRIBUNO WINES, INC.

Reference is made to the Assets Purchase Agreement, dated August 27, 1981 by and amoung WINERY ACQUISITION CO., INC., a Delaware corporation, THE COCA-COLA BOTTLING COMPANY OF NEW YORK, INC., a Delaware corporation, FRANZIA BROTHERS WINERY, a California corporation, MOGEN DAVID WINE CORPORATION, an Illinois corporation, and TRIBUNO WINES, INC., a New Jersey corporation (the "Agreement").

The undersigned hereby acknowledges receipt on the date hereof of each of the respective closing documents identified on the Buyer's Document List attached to this receipt and by this reference hereby incorporated herein.

DATED: August 27, 1981

~~WINERY ACQUISITION, CO.~~, INC. “Wacky”
on behalf of itself and its Affiliates, VINEYARD PROPERTIES OF CALIFORNIA, THE WINE GROUP, INC., FRANZIA ACQUISITION CO., INC., TRIBUNO ACQUISITION CO., INC. and MOGEN DAVID ACQUISITION CO., INC.

By Arthur A. Ciocca

pany would be. I told him that I didn't care because at the time I was focused on our trade name, “The Wine Group of Coke-NY.” We were trying to decide whether to change it entirely to signal a new start or simply drop “of Coke-NY ” to preserve the equity we had built. Bill Jesse chimed in saying the working name in the draft is perfect. The Winery Acquisition Company Inc.'s initials are W.A.C.I. – pronounced “Wacky”. We laughed then and laughed for the next 20 years every time the name of our holding company came up.

That night after the closing, Coke-NY management threw a big closing party at a New York night spot. Everyone was thanked and everyone except me was given a significant gift of appreciation. I was given a t-shirt that read: “No More Mr. Nice Guy.” I was especially proud of myself for earning that distinction under the circumstances.

I was also proud of myself for standing up for what had been right, what I believed in, what we had built and the people I built it with. I was pleased that I had faced down the board. It gave me even more resolve to make it work. The ball was 100% in our court and we had a lot to prove.

My state of mind and the circumstances leading up to that critical, split-second decision to challenge the board flashed before me that night. Was it pure luck? Or was it something beyond that? Something wired into my basic set of beliefs? I've always approached every job I was hired to do with a proprietary interest. I always owned my responsibilities. Was I preparing myself for real ownership all of my life without even knowing it or was it just chance that I stumbled onto this opportunity? I'm not sure I'll ever know.

What I do know with absolute certainty is that it is helpful to think like an owner. The employees I have persuaded to adopt a proprietary interest in their jobs greatly outperform their counterparts who are working solely for a paycheck. The good news is that in TWG sometimes having a proprietary interest leads to having real ownership, just as it did for me. When this happens, I feel like I have succeeded with my most important responsibility, creating an opportunity for another entrepreneur to leverage excellence in TWG and in society as a whole. It's a wonderful and rewarding feeling.

CHAPTER V — A DREAM COME TRUE

PRIVATE AT LAST

We never worked so hard to make something happen in our entire lives. When it did, we were in disbelief. 1981 must have been my lucky year. One good thing happened after another: it was almost unbelievable.

Thirty days to the day after the LBO in August of 1981, my good friend Joe Gallo called to congratulate me on the transaction. He invited me to dinner to celebrate and suggested that I bring along my tennis racquet if I wanted some exercise. I said yes to dinner and tennis. Like a good salesman, once Joe got me responding affirmatively, he said, “And if you'd like to meet my cousin, Carlyse, I'll invite her to dinner, too.” What could I say?

As usual, dinner at Joe Gallo's was wonderful except for one thing, Carlyse and I barely got a chance to talk to one another given all the activity. So I invited her to dinner later in the week at an Italian restaurant in Stockton, midway between our two homes. It was owned and operated by a mutual friend. We sat down at 7:00 pm and the owner had to ask us to leave so he could close down at 11:45 pm.

After a very short courtship (eight months), we were married April 24th. Within that 12 month timeframe, I had purchased a home in San Francisco (before the LBO so I actually had something to mortgage), a wine company in Ripon and married a girl by the name of Carlyse Franzia who was the granddaughter of the petite immigrant Italian mail-order bride who started one of the wineries I now owned. What a story!! Carlyse must have inherited her grandmother's drive, determination and vision because for the next few years she selflessly supported my 80-hour weeks, long road trips and preoccupation with the business. I owe much of my success to her love and support.

After the initial euphoria of the LBO wore off, our management team had to make up for lost time. There is no way to explain the burst of energy we got. We had achieved what we wanted. We were now masters of our own destiny with a chance to test the organization we had built, the values we shared and the plans we had written without the distractions of the public market or schizophrenic board. It was all up to us and only us. If something went wrong, there was no one else to blame. Even

THE WINE GROUP

Arthur A. Ciocca
Chairman and C.E.O.

August 27, 1981

TO ALL EMPLOYEES:

After several months of negotiations, I am delighted to announce to you that the management group has successfully concluded the purchase of The Wine Group (consisting of all brands, facilities and other assets) from Coca-Cola. The new company is a private corporation. Its new owners, in addition to myself, are as follows:

F. Lynn Bates
Morris Ball
O. Lynn McShane
Steve Hughes
Lou Quaccia

Although there will be other investors at a later time, the above management team will retain controlling equity interest in the company.

We are looking forward to a continuation of the growth in sales and profits the company has experienced over the past several years, and I know we can count on the continued full cooperation of everyone relative to the enormous and exciting challenge that lies ahead. It goes without saying that we as new owners perceive a bright future for the company in the years ahead.

I am personally looking forward to meeting with each of the departments, and groups within departments, to answer questions and to provide an additional insight into our future plans and method of operating.

AAC:pd

The Wine Group Franzia • Tribuno • Mogen David
~~of The Coca-Cola Bottling Company of New York, Inc~~ 177 Post Street Suite 550 San Francisco, California 94108 (415) 986-8700 Winery (209) 599-4111

worse, there was no deep pocketed parent to bail us out. The full realization of this was both frightening and exhilarating. We were no longer hired guns. We were owners. By all objective standards, we had been excellent professional managers. What we were about to learn was that we would be much better in our new ownership roles. We began to see issues with greater clarity, make sharper decisions and set better examples. There is something transformational, almost magical about ownership and we were about to experience it first-hand.

WALKING OUR TALK

Somehow, being new owners enabled us to see through issues with unobstructed clarity. We could finally set our sights on what the company needed to do to be successful. We wanted to make it obvious to the organization that this was a whole new ball game now that we were private.

Early on, these were just words. The real proof would be in our actions. Fortunately, luck was with us again. Three or four months after the transaction, I had my hand forced by what started as an incredibly unfortunate event. Someone in the cellar made a mistake and 25,000 cases of vermouth had developed a tartrate precipitate at the bottom of each bottle. Under Coke-NY, if the product was shippable and wouldn't harm anyone, they would invariably suggest that we sell it to avoid the short-term hit to earnings, even if it would turn off consumers in the marketplace.

I'll never forget Lou Quaccia's phone call announcing this particular piece of bad news. It meant a $250,000 hit to earnings, something we most certainly could not afford. Because the precipitate was hard to see through the green glass, no one would ever notice. But after mulling the matter over, Lou and I finally concluded we didn't buy this company to behave like Coke-NY and we weren't in business to sell marginal products. Lynn Bates, our financial conscience, agreed, so we decided to destroy the product.

Had we realized what a profoundly positive example this decision would have on the organization, we would have made it more easily. Destroying 25,000 cases of vermouth can't be done inconspicuously. Before the day was over, every single plant worker knew what had happened and a switch clicked throughout the facility. You could almost feel it from that moment on. People realized this was a whole new ball game. If that's the way these new owners were going to act, they recognized their responsibility to step up to the plate too. That $250,000 hit to earnings was paid back many, many times over with improved morale and productivity.

In the final analysis, it was much easier for our people to identify with us as people and owners than it was to identify with a NY company run by a faceless board. Our people soon realized we had everything on the line, including our homes, so they gave us their utmost effort. It was in stark contrast to the example set by our former public parent.

That's when it dawned on me that many of the values we believed in were very difficult to fully sell to the organization in a public company environment where short-term earnings were the driving force. Sure, we would buffer our people from some of it, but on balance, employees at all levels are smart and perceptive and unless we walked the talk, the rank and file would see right through us. Becoming private gave us a chance to start with a clean slate. It put us in the spotlight to be unequivocal about our values and to set a good example as owners. Becoming owners transformed my partners and me; becoming private transformed the entire organization.

Shortly after the vermouth destruction, the organization changed noticeably. People throughout the company, at all levels, began to take real ownership of their work. Overall performance, which was already improving, took a significant turn for the better. This was the start of an incredible transformation.

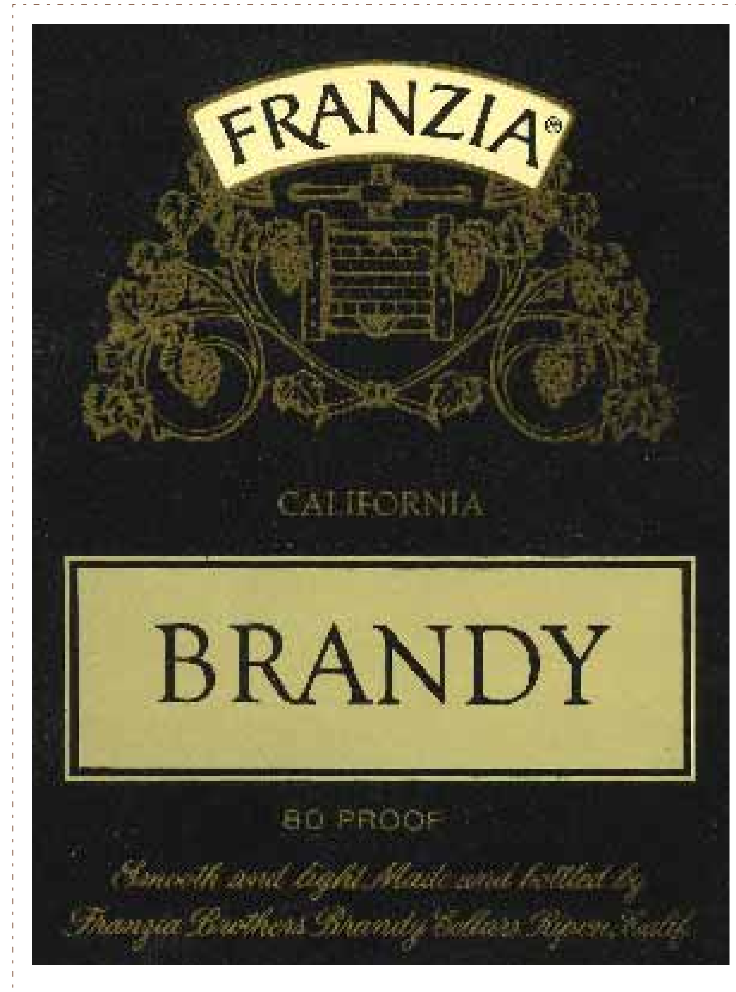
GROWING PROFITS AND SHRINKING DEBT

We needed more than just setting a few good examples to make our bank happy. We needed more margin dollars and less debt. Our early intelligence indicated the grape supply was going to be tight going into 1982. There weren't enough grapes to go around. We knew our own supply was limited and we could sell it all at current prices, but we wouldn't meet our profit plan. If we took a risk and raised prices and competition did not follow, sales volume would erode and even at higher prices, we would still miss the profit plan.

Our only hope was to lead a highly unusual September price increase and hope that shortages would force our competition to follow. We got lucky! The competition followed and we sold our limited supply at higher prices. We made our all-important (for the banks) first-year profit plan and the price increase set the stage to do even better in 1982.

Concurrent with this Profit & Loss accomplishment, we were successful in selling several nonproductive assets, some vineyards, two Chicago wineries, a vermouth facility in New Jersey and miscellaneous excess equipment, all of which were sold for cash that we used to pay down debt and improve bank covenants.

By the beginning of 1983, 16 months after the



LBO, we had sold all nonproductive assets, but retained everything we thought had future potential. We were conflicted about brandy. On one hand, we believed the business had excellent potential because the category had only one significant brand and only a couple of lesser, inconsequential brands. Nothing progressive or exciting was being done in the brandy category. Christian Brothers, the only major brand, was vulnerable because they were coasting on their past successes.

We had developed a marketing plan with a unique packaging concept to exploit this situation. On the other hand, previous management, in its exuberance to enter the business in 1973, had built a brandy facility that now required further capital because it was incomplete and inefficient. The brandy business is capital-intensive because the inventories must be aged for three years and are three to four times more expensive than wine. Adding new inventory to support uncertain sales would not only consume cash, but would be risky.

Just as we were evaluating our options, Gallo dropped a bombshell. They were launching a new brandy, "E&J," that would come in a unique decanter. Their announcement troubled us for two reasons. First, our marketing concept to use a unique decanter had just been preempted. Second, and more importantly, the price of admission to this game had just greatly increased, while the odds for success had become lower. Instead of a complacent company like Christian Brothers, a vibrant and powerful player was stepping up the pace with an imaginative marketing program. We were in a quandary.

Our experience with the teardrop decanters years earlier taught us to be in position and prepared before implementing a marketing program of consequence. Clearly, the organization was not ready for this project, especially given other more significant priorities. It was much more important to have the certainty of eliminating debt from our balance sheet rather than adding to it, which this project probably would have done. We wanted the freedom and financial flexibility to pounce upon other less risky and potentially more fertile opportunities. Most importantly, it was just not a good entrepreneurial risk, not because the odds of success were so low but because the consequences of failure were so great.

Although we were eager to get started on marketing and brand-building, it was obvious that brandy was not a prudent place to do so. In 1983, we made the decision to sell off several million dollars in bulk brandy and exit the business. We needed to pay down debt, simplify our lives, focus on our core business and have the flexibility to seize the next opportunity.

BUILDING A BOARD THAT WORKED

With Coke-NY out and the Met and First Boston in, it was time to put together our own Board of Directors to add perspective and experience to our decision-making process. Our goal was to assemble the most talented team of individuals we could find, each with different and complementary backgrounds. I was fortunate to have had the opportunity to meet a lot of talented CEOs at the Young Presidents' Organization (Y.P.O). As a result, I had a lot of excellent YPO candidates to choose from.

Bill Jesse was an easy choice. Bill and I had known each other from the early years at Coke-NY, where he ran its Delta Steamboat Division. He knew our business intimately because he'd single-handedly orchestrated and led us through the LBO. Bill remained a good friend, confidant and informal advisor.

Dino Cortopassi brought both agricultural and operating company experience to the table. He was a successful grape grower. He was also the CEO of a tomato processing company that sold their products to restaurants through food service channels.

Bob Jaunich was an experienced CEO in both private and public companies who had come up through the marketing ranks in the consumer packaged goods business, starting with Procter & Gamble. Bob has since gone on to run several multibillion dollar companies.

Gary Rogers was an entrepreneur who got into the restaurant business following Harvard Business School and a tour at McKinsey Consulting. He had recently executed an LBO with Dreyer's and Edy's Grand Ice Cream which he subsequently built into a multi-billion dollar business and the preeminent ice cream company in the U.S.

Mike Berolzheimer had started Duraflame Log Company which he developed and recently sold to a large Fortune 500 company. Mike was an excellent marketing thinker and a sound strategist.

Bob Smelick, who represented First Boston in the LBO, was a seasoned investment banker with excellent perspective about business in general. Jerry Clark, who represented The Met in the LBO, was a good complement to this group as well.

This was an all-star lineup that a little company like ours was very fortunate to have. We didn't recruit them for their credentials. We recruited them because they were the best and the brightest we could find in each of their respective areas of expertise and they were better and brighter than we were. As it turned out, for no reason other than the above, the board of our small company had four MBAs from Harvard Business School, one from the University of Chicago and one from Wharton. I must say, to their credit, they never held it over their friend, Art, whose credentials included a night school Executive MBA from Roosevelt University!

We knew from the outset that it would be a challenge to keep such a powerful group motivated unless we made it fun, interesting and a learning experience for them as well as us. Our entire management team worked hard preparing for board meetings. In a way, this was easy because we were anxious to teach the board about our business so we could get their input on real problems and opportunities we faced. We found that the better we prepared them, the more we learned.

We approached board meetings with the same candor that we approached one another in our management brainstorming sessions. We were there to debate issues and learn, not to guard prerogatives or dazzle anyone with accomplishments. In spite of the fact that we had outside investors involved, who at times had different agendas than ours, we never approached an issue with anything but sheer objectivity. The board meetings, just like the company, focused on performance not politics.

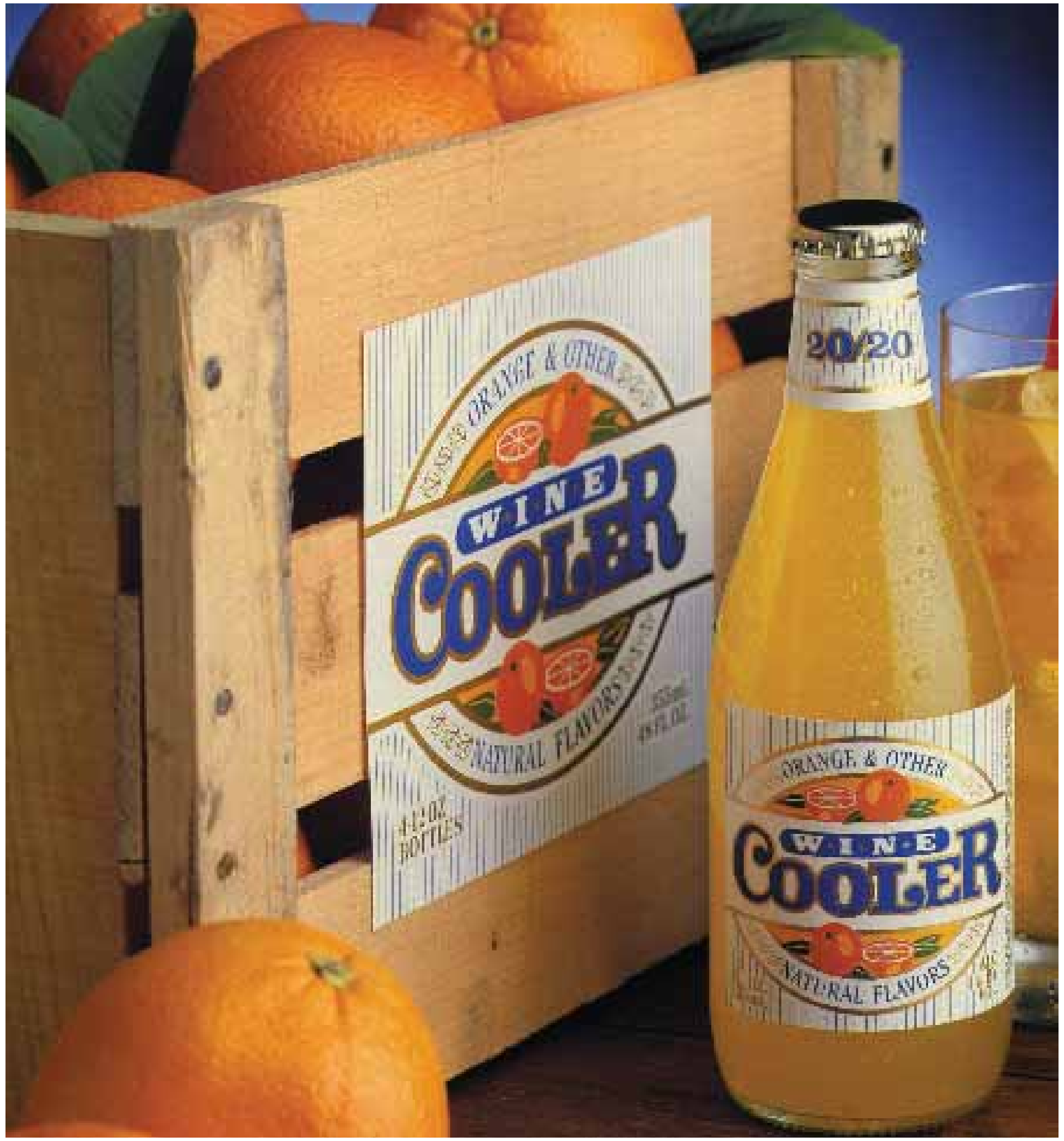
There was good personal chemistry between board members and management. We had fun at those meetings and got a lot of good input, most of which we followed. When we didn't follow the advice of the board, we always told them why and if necessary, re-opened the subject for debate. Our board members say they got take home value from the dialogue and issues we discussed. They took great satisfaction in seeing their ideas implemented and working.

This board enriched us in many respects. Not only did they keep us out of serious trouble on occasion, but they also channeled us in constructive directions, especially with new initiatives. Our management team learned a lot in preparation for meetings by trying to anticipate the questions and reactions from such an elite group. The most important thing they did was to blast us out of our day-to-day tactical operating mode and force us to think more strategically.

Our board worked because everyone learned, grew and contributed. Today, over 25 years later, we are all very good friends. We see each other regularly and still seek each other's points of view. Some of us are still together on one board or another and we are having even more fun brainstorming and solving new and different problems–most of which have little to do with business.

CHAPTER VI ADDING VALUE THROUGH INNOVATION

FIRST TO THE PARTY WITH A NEW TWIST



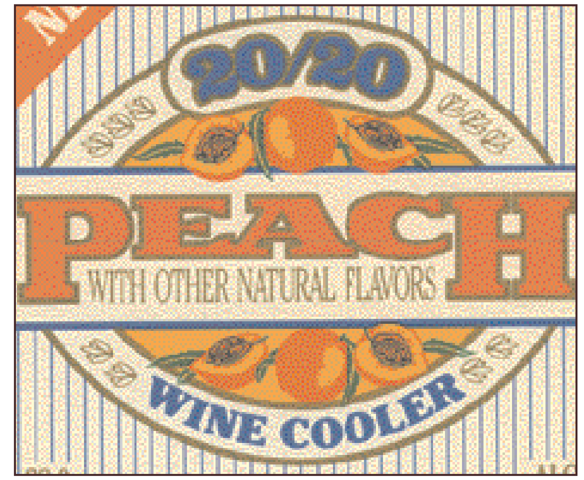
Building a business is a long, slow process. Building a traditional business is even slower. Our portfolio needed something big with explosive volume – something nontraditional. We needed something new to fuel growth that would allow us to outpace the industry. We loved being heretical and now we could finally afford to swing for the fences.

We had been successful by understanding marketplace trends and getting in front of them. The status quo favored our big established competitors. Change favored us because we were faster, more nimble and had more to gain from new trends. We could maneuver because we were small. We were David and our competitors were Goliath. The consumer marketplace was increasingly more dynamic. New trends and fads were common. Latching onto the right one, at the right time could revolutionize a small business like ours.

One of the trends that seemed unstoppable at the time was wine coolers. Two entrepreneurs, operating out of a garage in Stockton, California, developed a product called California Cooler. Within a few years, it had become a 20,000,000-case business by offering wine consumers a single-serving low alcohol (4%), carbonated beverage that tasted like lemonade. It was, in fact, made with lemonade and white wine. Unfortunately for them and fortunately for us, it looked like dishwater. We knew if they could do it, we could do it better. And that's exactly what we did.

Our concept was to offer consumers a new and different taste with superior visual and appetite appeal. Since we were not planning to advertise, we decided to show off our unique difference at the point of sale to attract consumer trial. We shared our thinking with our product development team and suggested they work on new tastes that could be produced with distinctive but clear colors, avoiding the cloudy dishwater look of the California Cooler brand.

Within a few days, our production staff had come up with several alternatives. The orange cooler was the best one. It tasted exactly like carbonated orange juice. But instead of looking like dishwater, it also looked like orange juice. It not only tasted great, it looked great! Most of all, it looked different! Armed with a unique flavor and superior form, we introduced it in a snappy 4-pack carrier



under a name that was well-known and carefully segmented and targeted. The 20/20 name made distribution into stores easy and the unique color and form propelled the product of the shelves. The 20/20 Cooler was an overnight success for TWG and sales and margins were staggering.

The orange flavor was such an innovative breakthrough that it propelled our sales to over 1,000,000 cases in the first year. We were flabbergasted! None of us had ever experienced a new product that catapulted to success so quickly and certainly not one so profitable. We were almost irrationally enamored by it, not because we created it, but because of what it could do for a new, highly leveraged company. At margins of $5.00 per case, it was our most profitable item and the perfect cash flow vehicle to pay down debt.

The fact that it was huge for us and had less than a 4% share of market caused our imaginations to run wild. What if it grew to an 8-12% share of market? Or even 16%? Within no time we were calculating production maximums and developing a television commercial that would really put it on the map! We were so excited we nearly neglected the upcoming board meeting.

Events were unfolding so rapidly that, in our euphoria, we were having trouble objectively processing and evaluating data. We were so busy racing to make our next move that we failed to accurately evaluate what our competition was doing. When we finally got around to assessing the competitive data to prepare for the board meeting, we counted almost two dozen new cooler brands headed to market.

Behind these brands were the most powerful companies in the wine, spirits and beer business, Gallo, Seagram's and Anheuser Busch. Furthermore, trade rumors suggested two of them were planning television advertising budgets in the range of $20,000,000, which exceeded the total revenues of our cooler.

Early in the board meeting, we presented a situation analysis of the cooler category and our marketing plan. Although this plan was not quite finalized, we showed the board a TV commercial in storyboard form that we liked a lot. That's when Mike Berolzheimer, one of the directors, took the floor. He said our cooler was an early stage product that captured big, easy profits because it was first to tap into a new niche. He argued that we should protect those profits, not by running with the big guys, but by keeping our expenses down and harvesting profits as our competitors waged World War III on national television. Everyone in the room jumped in and a "no holds barred" debate ensued.

We were marketing people and brand builders. After seven years of retrenching and building a foundation, this was our first real chance to register a marketing hit with the potential to be a successful brand. In the beginning, management was united in favor of building the brand while the board was divided, half were in favor of building and the other half were in favor of harvesting profits. As the arguments were advancing, the momentum shifted away from brand building and toward profit harvesting.

In the end we concluded that Mike was right. Even though our high hopes for the brand were disappointed, nobody was hurt or defensive. We were all there to take advantage of the great minds in the room and chart the best course for the company. Without another moment's hesitation, I turned the direction of the discussion and asked everyone what they thought the best harvesting strategy was.

We decided the best course was to operate in smaller, more practical niches while the big guys were focused on unseating California Cooler and building their own brands. We used our imagination to be the first to roll out unique, novelty flavors. We were ready for the competition. When they emulated our orange, we introduced the first strawberry flavor and followed with raspberry, peach and tangerine. We extended the life cycle of our brand and by using creativity instead of advertising and promotional dollars, we maximized profits.

In retrospect, letting coolers die a slow, controlled death produced fabulous profits that enabled us to pay down debt and de-leverage the company at a critical time. Had we bet the farm and succeeded, I'm not sure our returns would have been much larger. Had we bet the farm and failed, we might have lost the company.

Part of what helped us reach this decision was a very constructive board dialogue. We were fortunate to have a board that valued strong debate and didn't confuse differing opinions with lack of respect. This board understood us and our business. They were involved and they cared deeply about our success. As a result, they were invaluable. The great cooler debate is just one example of that.

One of our competitors, Canandaigua Wine Company, decided to take the opposite approach with their Sun Country Cooler. They launched a heavy TV fight in order to get their brand seated prior to the competitive onslaught. Initially, it looked like a success, but in the heat of battle they became the first casualty. Although they sold millions of cases, it was done at a huge dollar loss per case. This unwise decision not only set them back but could have cost them the company.

STAYING A STEP AHEAD

One of the most effective ways we drove profits in the mid-80s was to apply our new product development capability to other products in our line – which benefited by having something new to offer trendy consumers.

While Gallo and Seagram's were attacking the flavored wine cooler category, we moved ahead toward the next niche by capitalizing on two of the hottest trends in the industry at the time. Flavored wine coolers were on fire in the beverage category while White Zinfandel was becoming the "in drink" in slightly more traditional wine circles. It was especially popular among newer and younger wine consumers who were trading up from coolers. We seized the opportunity for the perfect trade up by offering the first low alcohol single-serving, carbonated White Zinfandel drink. The Franzia White Zinfandel Real Wine Cooler was born!

It was an immediate success. It gained distributor, retailer and consumer support instantaneously. Sales ramped up from 100,000 cases in the first year to over 1,000,000 four years later. Because this cooler was more like wine and less like soda pop, it grew slower and sustained itself longer. It was a smaller less trendy niche than flavored wine coolers, and Franzia was able to dominate the trend for the cooler's entire 10-year life. At a particularly vulnerable point in the lifespan of our profitable new product, we blocked all competition for two years.

It took more than flavor innovation to maintain our 100% market share of this category. It took extremely good field intelligence in the grape marketplace, superb grower relations and the willingness to take calculated risks. We were able to eliminate competitive entries during the most profitable period in the life cycle of this product by buying up all the surplus White Zinfandel grapes and depriving competitors of any supply.

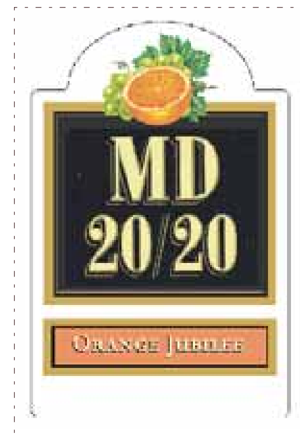
These trends were visible for the whole world to see and exploit. We were simply more responsive to them than anyone else. The Franzia Real Wine Cooler worked because we identified and innovatively capitalized on a developing trend first. We kept it working by cornering the excess grape supply before anyone else could lay claim to it.

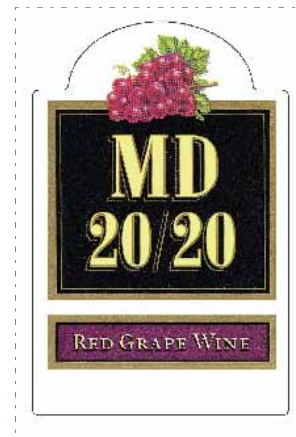
A NEW CHANGE TO AN OLD LINE

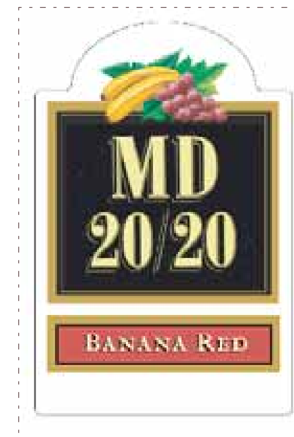
Before the flavored wine phenomenon faded, we found one more way to capitalize on it and invigorate yet another product line. Our MD 20/20 brand was losing market share to its two strong competitors. It needed something new and dramatic. Nothing fresh had been introduced in years. Our two larger competitors were content with the status quo, given their dominant positions. Innovation favored our low share of market position. If we could shake up consumers with something new, perhaps we could coax some of them to buy our brand.

Orange juice-flavored, low-alcohol wine worked to sell coolers. Why not give it a try in a more traditional wine? Our new introduction, Orange Jubilee, was an instant winner selling nearly 1,000,000 cases in the first year and nearly 6,000,000 over the next decade. By now we knew how to keep consumer interest in our line high with new flavors. When Orange Jubilee slowed, we introduced Strawberry and then Kiwi Lemon, Banana Red and others which on a combined basis nearly doubled Orange Jubilee's sales.

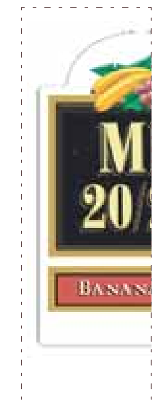
Our strategy helped bolster sales and relevance of the line at a time when it might easily have slipped out of contention. Instead, we turned the MD 20/20 brand around and gave it not only a permanent place in the category but a permanent place as another important TWG annuity brand.












INNOVATION AND INDEPENDENCE

In the period from 1984 to 1994, those imaginative ideas resulted in new sales of over 20,000,000 cases of highly profitable coolers and flavored beverage wines with margins of nearly $5.00 per case. No single move helped to de-leverage the company more or guarantee its financial success.

Sales Volume of TWG Flavored Products (in cases)

	Coolers	Other Flavored	Total
1983	00	115M	115M
1984	916M	246	1,162
1985	1,801	386	2,186
1986	1,804	1,050	2,854
1987	1,322	1,007	2,329
1988	858	1,265	2,123
1989	617	838	1,455
1990	412	1,200	1,612
1991	273	1,073	1,346
1992	227	1,571	1,798
1993	195	1,808	1,808
1994	173	1,358	1,531
Grand Total			20,319 MM

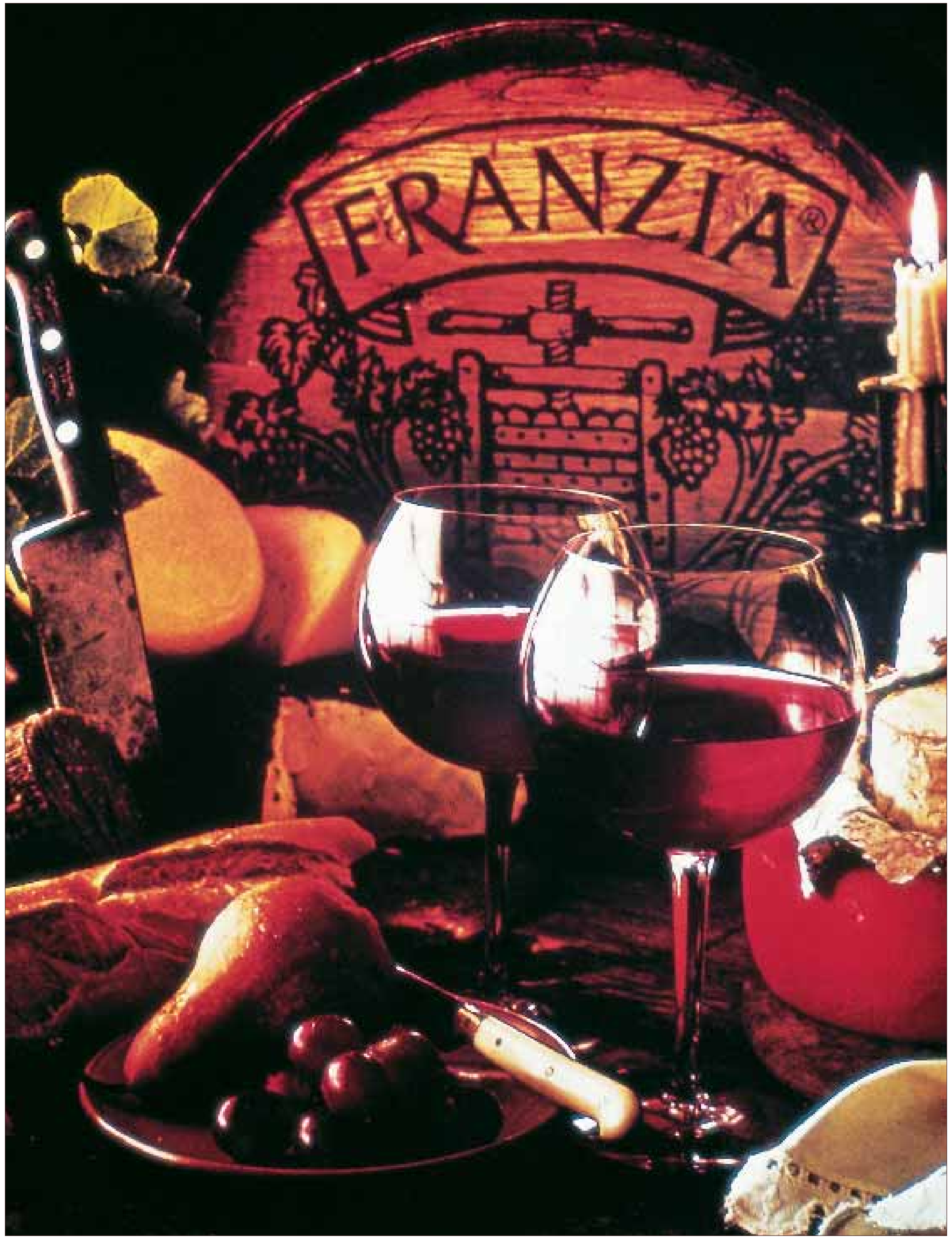
New brands, new products and new ideas are the life blood of our business. For a 15-year period until the early '90s, between 25% and 35% of the company's margin dollars came from products that didn't exist five years earlier. For years, we scoured markets around the globe for new trends, fads and ideas. In order to encourage thoughts from all corners of the company, we promoted the belief that there are no bad ideas. We encouraged our people to position themselves for success. We especially liked new product ideas that played to our strengths and capabilities. If a new project failed, we never dwelt on it or punished ourselves or our people. Instead, we moved onto the next new opportunity to start the process over again. Unlike many of our competitors, we never hung on to a loser.

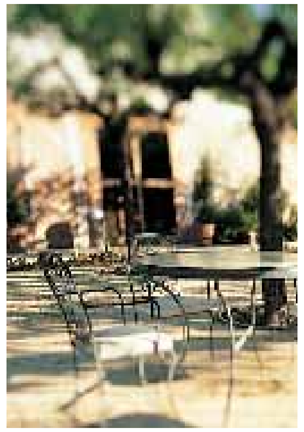
There is a quote by Louis Pasteur, who said, "Chance favors the prepared mind." Maybe that's why we had such a streak of good luck in the mid-80s. Maybe we positioned ourselves to be lucky by understanding what the consumer wanted and positioning the company to offer it sooner and better than others did.

WINE FOR THE MASSES, NOT THE CLASSES

A colorful story sticks out in my mind. It helped me form my opinion about how I really feel about wine and my role in the industry.

One Friday night, some friends invited Carlyse and me to a black tie event in San Francisco. It was being thrown by The Les Amis du Vin, a prestigious wine society. After a lovely dinner, our small group launched into our fourth different bottle of wine, saving the best for last, of course. I'll never forget my reaction as






two friends stood swirling glasses of a big name, high-priced Bordeaux, extolling its virtues of color and clarity.

To put this into perspective, that day TWG had shipped 100,000 cases of orange wine cooler, cases that would be distributed into supermarkets and liquor stores all over the country. Literally millions of people would be sipping them soon. I thought about what it would take to sell an equivalent amount of French Bordeaux. How many pretentious restaurants with stuffy wine sommeliers would we have to court to get them to carry our brand? How much butter, cream sauce and gravy would we have to eat with all those overpriced mediocre meals to convince them that our brand was right for them? One is too many to consider! That's not what I believe wine is all about. Wine should be available and appreciated by anyone who has an interest, not just for the self-proclaimed elite who believe they're in the know.

That night while swirling that particular French Bordeaux, I learned a lot about myself. I realized that my view of wine was at odds with *Les Amis du Vin* and I learned that I would not trade my role in the industry for all the Bordeaux in the world. To me, what makes the business fun and exciting is the dynamic, ever-changing, volatile, mass market with its hot trends and fickle consumers. It's a market where change is your ally and entrepreneurial risk-taking can be handsomely rewarded.

Clearly, a good French Bordeaux deserves a well-respected place in the industry. But I wish it would enjoy that place without the pomp, circumstance and exclusivity it has garnered now. Good wine is for everyone to enjoy according to their own tastes and within their own comfort zones. Wine is a simple drink that has been around for centuries. The ability to make good wine is both an art and a science, but not rocket science. There are thousands of excellent winemakers around the world. To perpetuate the myths and pretentious social barriers is a shame because it prevents good wine from being shared with the world.

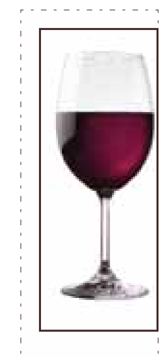
A great example of perpetuated myths is the "aging myth." While it's true that some wines improve with age, most do not, especially white wines. And yet many expensive new homes built today are equipped with extensive wine cellars. The good news is that the industry gets a surge in sales as these cellars are stocked. The bad news comes years later when much of this wine has gone off condition but is served anyway by a proud and unsuspecting host. In most cases, the truth is everyone would have been better off if the host had purchased the evening's wine at the nearby Safeway the day before. It is unfortunate that a lot of the deception about wine is promulgated by people on the fringes of the industry to justify their own existences.

TWG has tried to debunk some of these myths. In doing so, we hope Americans will follow the European trend of drinking what they really like instead of what they're supposed to like. The Wine Group has spent 26 years expanding the wine business by making wine more broadly appealing in taste and price. We have introduced unique new products and we've made wine more convenient to pour, store and carry. We've lowered the price to make it more accessible to a broader range of people. At every turn, we have had to break down insecurities fostered by false mystique, self-important imagery and nonsensical wine rating scales.

In spite of it all, our brands and products have prevailed and brought hundreds of thousands of new consumers to wine, many of whom will one day enjoy a fine Bordeaux and hopefully appreciate it for what it really is.

BANKERS BACK OUT FOR BONUSES



Wine coolers and flavored wines accelerated our financial performance by light years. By the early 1980s, we had a strong enough balance sheet to start eyeing acquisitions. We were even positioned to do a recapitalization. Things could not have been going better until I received a critical phone call from The Met. They wanted out of the deal, now.

It was just three years into our life as a private company and The Met wanted to liquidate their position. That wasn't our agreement. In the 11th hour, before the deal closed and without the ability to document it, I gave Jerry Clark, the lead man at The Met, my promise that they would have a liquidity event at the end of five years.

Only three years had passed and we were deep in acquisition talks with Manishevitz. We were extremely excited because we thought they were a great fit for us. I told Jerry I would honor my commitment, but reminded him of the five-year timeframe. He didn't care. That's when I learned another valuable lesson about public companies and big lenders. They were investors, purely investors, not owners even though they called themselves owners. The distinction between the investors and owners was never clearer. The owners wanted the company to be successful, the investors only wanted to maximize their return on investment.

As it turns out, our performance was so extraordinary that The Met's internal rate of return was higher after three years than it was projected to be at the end of five years. Because The Met was having a poor year and personal bonuses hung in the balance, it was in their best interest for the short term to get out. If Jerry and his people could affect a transaction during this particular year, their bonuses would be much higher than if they stayed in longer.

It got nasty. We begrudgingly abandoned our plan to acquire Manishevitz and bought out The Met at a fraction of the price they would have received if they'd played it straight and stuck to the five-year commitment. But the hired guns at The Met needed their bonuses so they could be happy for one more year.

In retrospect, buying back half of our company at a discount was an even better deal than making that acquisition. We owned the company outright and had no one but ourselves to answer to, no financial investors, no investment bankers, nobody. In spite of the fact that these people brought a certain discipline to the board, we operated better without them. The last real constraint was behind us. It was time for another bold initiative.

CHAPTER VII

THE FRANZIA WINETAP®

BRAND-BUILDING AT LAST

It took eight long years to position the company to begin developing brands in the early ‘80s. Fixing operations and the commodity side, slowly building distributor channels, getting the organization and the financial picture in place had taken priority.

From the outset, we envisioned a complete company, one that would evolve from an agricultural, production-driven company into a company with strong brands and pricing power. We approached the business of building traditional brands with the same approach as we had with wine coolers. We knew the old paradigm would not work and we needed to take a leadership role with something new and innovative.

DISCOVERING THE "BAG-IN-A-BOX"

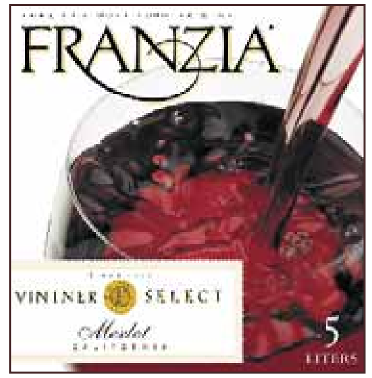
After eight years of competing on a playing field that was tilted against us, we knew the only hope for lasting success in our own right was to come up with something different. For years we’d tried to compete in the traditional large-size glass business with the Franzia brand, but we were always smothered by competitive pricing that we could never comprehend or match. We knew competition had a cost advantage because when we sold at their prices, our profits were unsustainably low. However, we didn’t know the magnitude of this disadvantage.

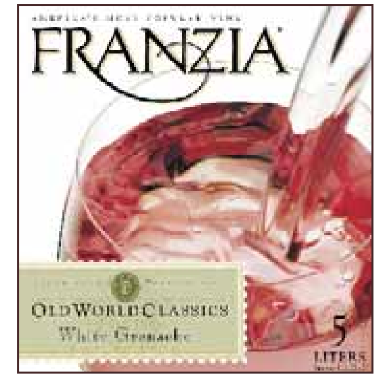
Some light was shed on the matter when we were divested from Coke-NY and Owens Illinois discontinued the corporate discount we had been getting to purchase their glass. They said, “You’re no longer a division of a national company. We’re going to take away your national discount.” That was a big deal because it was the only thing that offered the chance for us to competitively price our wines.

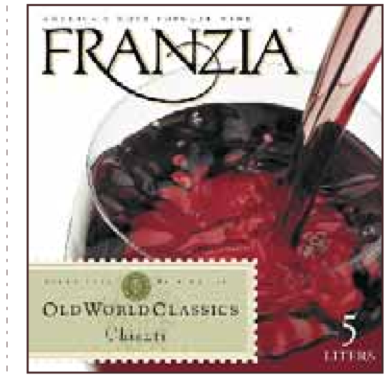
Losing the corporate discount affected us to the point where Franzia had no hope of competing profitably in large sizes, three and four liters. At the time I resented it. I saw it as a slap in the face and a “no confidence” vote for our new company. But now I think it was just the jolt we needed. It was obvious that we could not be competitive without the discount, especially against competitors who self-manufactured glass.

Perhaps we owe Owens Illinois a “thank you” for that wake up call.* It was urgently necessary for us to find an alternate form of packaging that would put us on even footing with our competition despite their advantage. We knew we had to come up with something that would give us an edge.

* Owens Illinois’ decision to take away our corporate discount ultimately resulted in hundreds of millions of cases of wine being produced in plastic and cardboard instead of glass. What poetic justice! I wonder what that smug sales manager who delivered the news thinks now. I’ll never forget the look on his face when he told us he was taking away our discount. Little did he know that he inspired the Winetap® innovation that would impact the industry and change our company forever.







We soon discovered a revolutionary form of packaging that would become the key link in reinventing the Franzia brand. We had been tracking a concept that had been introduced in Australia several years earlier. It was called a "bag-in-a-box" and was simply a plastic bladder inside a cardboard box that had a spout enabling wine to be poured. Although it was successful in Australia, it faced challenges in the U.S. The bag-in-a-box monopolized the three- and four-liter size market because Australia's small population made it economically unfeasible to produce glass bottles larger than a one liter size. In the U.S., large size glass jugs already owned 35% of the market so there was no reason to believe the bag-in-a-box would work here.

We weren't the only ones tracking the concept. Geyser Peak Winery in Sonoma, owned by a large grape grower, Henry Trione, was also evaluating it. Geyser Peak was motivated to adopt the idea because they saw it as a high volume vehicle for liquidating grapes and wine they otherwise couldn't sell. It served them well for this tactical purpose but it wasn't a good long-term strategic fit. They were an inefficient, high cost producer in a value market. They simply weren't profitable. Summit, Geyser Peak's product, turned out to be a useful test market for us. We tracked it carefully and quickly concluded that it not only had potential in the marketplace, but that it fit our needs and capabilities perfectly.

We knew we could make wine more efficiently than most, but we needed to learn how to buy, package and ship the new package efficiently. There was no better place to learn this than Australia where they had already been doing it for years. Carlyse and I had already scheduled a trip there so after our visit to Melbourne, we toured dozens of wineries, three of which specialized in bag-in-a-box. The Australians were incredibly accommodating and generous with information. It was an accepted practice throughout the worldwide wine community at the time to share technical information that would improve overall wine quality. The Australians knew what they were doing. This trip set a high standard for our performance and advanced our knowledge by years.

In some ways it was too good to be true, but it was no slam dunk and would take years to pioneer. The advantages were mind-boggling, but so was the challenge of making this *déclassé* packaging socially acceptable and the smart choice to the wine consuming public. What a monumental task for a small, newly formed private company. Nonetheless, the Franzia Winetap was born!

We were bolstered by the overwhelming competitive advantages this new concept offered and the way it perfectly fit the unique position in the industry we had carved out.

Competitive Advantage #1:
Shelf Dominance

TWG's sales force was outnumbered by competitive giants that could overpower our organization in stores and subordinate our products to the point where consumers couldn't even find them on the shelves. But this box of wine was too big and dramatic to hide. It was 11 inches by 7 inches and created a huge billboard when shelved in multiple facings. Even the biggest competitive army couldn't camouflage this.

Competitive Advantage #2:
Consumer Value

The Winetap's consumer benefits were far superior to competitive glass jugs. It was simply a better value. Winetaps were less expensive for us to produce and we passed the savings on to our consumers. Additionally, our wine quality was better. It was better because Franzia was our most important brand and therefore got our most important wine. Our competitors had a higher and better use for their best wines which left their jugs with the lesser quality product.

Competitive Advantage #3:
Consumer Convenience

The Winetap was much more convenient than glass jugs. It was easier to carry, store, pour and it was unbreakable. Most importantly, it stayed fresher longer after opening. Wine in large bottles oxidized after they were opened because the air in the headspace came in contact with the wine. There was no room for air in the pouch because it collapsed around the wine as it was decanted into a glass.

Competitive Advantage #4:
Barriers to Entry

Competitive glass plants were ultra-efficient when run at high, steady volume and inefficient at low volumes because unit costs increase when volume declines. That's what our competition feared most about the Winetap. If they adopted their own, it would cannibalize their jug volume, drive their costs up and erode their glass manufacturing advantage. The best way to blunt the Franzia Winetap was with competitive entries, but their entries would undoubtedly cannibalize their established jug sales and render their glass manufacturing inefficient. Worse yet, it would endorse and lend credibility to a concept with consumers that would hurt their glass jugs.

Fortunately for us, they elected to disregard the concept rather than become part of it. This made our job more humbling and tough. In the long run, we were better off without them. We could build primary demand for a new category, our way.

A parallel situation was developing in the brokerage industry. In 1981, when Charles Schwab entered the discount brokerage business, Merrill Lynch had a choice. They could erode margins and block Schwab by competing head on or they could disparagingly sit on the sidelines. Fortunately for Schwab and Franzia, our competitors chose to ignore our strategy or neither of us would be where we are today.

PIONEERING A NEW CONCEPT FOR WINE

Some believe that if you make a better mouse trap, people will beat a path to your door. That wasn't the case with the Franzia Winetap. Establishing the Winetap brand was just plain hard work and it took a solid 10 years to make it successful. It was a bootstrapping effort for a small company with limited resources and we leveraged every advantage we could find. This was our first big chance and we intended to capitalize on it.

The package itself was an advantage. It was physically large to begin with and we asked our graphic designer to make it look even bigger visually. He created a huge photographic rendition of an oversized wine glass that wrapped around the side of the package. Not only was it bigger than life size, it looked even more appetizing than real wine. The glass was dripping with precipitation and looked good enough to drink then and there. I think it even intimidated those competitive salesmen whose intent was to kill it!

The Winetap was a novelty at parties – people were curious. They passed it around and scrutinized its unusual characteristics. We learned this from research and saw it as a huge opportunity. Our marketing people seized the chance to drive home the consumer benefits on the spacious side panels.

Franzia's biggest competitive advantage against glass jugs was value. We exploited an additional weakness of the glass jugs, namely that they were constrained by size to four-liters or less. Winetaps could be any size. In fact, they became more efficient to bottle and ship as the size increased. As soon as we realized this, we increased the size of Franzia to five-liters and applied a huge violator to the front of the package that read "FIVE LITERS FOR THE PRICE OF FOUR."

This change alone doubled the rate of sales out of stores. The Franzia Winetap was growing smartly in response to innovative packaging, point of sale promotion and sales push. Growth was solid but not yet breakthrough.

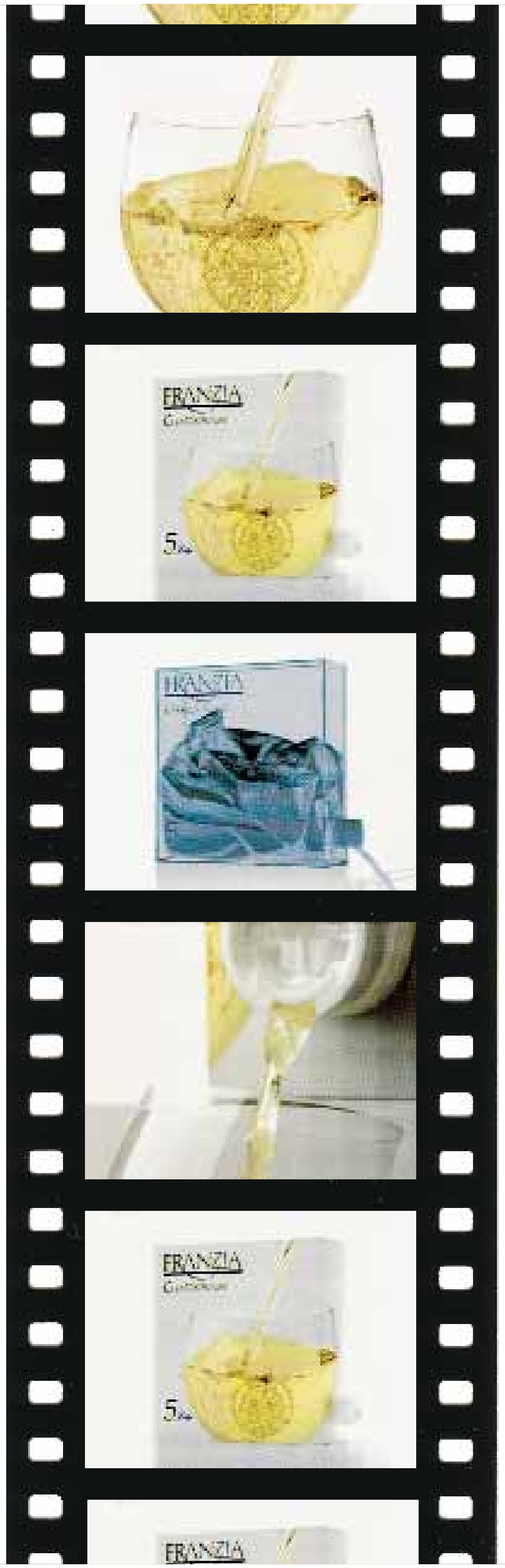
The opportunity to take growth to the next level came as a result of the expertise our people had developed with grape supply cycles and the commodity aspects of the business. This was coupled with keeping close tabs on consumer trends and Franzia brand trends. An oversupply of grapes was developing as a result of recent planting of varietals like Chardonnay and White Zinfandel. Our marketing people market-tested these varietals as part of the Franzia line with excellent results. We had an information advantage. We knew we could sell a lot of Chardonnay and White Zinfandel in our five-liter Winetap.

It was time to take another calculated risk by purchasing a large supply of grapes. We sent our buyers out early with instructions to latch onto every ton of Zinfandel and Chardonnay they could get their hands on. We knew by doing so we would preclude competition from a large-size varietal entry for more than a year, thereby giving us an unimpeded free run at the market. Offering prestigious varietals in the Winetap format brought instant credibility to Franzia and sales surged to a new level. The brand now had momentum that was being recognized throughout the industry. It was becom-

ing a competitive threat and our adversaries were exploring entry points. Fortunately, by cornering these grapes, we were able to block competitive entries for at least a year.

Wine is an image-intensive product. Perceived value frequently influences purchase decisions more than demonstrable value. The truth is that people taste price, imagery, packaging and ambiance more than berries, cherries and pineapple. This aspect of wine posed a huge challenge in marketing it in a plastic bag and cardboard box. How would we ever get consumers past the perception of the packaging to the reality that the wine itself really was good? And in fact *better* than comparable products sold in glass jugs?

It was time to solidify our brand in the minds of consumers or lose out on a concept we had pioneered at great expense. My friend, Jack Trout, had inspired me with several of his books on marketing. One I will always remember was called *"The 22 Immutable Laws of Marketing."* The first chapter in particular, entitled the "Law of Leadership," left an indelible mark on me. It stated, "It is better to be first than it is to be better." In other words, the first brand in the marketplace has the opportunity of becoming the first brand in the minds of consumers. Said another way, the first brand could become as synonymous with the category as Kleenex had become to tissue paper, and Xerox to copiers.



"WINES THIS GOOD MUST BE GUARDED WITH CARE."

"THAT'S WHY FRANZIA COMES IN AN..."

"...AIRTIGHT POUCH THAT PROTECTS THE FRESH TASTE..."

"...TO THE LAST DROP."

"MAYBE THAT'S WHY IT'S AMERICA'S FAVORITE WINE..."

That's what we wanted for Franzia. It became our unalterable goal. Although we were still heavily in debt, we believed we could free up enough money to explain the Winetap concept broadly through advertising and we could put the brand on the map.

It was a big risk. Some suggested it was almost a "bet the company" risk, but it was one we had to take, given what we believed was a short window of opportunity. We bit the bullet and developed a TV commercial. It showed how the package and the airtight pouch inside protects the fresh taste of Franzia to the last drop. It concluded "Maybe that's why it's America's Favorite Wine."

We purchased a national TV schedule. It worked! The National TV campaign brought Franzia instant credibility. Consumers reasoned: if it's on national TV, it must be good. More importantly, it must be socially acceptable to buy since it's on national TV.

Once we achieved scale, it was important to capitalize on it by doing what others couldn't, namely capitalizing on freshness one more way. Because of Franzia's scale, our products flowed through distribution channels to consumers faster than competitive products. As a result, our product itself was fresher and never old or off condition as were many competitive products. In order to communicate this product quality advantage to consumers, we flagged each package: "This wine is best when it is consumed before (09/02/xx)." Freshness dating was one more way to communicate to consumers that our product was fresher and therefore superior to competition because it was always available to drink well before its expiration date. If slower moving competitive items copied this strategy, they would either be forced to spend a fortune buying back their off-condition product from retailers because they didn't sell it all, or their brands would be exposed as old and outdated.

Keeping oxygen out and freshness in so the wine would be good to the last glass, is what the Franzia Winetap stands for. It was an ideal way to underscore the advantage of the packaging concept itself and the Franzia brand in particular. Freshness dating was perhaps the greatest strategic move we made. It forever marked our competitors as inferior.

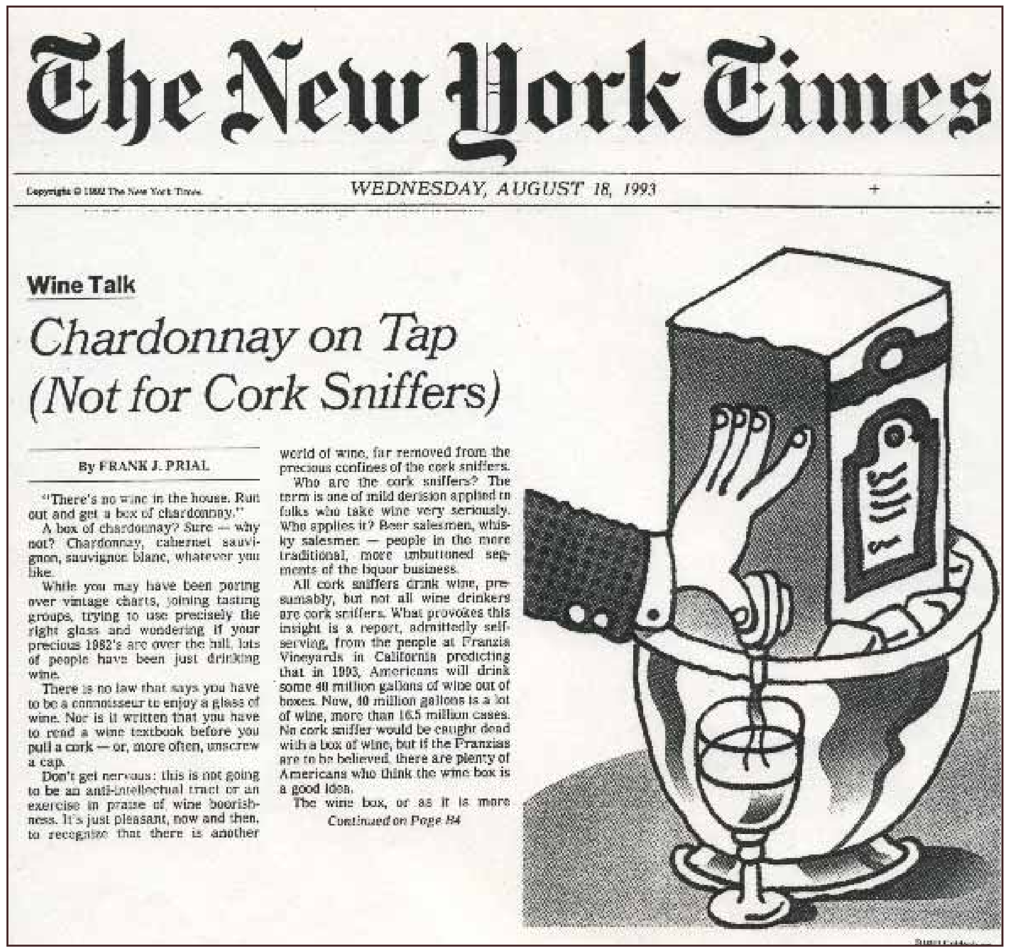
WINETAP PUBLICITY – EVERYBODY LOVES A WINNER

For years when Franzia badly needed publicity, not a single wine writer had one positive word to send to press. Afraid to take a position on a controversial matter, they chose to ridicule it to bolster their reputations.

Only one wine writer in America had the courage to tell it like it is. When we took the story of Franzia's dramatic success to Frank Prial at the *New York Times,* he "got it" instantly and ran a feature story. Within weeks, dozens of newspapers all over the U.S. syndicated the piece.

Before we knew it, wine writers around the country were endorsing the Winetap as if they had invented it themselves. Our organization, which didn't need or seek recognition, got a huge boost from this ironic twist of fate. It was great vindication for a team that had taken a lot of heat from many of these same critics.

In a little over 10 years, Franzia became the largest selling brand of wine in the U.S. – and the world! Even today, over one in every seven glasses of wine consumed in the U.S. is decanted out of the Franzia Winetap.



The New York Times

Copyright © 1993 The New York Times

WEDNESDAY, AUGUST 18, 1993

Wine Talk

Chardonnay on Tap (Not for Cork Sniffers)

By FRANK J. PRIAL

"There's no wine in the house. Run out and get a box of chardonnay."

A box of chardonnay? Sure — why not? Chardonnay, cabernet sauvignon, sauvignon blanc, whatever you like.

While you may have been poring over vintage charts, joining tasting groups, trying to use precisely the right glass and wondering if your precious 1982's are over the hill, lots of people have been just drinking wine.

There is no law that says you have to be a connoisseur to enjoy a glass of wine. Nor is it written that you have to read a wine textbook before you pull a cork — or, more often, unscrew a cap.

Don't get nervous: this is not going to be an anti-intellectual tract or an exercise in praise of wine boorishness. It's just pleasant, now and then, to recognize that there is another world of wine, far removed from the precious confines of the cork sniffers.

Who are the cork sniffers? The term is one of mild derision applied to folks who take wine very seriously. Who applies it? Beer salesmen, whisky salesmen — people in the more traditional, more unbuttoned segments of the liquor business.

All cork sniffers drink wine, presumably, but not all wine drinkers are cork sniffers. What provokes this insight is a report, admittedly self-serving, from the people at Franzia Vineyards in California predicting that in 1993, Americans will drink some 40 million gallons of wine out of boxes. Now, 40 million gallons is a lot of wine, more than 16.5 million cases. No cork sniffer would be caught dead with a box of wine, but if the Franzias are to be believed, there are plenty of Americans who think the wine box is a good idea.

The wine box, or as it is more

Continued on Page 84

STRATEGIC ACQUISITIONS DEVELOP THE CATEGORY

The Wine Group's acquisition of Summit and Colony helped build primary demand for Winetaps and develop the Franzia brand. Summit was purchased in 1985, the year Franzia overtook it in the marketplace. It had grown sharply since its introduction in 1980 while it had the market for this unique packaging form all to itself. In 1984-85, the two-year old Franzia Winetap delivered a damaging blow. Summit was owned by Geyser Peak Winery in Sonoma which gave them a pedigree and caché, but they were cost-inefficient and unable to compete with the consumer value that Franzia offered. They either had to invest heavily to change their structure with no assurance of success, or sell.

Summit was a very strategic and lucrative acquisition. TWG was able to create instant cost synergies to make it highly profitable for us from the start. We were able to generate huge margin dollars which were then invested directly in creating primary demand (new consumers) for the Winetap category. This was an easy decision since we owned the only two consequential brands. Prior to the acquisition, there were no brands capable of promotion because Summit was only marginally profitable and Franzia was a small brand spending only to drive new in-store distribution.

We immediately positioned Summit to appeal to different customers and to be as noncompetitive as possible with Franzia. Franzia was always our premium growth vehicle and the brand we wanted to protect and grow for the long term. Fortunately we made this choice early, so when competition eventually came, Franzia was strong and ready. Just to be certain, we repositioned Summit, which had already delivered 6,000,000 cases of profitable volume to TWG, as a flanker brand and sacrificed it to protect Franzia from sustaining losses to competition.

The purchase of the Colony brand in 1989 had strategic relevance as well. It was a weak and declining brand engaged in desperate moves to generate cash to satisfy its bankers. We were motivated to buy it because their poor quality product and ill-conceived pricing were reflecting poorly on the overall Winetap category and we were intent on developing that category.

This acquisition did enable us to clean up the category. There is only one thing I regret. When we controlled all of the brands in the category, we squandered an important opportunity by reserving the best name "Winetap" for Franzia and calling the others "Wine Cask" and "Wine Keg". As a result, we created confusion and a void in terms of naming and positioning the category. Our competitors, intent on disparagement, seized the opportunity to frame the issue by relentlessly referring to the category with the name "boxed wines." Unfortunately, it stuck and because that name was first in consumers' minds, it took years to change their perception of the Winetap category.

TWG, INC. WINETAPS – THE FIRST TWENTY YEARS*

	Franzia	Summit	Colony	Total
1983	90,000	**	**	90,000
1984	495,000	**	**	495,000
1985	815,000	103,000***	**	918,000
1986	988,000	717,000	**	1,705,000
1987	1,336,000	581,000	**	1,917,000
1988	1,785,000	526,000	**	2,311,000
1989	2,365,000	453,000	60,000***	2,878,000
1990	2,716,000	445,000	324,000	3,485,000
1991	2,761,000	533,000	196,000	3,490,000
1992	3,895,000	665,000	276,000	4,836,000
1993	4,462,000	622,000	273,000	5,357,000
1994	5,056,000	485,000	218,000	5,759,000
1995	5,893,000	305,000	153,000	6,351,000
1996	7,093,000	226,000	124,000	7,443,000
1997	8,020,000	83,000	102,000	8,205,000
1998	8,023,000	24,000	81,000	8,128,000
1999	7,876,000	--	55,000	7,931,000
2000	7,716,000	--	2,000	7,718,000
2001	7,835,000	--	--	7,835,000
2002	8,073,000	--	--	8,073,000
2003	8,330,000	--	--	8,330,000

*Physical cases, typically 16-20 liters each
**Owned by another company
***Partial Year Sales

FRANZIA WITHSTANDS COMPETITIVE ASSAULT

By the mid-90s, the Franzia Winetap had become the biggest wine brand in the U.S. – growing at double-digit rates and devouring everything around it. It was too big to ignore any longer and competitive entries were being planned by Franzia's two largest competitors.

Fortunately, we had a lot of time to anticipate their actions and develop a plan. Gallo was the main threat, but this time we had them in the same predicament they had us in years before when we were cost-disadvantaged with glass jugs. As a result of our scale, we had significantly lowered packaging and filling costs and our selling expenses were lower. We knew Gallo would try to undercut our pricing to get retail distribution and consumer trial. We also expected that they would try to trump our packaging and perhaps even run media advertising to support their product introduction.

We were ready on all counts. We were prepared to meet their low pricing. We knew it would be more painful for them because of our cost advantage. Sure enough, Gallo launched at "blow out" prices which we met on Day One. Anticipating Gallo's packaging was more difficult. We'd been working on improving our package for over a year and we had several very exciting designs ready to go. We could have launced earlier but we didn't want to tip our hand and give them a target to shoot at, so we waited. The minute we received early intelligence about their design, we sprang into action with the option that blunted their effort most effectively. We were able to move so quickly that the two competitive packages got to the shelf at the same time. Gallo looked like it was emulating us.

Our plan if they advertised was to make our product as prominent in stores as possible to attract some of those new users to Franzia. Given our head start as an established brand, we had the best store presence. As it turned out, Gallo's strategy was simply to steal share of market from Franzia. They had no intention of building the category because it disadvantaged their jugs. Consequently, they did not advertise. Our head start paid off. Franzia consumers were loyal and refused to switch sides. Much to the chagrin of our competitors, their entries not only failed to cannibalize Franzia as they had hoped, but also actually expanded the category. As the category grew, Franzia added one million cases in 1997 and then dug in to hold the dominant position with a 60-65% market share, which it has held to this day.

In spite of Franzia's 15 year dominance, it was, and still is, important for TWG always to remain vigilant and guard against complacency. Leading brands are difficult to unseat unless they make mistakes and allow their strategic advantages that got them to the party to erode. The best way to protect against this is for the organization to be cautious, humble and mindful of what the brand stands for.

PROTECTING THE FRANCHISE: STRATEGY AND EXECUTION

The strategic advantage that secured Franzia's position will protect and ensure continued category leadership, as long as it is constantly cultivated.

The biggest contributor to Franzia's success was the head start it achieved at becoming an established brand in consumers' minds when there was no competitive clutter. Jack Trout's Law of Leadership served Franzia well. It was "better to be first than to be better." As a result, Franzia is synonymous with the category of box wine. People hear Franzia and they think, "Wine in a box." While it is hard to displace brand images once established in consumers' minds, it's not impossible. Other leading brands have abdicated their position by allowing their brand names to be tarnished and eroded. Management's most important responsibility with regard to Franzia is to build, enhance and protect the Franzia brand name with consumers.

The other half of Franzia's success equation relates to cost-efficiency. Franzia catapulted itself into a leadership position by generating the best economies of scale. Economies of scale are driven by volume which creates purchasing and production efficiencies. Brands either climb and become more efficient or atrophy and abdicate their position altogether. The company's mission here is clear: continue to drive volume and efficiencies; avoid arrogance, complacency and hubris. Economies of scale are self-perpetuating. The more you generate, the more you have. The more you have, the less your competitors have and the harder it is for them to overcome your lead. Scale serves as a moat around the castle.

A good example of volume-generating efficiencies and economies of scale developed in the early '90s when Franzia sales were outstripping production capacity. The incremental volume was actually coming from weak competitors who were shrinking and becoming inefficient. Capturing this competitive volume stalled competitor plants and allowed Franzia to make strategic purchases. The 1992 acquisition of Sanger added 16,000,000 gallons of capacity to the existing 40,000,000 gallons (a 40% addition). The 1995 Tulare acquisition added 13,000,000 gallons and the 1995-1998 Ripon Winery expansion added 21,000,000 gallons. All total they added 50,000,000 gallons to the existing 40,000,000, more than doubling volume.

These capital expansions were the vital link to supporting the Franzia and wine cooler growth that was already bursting the winery at the seams. We made efficient purchases because of the explosive growth of Franzia and the wine coolers. Their success idled competitors' plants. As a result, we continued to put the winery in the position of being the low cost operator. These acquisitions substantially lowered capital and operating costs and further enhanced productivity.

Having a good strategy is as important as having good grapes. You can't make a good wine without good grapes, but good grapes do not guarantee a good wine. The same is true with a good strategy. It will only work with sound execution, more execution and even more execution.

The Franzia brand has one simple strategy: to offer the very best consumer wine value in America. The hard part was the execution. The better we got, the faster our competitors ran. Executing our value proposition was a continuous process of finding new and better ways to lower cost and to improve both demonstrable and perceived quality. Executing through distribution channels was also an ongoing activity. The battle for retail shelf space and position is neverending, just like the challenge to gain promotional support. The strategic advantage that secured Franzia's position will protect and ensure continued category leadership, as long as it is constantly cultivated.

GUTSY, DETERMINED PEOPLE MADE IT HAPPEN

1996 SALES MEETING AT LAKE TAHOE

The Franzia Winetap became the best selling brand of wine in America because of the gutsy, determined people in our organization who made it happen against extraordinary odds. It wouldn't have found success without them. Few organizations would have had the fortitude or resolve to stick with it through the competitive attacks, the doubting trade and the insecurity of consumers who were not strong enough to ignore social ostracism.

The adversity of the early years steeled the organization for this unique opportunity. The LBO, the union strikes, the merger, building distribution channels one by one, competitive onslaughts and critics all strengthened people's resolve. It also sharpened their understanding of what TWG was and was not good at. As we gained experience with the Winetap concept, they easily saw how it fit our value strategy, played to hard-earned strengths and disadvantaged our competitors. The prospect of playing on a level field, or one tilted to our advantage, motivated our people for the long battle ahead.

Nevertheless it was demanding, especially in the beginning. Challenges ranged from the package to shipping to storing to leaking. We were reinventing a package in an industry that hadn't changed in 50 years. Winetaps loaded and stored differently than bottles. Bag-making technology was primitive and although only one in a hundred leaked, four-liters of wine could do a lot of damage in a retail store. On top of all that, the concept was less than socially acceptable for consumers. It was open to ridicule by the press, our competition and worse yet, our retail customers.

In spite of all this, we knew that when we got it right, it worked. Seasoned sales managers like John Quinlivan, Tom Stine, Dave Mackesey, Vic Strader and John Sexton never wavered. They parlayed successful tests from one retail store to another, sometimes to entire chains or markets. They kept in close communication and passed along even the most meager success story. After a lot of trial and error, they identified and solved problems so they could arrive at a formula that worked.

Throughout the early pioneering efforts, all parts of the organization worked together closely. The marketing department eagerly welcomed suggestions from the field to improve packaging, develop point of sale material and construct presentation aids. Everyone worked feverishly to identify the cause of troublesome “leakers” and report them to Lou Quaccia so he could work with suppliers, shippers and warehouses to solve the problem. Dale Jackson and his Customer Service Department stayed on top of every problem, responded fast and usually pacified the occasional irate customer.

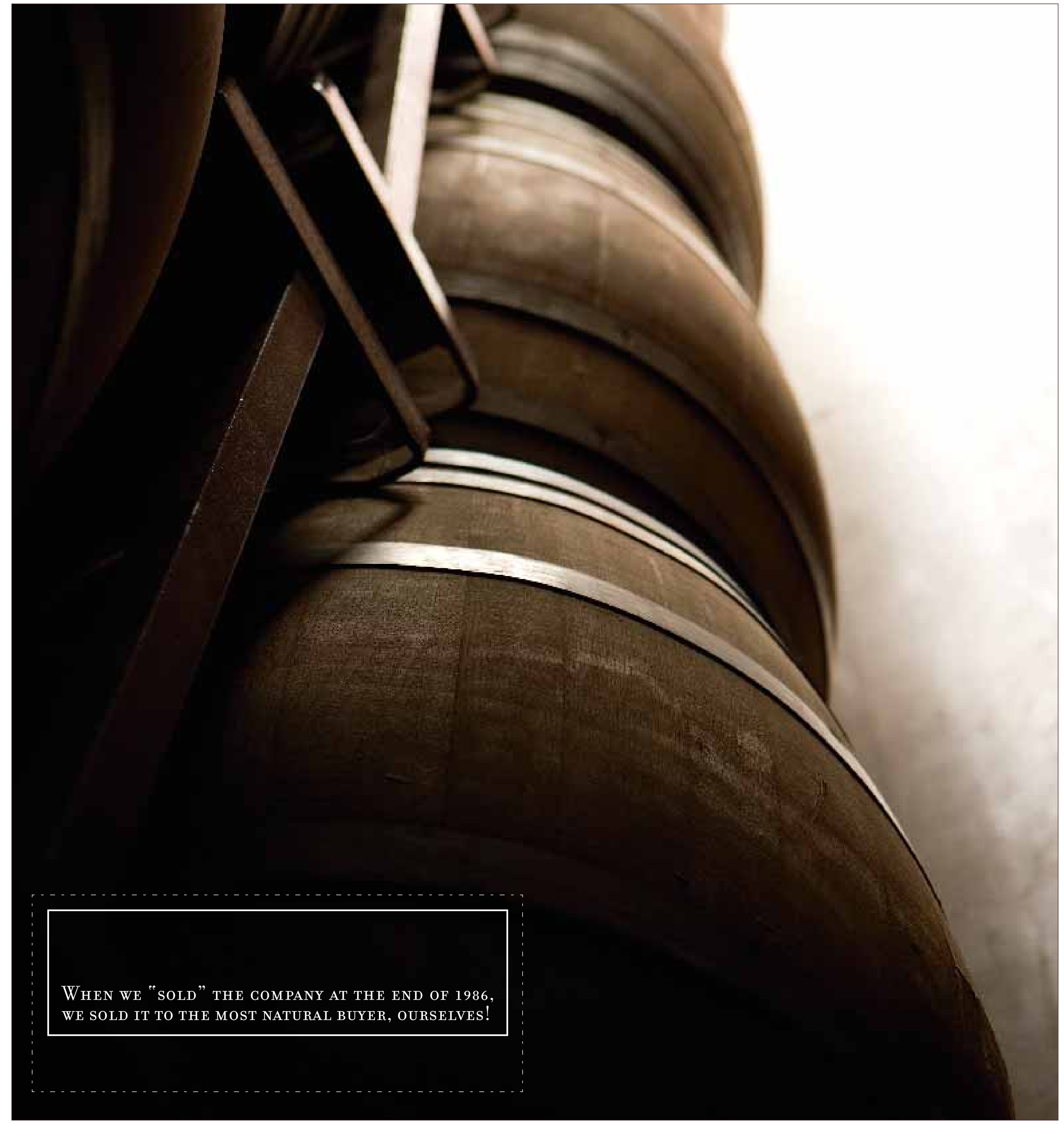
The Winetap was an easy sell to the organization. It wasn’t as if anyone in management had to motivate our people to tackle this difficult job. They got it and bought into the concept early on. They were hungry for their own brand success and saw the opportunity this unique fit offered. It didn’t happen overnight. It took 15 long years and the organization stuck with it every step of the way.

Finally, the problems receded and the successes swelled. As sales skyrocketed and the brand gained dominance, everyone who contributed to the accomplishment took pride in it, and their determination was rewarded.

THE WINE GROUP COMES OF AGE

Wine Coolers and the Franzia Winetap served as catalysts for much more than new sales and profits. They had significant impact on the development and stature of our entire company especially with distributors. We were now seen by the distributor community as an innovative and successful company with a bright future and they wanted to share in our growth. We were courted by important new wholesalers and our established ones were much more anxious to please us with their performance for our brands. One good thing led to another. It was like a nuclear chain reaction. Volume drove improved profitability and performance at the distributor level. Improved distributor performance generated new distribution, improved shelf presence and extra sales at retail on all TWG products. The success of coolers and the Franzia Winetap pulled along everything else and our entire business grew. We became even more cost efficient in the plant. Success drove morale and confidence and provided the resources to expand the organization, especially the sales organization.

By the end of 1986, our overall performance was so strong that we had an opportunity to restructure the company’s finances, pay down debt and achieve a respectable debt-to-equity ratio on our balance sheet. Although we still used some leverage in the purchase, the debt to equity was more like 2 to 1 instead of 26 to 1. This restructuring enabled my partners and me to receive a little money to get our own personal balance sheets in order and relieve financial concerns. It was a breath of fresh air that made us better people both personally and professionally. It didn’t change our passion and enthusiasm for the business. If anything, it heightened it and enabled us to become more balanced and less conservative about investment decisions. It resulted in accelerated investment in capital equipment, new product development, marketing and acquisitions, all of which positioned the company for even more success.

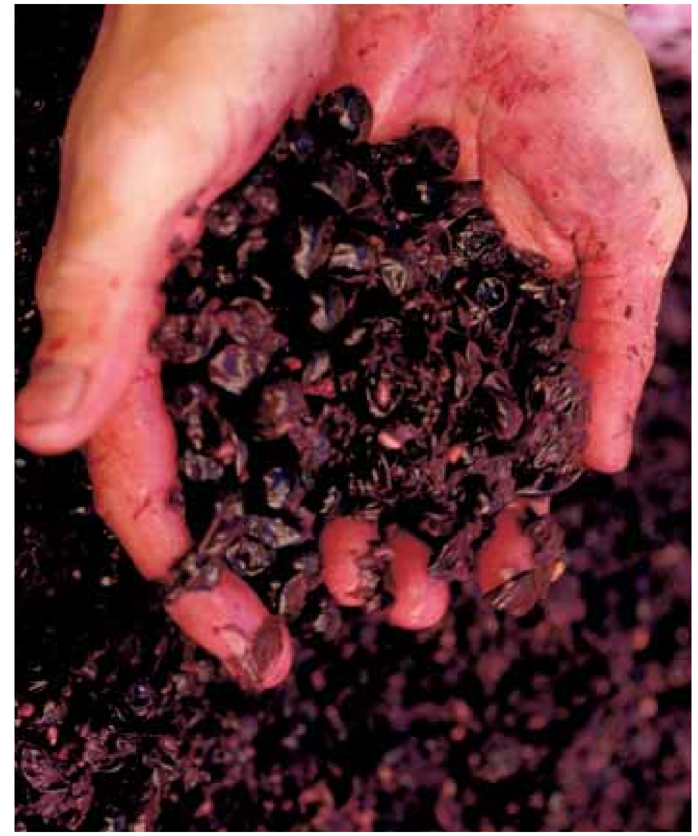


Ironically, it was exactly the timing I had committed to Jerry Clark at the time of the LBO, five years earlier. The good news for us was that The Met and First Boston were no longer partners, so when we “sold” the company at the end of 1986, we sold it to the most natural buyer, ourselves!

BOLSTERING AN ENTIRE INDUSTRY

Three innovative new flavored wines and one dramatic new package transformed not only our company but also our industry. Over the 10-year period starting in 1985, the industry was under pressure from anti-alcohol groups and overall industry sales were flat. During that same time, new products from TWG added over 20,000,000 cases of flavored wines and coolers, and 70,000,000 equivalent cases of Winetaps to overall industry sales. Some of this undoubtedly came as a result of existing wine consumers switching away from other brands to ours. But extensive research suggested that more of it came from new wine consumers who were attracted away from non-wine beverages. Wine coolers, which were only 4% alcohol, carbonated, flavorful and refreshing, attracted beer consumers. Winetaps were frequently served at large social gatherings because they appealed to a different set of consumers. Their appeal was approachability, drinkability, affordability and convenience. Never before had wine been so easy to carry, store and pour, In addition to attracting new wine consumers, research indicated that the widespread availability of Winetaps, usually in the refrigerator where it was highly visible, expanded people's usage occasions.

It's impossible to say how many new wine drinkers were created by the unique appeal of these innovations or what premium wine products they have traded up to today. It's also difficult to say how much volume was added by expanding people's usage. What is clear is that without these 90,000,000 cases of new products, overall industry sales would have been significantly lower. These innovations bolstered the industry by generating new enthusiasm for wine at a time when industry sales needed a boost.



CHAPTER X

CORBETT CANYON–CANYON–CANYON

The fighting varietal premium wine category was attractive and growing in 1988. Corbett Canyon Vineyards was a struggling little winery in San Luis Obispo, selling approximately 200,000 cases annually. It was owned by a liquor company and going nowhere.

We bought Corbett Canyon as an experiment that would test the capabilities of our organization. We wanted to learn this business and take advantage of our newfound resources. There wasn't much financial downside. What little there was, we protected against by spinning out the Shadow Creek Champagne brand and its inventory, which had come as part of the acquisition but had little value to us. This enabled us to recover approximately one third of the Corbett Canyon purchase price.

In some respects, Corbett Canyon was a little like Mogen David. It had an excellent winemaking and operations team and a brand that had a good reputation. It also had a lot of unproductive overhead expenses. The sales, marketing and administrative people had a liquor company mentality. The departments were overstaffed, inefficient and overly complex for the mission at hand. There was a bureaucratic instead of an entrepreneurial mindset. This made them unproductive and a poor fit for our organization.

In retrospect, we approached the integration and brand development of Corbett Canyon far too conservatively and cautiously. We spent over a year nurturing its people because we feared there was something special about premium wines that we couldn't risk losing. In the end it was a waste. Everyone ultimately left either because they figured out they had little to contribute, given the no-nonsense way we ran the business, or we figured it out and asked them to leave.

We were even more cautious in the marketplace as we tried to play the premium wine game with a dedicated on-premise sales force. After a year of subsidizing on-premise losses with off-premise profits, we gained enough confidence to abandon this effort. We were a volume and value wine company: selling onesies and twosies would never make practical sense for us.

The marketplace was telling us that our opportunity was in the larger, varietal, 1.5-liter business. This matched perfectly with our capabilities – larger packaging for high quality, high value wine. But we knew it would be difficult for us to succeed if we were just another premium wine brand trading off of a 750 ml image (the standard wine bottle size) with larger-size 1.5-liter bottles. We had to do something different and dramatic, again.

I always believed there was huge opportunity in specialty packaging. It gave the sales organization a device to drive distribution and spark in-store consumer recognition and trial, and we committed to this with Corbett Canyon.

The new Corbett Canyon positioning and product launch was a big, industry-wide event, planned to the last detail. The debut featured a dramatic new bottle that was square on the bottom and round at the top. Its size and value impression was superior to competition because it towered over them physically on the shelves. It was priced directly in line with competitors' pricing or less.

Most importantly, it was supported by dramatic, breakthrough radio advertising that carried one of the most memorable mnemonics in wine industry advertising history. To this day, people still remember the "Corbett Canyon … Canyon…Canyon…" echo. There is no question – this advertising worked to generate among the highest levels of recall of any wine advertising. Consumer research documented that recall. More importantly it drove consumers into stores. Within a few years, sales had skyrocketed from 200,000 cases per year to over 3,000,000 cases. The brand was en route to sales of 5,000,000 cases and seemed unstoppable.

That's when we made the mistake of our lives. We began to believe our own public relations. We thought that our brand, our advertising and our organization were stronger than they were. We got greedy and when we didn't have enough top quality wine to meet the growing sales forecast, we stretched our wine supply. When sales continued unabated and it looked as if sales were going to outstrip supply, we made the biggest mistake of all and raised prices to moderate demand. We thought consumers would understand. We thought our competition was weak. We were arrogant and wrong on both counts.

The decision to stretch the limited wine supply to meet increasing sales was made in several increments over about 18 months in several competitive tastings. Each time, we compared our current blend to a proposed "stretched" blend and evaluated it against competition. Each time, the change was barely discernible and easy to rationalize. What was missing at the end was a comparison of the original to the latest proposed change. The growth rate of the brand not only moderated, it hit a plateau at three million cases. Momentum was lost and never regained. A competitive brand captured the high ground we were headed for and never relinquished it.

I hope our organization learned three important lessons it will never forget.

First, hubris is deadly. If an individual or organization's self-perception of performance displaces reality, bad decisions will be made and there will always be someone waiting in the wings with a realistic view of how to capitalize on them.

Second, brand momentum is precious and illusive. It is difficult and costly to achieve. Once lost, it is usually impossible to regain, so when you have it, guard it carefully.

And finally, consumer loyalty is a two-way street. Consumer trust can never be violated if brand loyalty is to be maintained.

CHAPTER IX MANAGEMENT SUCCESSION

I was CEO of The Wine Group for 26 years. I was lucky to be part of one of the most exciting growth industries in America at the time. I loved the challenge and felt privileged to work with such a great team of people at TWG and in the industry as a whole. My tenure was varied and unfolded in distinct phases each requiring different disciplines. The first six years involved turning Franzia around and merging it is organization with Mogen David in order to build a business base upon which to grow the company. The next stage required financial discipline in order to execute the LBO and de-leverage the company to ensure its viability. The boom years of the mid-80s to the late-90s were the most exciting period of all. These were the marketing years when we drove our overall California business up four-fold.

During this 15-year growth period, TWG accounted for over 90% of the industry's growth and most of its new consumers. The company rose to become the third largest player in the industry (at times the second largest) and Franzia became the largest brand in the U.S. and the world.

Unfortunately, all of this came at a price. At some point around my 20th year as CEO, I believed I reached the point of diminishing returns in terms of learning and contributing. I sensed some of my original partners were in the same boat. We had succeeded beyond our wildest expectations, but we had paid a price to do so. We had lived for the business for over 20 years, and it was time to restore balance in our lives.

I was proud of our managerial team and what we had accomplished. I believe we were exactly the right team through the early development years and into the boom years. We were not the right team for what lay ahead. As clear as this is to me now, it was not that clear at the time. It was this blind spot that left the organization unprepared for the future.

I had lost perspective. One of our great past strengths had evolved into a huge weakness. Our top and middle management ranks were made up of senior people who had been doing the same job for years. We had spent a lot of time together, much of it in foxholes. As a result, we had become very close and in some respects, interdependent. This was comfortable and extremely efficient. We could do things with a fraction of the manpower of most organizations and we could do them better.

But we had become too comfortable, conservative and complacent. It wasn't a conscious decision. It just happened because the fire that drove our past achievements had dwindled. Before long, growth stopped and the company hit a plateau. A void had been created and no one was rising to fill it. There was no spark, vision or entrepreneurial zeal to drive the company forward. We were stuck and I was deluding myself, hoping someone would rise to fill the void that existed.

There is a time in the life of every CEO when he or she is too close to the forest to see the trees. It's times like this when it pays to have good friends, confidants or advisors with perspective who can help you see more clearly what you're missing. I was fortunate to have Ross Brown. Ross is an experienced management recruiter, but most of all he is a good and insightful friend who knew my situation.

From time to time in various meetings, sometimes even on the golf course, he would detect inconsistencies between my goals for the company and what

I was actually doing. As only a good friend will do, he pointed them out in a manner that enabled me to face reality. I had left a void in the company's organizational structure and it had to be filled if we were going to get back on track. Ross not only identified the void – he told me what I had to do to fill it.

I learned the hard way that succession planning is a vital area that must be managed, reviewed, and evaluated on an ongoing basis by the CEO, Advisory Board and when necessary, outsiders. It is far better to have a long-term plan and gradually upgrade it over time than to allow the organization to decline. No one is smart enough to do it all on their own. Everyone needs help and perspective, especially CEOs who have been in place for a long time.

Within just a few months of coming to this reality, I had the good fortune of being introduced to David Kent. I knew after our first meeting that David could do the job. He "got it " from the outset. He understood our strategy, positioning, competitive strengths and weaknesses. Since becoming CEO in 2001, he has grown to understand them even better.

Most importantly, he has a clear vision about how to lead the company to the next level and has assembled an all-star line-up of talent to take it there. David and his team are well on their way to bringing the company into the future. Since David has come on board as CEO, his team has made a number of very important acquisitions like Glen Ellen, Concannon and Golden State Vintners. During his tenure, sales have increased and profitability has grown dramatically.

Of greater significance, David and his superb team understand the values that contributed to the company's success and they have an even better sense of the values that will be required to achieve their goals. David and his people believe in their stewardship roles and pay a lot of attention to succession planning. They are already doing a better job of planning and preparing successors than we did and I am certain they will continue to do so. I believe the company will be much larger and stronger and there will be a third generation team in place, ready to go and well-qualified to step up and replicate the current team's stewardship responsibilities.

The culture continues to evolve to fit the changing world, but the key values that got the company here remain largely intact, as I suspect they will for a long time. Wonderful evidence of this exists in the documents David has written on values.

His first writing on the subject was called, "What Counts Factors for TWG," and his second was a refinement and evaluation of the existing value system entitled, "TWG People Define TWG Culture."

WHAT COUNTS FACTORS FOR THE WINE GROUP, INC.

First-class management.
Recruit, develop and retain the best and brightest within the industry; managers who do what they say they are going to do. Foster an “upgrade” mentality.

Enlightened ownership structure.
Provide significant equity stakes, with long cash-out provisions, held by key “members” to facilitate building strong brands and management depth for the long term. Although we must grapple with an inherent disadvantage in capital access, our structure is a key competitive advantage in terms of managing the business.

Superior price-value.
Produce wines that consistently drink a tier of quality above their price. Manage the business cycle to anticipate fluctuations in the price and supply of key raw materials at the required quality level.

Focus and constancy of purpose.
Ensure that our limited resources are deployed against those things with the most significant impact on the business, resist distraction of those resources and apply sufficient energy against each task until it is successfully completed.

Performance culture.
Work in a decentralized, but well coordinated, team effort that is results oriented and non-political.

Lean expense structure.
Improve the competitive position of our brands by keeping costs low for the ultimate purpose of improving wine quality, hence consumer value/demand. In times of oversupply, we will only make the money that our competitors spend and we don’t.

Proactive change management.
Read market cycles and expand operations through inexpensive acquisitions, continually restructure current efforts to adapt to changing environments, and integrate changes without damaging core cultural values or diminishing the value of each change.

Successful international operations.
Expand internationally to reduce the risk of being tied too closely to domestic business cycles and farming risks.

Leadership or growing market share in each segment we choose to enter.
Focus on pull brands that have a consumer-proven reason for being and sufficient mass to deliver superior price-value. Balance investment between strong brand annuities in mature segments and new brands in growth segments.

Strong balance sheet and returns on capital.
Preserve staying power to weather difficult economic cycles and competitive pressures. Always look to defer, but if you can't, invest capital wisely and reap superior returns on those investments. Maintain discipline in managing the cycle as to when to buy, sell, build, defer or walk away.

TWG PEOPLE DEFINE TWG CULTURE, TWG PEOPLE ARE:

Performance People who nurture an environment of continuous improvement and measure individual and team performance by the creation of value. They avoid pride of authorship, and personal agendas (politics) are never tolerated. Performance and politics are as antithetical as opposite ends of a teeter-totter: performance only rises as politics declines and vice-versa. Performance people demonstrate a sense of urgency, accountability, determination and measured risk-taking. They always operate with the highest standards of integrity, intellectual honesty, humility, compliance with the law and respect for others. They proactively plan for their succession by recruiting, developing and retaining the best and the brightest performers.

Empowered People who are highly responsive to the changing needs of our marketplaces (Trade and Grower). They are early adopters who embrace change and improve the odds of success through testing and experimenting to discover truth. Decisions are made by those with the best knowledge of the scope and details of an issue. Usually the best decisions result from collaborative fact finding and soliciting the very best thinking from all relevant, knowledgeable parties. Empowered people search as hard for evidence that disproves their theory as for evidence that supports it. They encourage new ideas (there are no bad ideas) and never punish failure, while being careful to avoid the same mistake twice and to minimize downside risk by always having a contingency plan.

Cost-Mindful People who understand and reinforce TWG's strategic competitive advantage at every level. They strive to improve the company's position as the industry's low-cost provider of strong brands and to ensure those brands deliver superior consumer value versus competitive benchmarks. Relative value is measured by Quality plus Perception divided by Price plus Scarcity. Cost-Mindful People challenge the status quo and guard against complexity. They instinctively question the necessity of solving a "problem" and the benefits of pursuing an "opportunity" before deploying any resources. Cost-Mindful People understand that what works for competitors (with very different business models) will rarely work for TWG.

I am hopeful that David will write a sequel to this book at the end of his tenure as CEO and after he has passed along the reigns to his successor. I believe it will be an exciting continuation of this company's story.

CHAPTER X STEWARDSHIP

Our wine industry, which is nearly as old as civilization itself, is rich in heritage, tradition and stewardship. Three Italian, family-owned wine companies, the Ricasolis, Antinoris and Frescobaldis, serve as extraordinary role models. These companies have been in the wine business for over eight centuries and have successfully polished the chalice and passed it on to the next generation at least thirty times. Today, they are all highly regarded brands among wine drinkers around the world.

As founders of TWG, Inc., my partners and I are profoundly grateful for having had the good fortune to own and lead this fine company for a brief 26 year period in what we hope will be a long, thriving future. Its history began at the turn of the 20th

Bringing the Joy of Fresh Wine
Since 1906

Celebrating 100 Years

To Your Home Each Night

Century with Teresa and Giuseppe Franzia fulfilling their American Dream by developing a successful vineyard and building a wine business that endured for 70 years. I hope our contributions to the Franzia Brand and its parent company, The Wine Group, Inc., over the last three decades provide the vision, the financial strength, cost-efficient facilities, sound distribution network and enduring cultural values to give it the impetus to survive and prosper for many generations.

The 1981 leveraged buyout offered the opportunity of a lifetime. It was a chance to test our mettle as entrepreneurs and leave our mark on an extraordinary industry in the greatest free market economy in the world. The industry and the marketplace challenged us over and over again. As we responded to the challenges and rose to face our responsibilities, we grew enormously, personally and professionally as individuals and as a team. We experienced situations we never could have anticipated. Our journey as owners and operators was extraordinarily exciting, fun and fulfilling. Now that our ownership roles are winding down, there is a sense of responsibility to offer similar opportunities for others to experience because it is our strong belief that the American Dream that Teresa and Giuseppe envisioned should live on.

We believe that there will continue to be greater and greater leverage opportunities for entrepreneurs in The Wine Group for generations to come. Private companies that add value through entrepreneurial innovation are the lynch pins of the U.S. economy and have continually outperformed all other forms of enterprise. We believe that passing on a solid private company with a strong value system to an enlightened management team is the best way to posture TWG for success in the future. In addition, we see it as our highest leverage opportunity to support the American free enterprise system.

Years ago, the easy course would have been to sell the company – we even received several unsolicited offers. It would have been equally easy to take the company public, with extraordinary payouts to the current owners. We never once seriously considered either of the options. Selling out to a competitor would probably have achieved the highest economic return but it would have resulted in the loss of jobs for a lot of valuable employees who were instrumental to our success. Going public would have been totally unprincipled, given our previously stated positions that cyclical agricultural companies don't belong in the public arena. Instead, we chose to be dedicated to investing in the growth of brands, facilities, distribution networks and an organization with enduring values.

By the mid- to late-90s, after 20 years of positioning the company to endure as a private management-owned and operated entity, we developed a totally unique membership agreement that attempted to memorialize this stewardship goal. It has been honed and refined several times since. The spirit and intent of our stewardship responsibilities are captured in the following recitals for future owners:

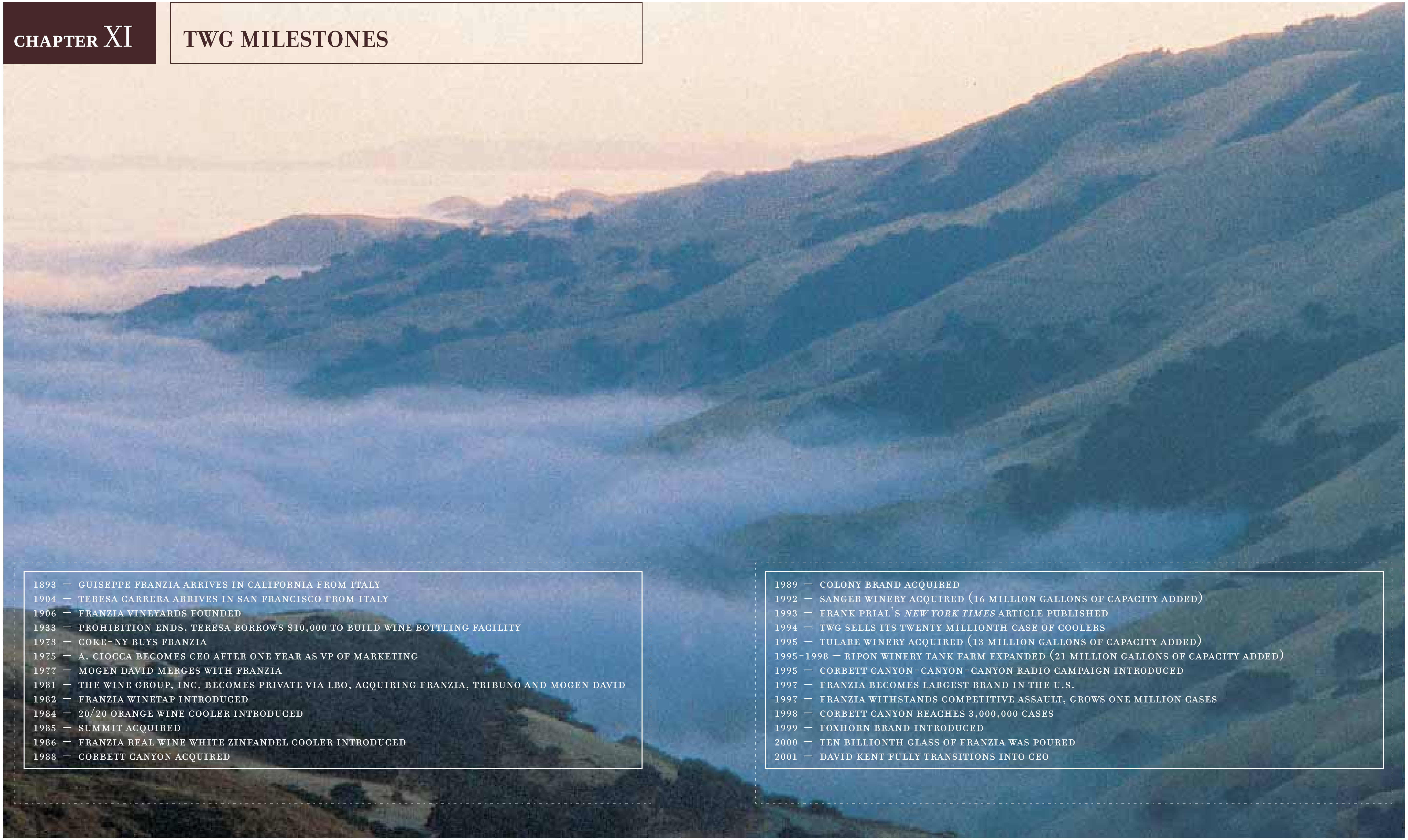
(i) To maintain an independent management-owned private company that will prosper and remain competitively vibrant in the wine business;
(ii) To ensure that the Company remains in a healthy financial condition with a view to continued enhancement of the long-term value of the Company;
(iii) To motivate the owners to manage the business as stewards of the assets of the Company, not only on behalf of current owners, but also on behalf of future owners and other stakeholders in the enterprise;
(iv) To ensure that current management aggressively develops successor management which is both skilled and committed to the objectives and principles embodied in these Recitals;
(v) To provide appropriate mechanisms which will enable successor generations of management to become owners of the Company; and
(vi) Consistent with and promoting the objectives and principles stated above, to provide appropriate mechanisms for owners of long-standing to be appropriately rewarded for their contribution.

In addition to providing strong incentives for management to add value and growth to the company, there is a severe disincentive for failure to discharge the stewardship responsibilities we take so seriously. The agreement specifically states the only circumstance under which the company may be sold is if it fails financially and can no longer be operated as a freestanding private company. In that event, only minimal proceeds from any sale may accrue to the owner-managers under whose watch the company deteriorated. All additional proceeds go to charity. Although we don't ever envision this happening, this is a safeguard installed to keep future management teams focused on fulfilling their stewardship roles. The membership agreement is drafted to reward future generations of management-owners in direct proportion to their stewardship and to the value they add. Ownership is not a right, but a privilege that can only be earned, just as are the financial rewards of ownership.

We have done our best to construct a sound foundation, efficient facilities, enduring brands and a set of lasting values, but in the end, it all comes down to people. We are willing to stake the important judgment we made about the long-term direction of the company on our faith that noble values will rise to the forefront when choices may have to be made between self-interest and stewardship responsibilities. We have built a business by betting on people. When the business got tough, good people and noble values prevailed. We hope that our legacy is giving birth to a new enlightened form of ownership that will not only position The Wine Group, Inc. in good stead for generations of new owners, but will serve as a model for the American free enterprise system for many years to come.

CHAPTER XI

TWG MILESTONES



1893 — GUISEPPE FRANZIA ARRIVES IN CALIFORNIA FROM ITALY
1904 — TERESA CARRERA ARRIVES IN SAN FRANCISCO FROM ITALY
1906 — FRANZIA VINEYARDS FOUNDED
1933 — PROHIBITION ENDS, TERESA BORROWS $10,000 TO BUILD WINE BOTTLING FACILITY
1973 — COKE-NY BUYS FRANZIA
1975 — A. CIOCCA BECOMES CEO AFTER ONE YEAR AS VP OF MARKETING
1977 — MOGEN DAVID MERGES WITH FRANZIA
1981 — THE WINE GROUP, INC. BECOMES PRIVATE VIA LBO, ACQUIRING FRANZIA, TRIBUNO AND MOGEN DAVID
1982 — FRANZIA WINETAP INTRODUCED
1984 — 20/20 ORANGE WINE COOLER INTRODUCED
1985 — SUMMIT ACQUIRED
1986 — FRANZIA REAL WINE WHITE ZINFANDEL COOLER INTRODUCED
1988 — CORBETT CANYON ACQUIRED

1989 — COLONY BRAND ACQUIRED
1992 — SANGER WINERY ACQUIRED (16 MILLION GALLONS OF CAPACITY ADDED)
1993 — FRANK PRIAL'S *NEW YORK TIMES* ARTICLE PUBLISHED
1994 — TWG SELLS ITS TWENTY MILLIONTH CASE OF COOLERS
1995 — TULARE WINERY ACQUIRED (13 MILLION GALLONS OF CAPACITY ADDED)
1995-1998 — RIPON WINERY TANK FARM EXPANDED (21 MILLION GALLONS OF CAPACITY ADDED)
1995 — CORBETT CANYON-CANYON-CANYON RADIO CAMPAIGN INTRODUCED
1997 — FRANZIA BECOMES LARGEST BRAND IN THE U.S.
1997 — FRANZIA WITHSTANDS COMPETITIVE ASSAULT, GROWS ONE MILLION CASES
1998 — CORBETT CANYON REACHES 3,000,000 CASES
1999 — FOXHORN BRAND INTRODUCED
2000 — TEN BILLIONTH GLASS OF FRANZIA WAS POURED
2001 — DAVID KENT FULLY TRANSITIONS INTO CEO