



Chateau Ste. Michelle, proudly of Washington state.

## LEAP OF FAITH FOR WASHINGTON WINE

Chateau Ste. Michelle almost singlehandedly put Washington on the map, says Kevin McCallum. Thanks to their efforts, the US consumer now knows that the state can produce top quality wine - a state of affairs that has paid off handsomely for the winery. So why are they now buying California icon Stag's Leap?

Many Californians, justifiably proud of the accomplishments of their own wine industry, tend not to take much notice of other wine regions in the United States. They've complacently convinced themselves the state's climate offers such ideal conditions for growing wine grapes that the other 49 states don't have much to offer. But a northern neighbor has stepped out of the long shadow California casts over other wine regions, staking its rightful claim as one of the pre-eminent wine regions anywhere.

"The Cabs of Washington are now right up there with the best in the world," says prominent industry analyst Jon Fredrikson, of the Gomberg,



»» Owing Stag's Leap gives us more credibility about the Washington story. ««

*Ted Baseler, CEO, Ste. Michelle*

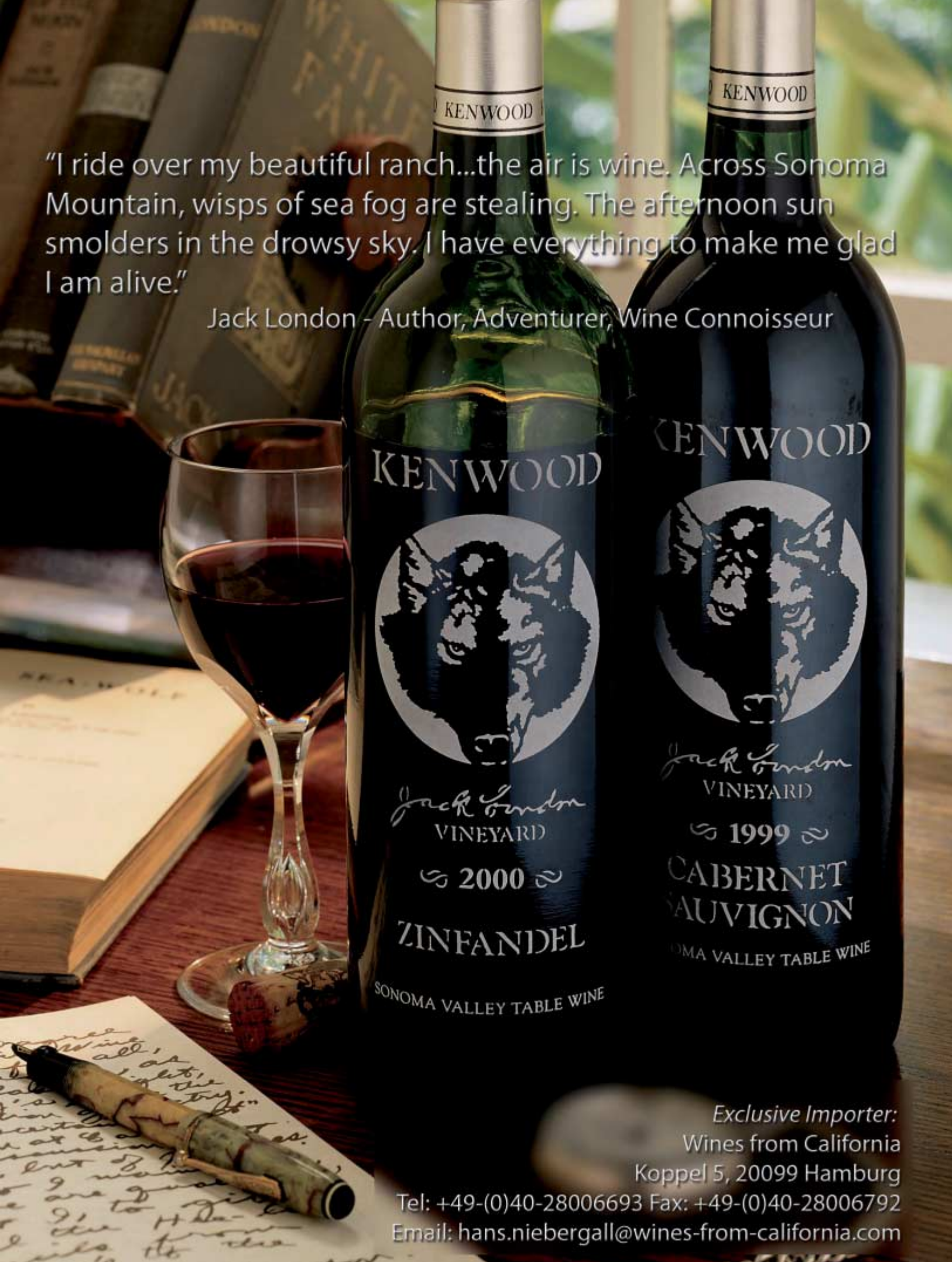
Fredrikson & Associates near San Francisco. "They're not playing second fiddle to anyone."

### *America's new wine country*

While the western third of Washington was busy grabbing attention for its wet weather, orca whales and killer lattes, the dry, rolling hillsides east of the Cascade Mountains were quietly proving themselves to be some of the best vineyard land on the planet. The state's wineries have racked up an impressive array of scores and accolades in recent years, attracted investment from renowned vintners, and have gained the respect of consumers. And the winery benefiting most from the hard-fought success is the one most responsible for

"I ride over my beautiful ranch...the air is wine. Across Sonoma Mountain, wisps of sea fog are stealing. The afternoon sun smolders in the drowsy sky. I have everything to make me glad I am alive."

Jack London - Author, Adventurer, Wine Connoisseur



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**“Ted Baseler is one of the foremost executives in the whole wine industry. UST gives him a large amount of leeway. And his recent performance has been phenomenal.”**

*Jon Fredrikson,  
prominent  
industry analyst,  
Gomberg,  
Fredrikson &  
Associates*



creating it, Ste. Michelle Wine Estates.

“They put Washington on the map,” says Robert Nicholson, principal of the International Wine Associates, a leader in wine industry corporate finance, mergers and acquisitions. “They have created a firm place in the U.S. trade and U.S. consumer’s mind for Columbia Valley wines and Washington wines generally.”

### *Outsized influence*

The wine group has clawed its way out of obscurity to become the fastest growing top 10 wine company in the United States. Its revenues surged 25% in 2007, to \$345m (€216), and profits soared as well, up 36% to \$60m. That’s a 244% increase over its profits in 2000. At just under 5m cases shipped last year, the company is still dwarfed by global giants like Gallo and Constellation. But it won’t be for long at this rate. Earlier this year the company, headquartered in the Seattle suburb of Woodinville, won Fredrikson’s 2007 Winery of the Year award, calling its recent performance “phenomenal.”

Ted Baseler, the company’s highly respected CEO, takes the company’s recent successes in stride. “It was a very, very good year,” he says.

Though smaller than many of its competitors, Ste. Michelle Wine Estates has assembled a portfolio of assets that

gives it an outsized influence on the industry. With about 20 wine brands and 10 winery facilities to its name, the wine group controls 4,200 acres (1,680 hectares) of vineyards in Washington, Oregon, and California. It is such a dominant force in Washington that estimates are the company consumes three-quarters of the state’s annual grape harvest, which last year hit a record 127,000 tons.

It is a subsidiary of UST, Inc., the largest producer of smokeless tobacco in the U.S. Being tied to a tobacco company has its downsides, but access to cash is not one of them.

UST’s tobacco products, also known as moist snuff or dipping tobacco, including Skoal and Copenhagen, and are tremendously profitable. Last year the company, which traces its roots back to the 1800s, managed a 28% profit margin on total revenue of \$1.9bn. In a bid to diversify, what was then called United States Tobacco Company entered the wine business in 1974 with its purchase of Chateau St. Michelle, then the largest of the handful of wineries in the fledgling Washington wine region. There were still just 19 wineries in the state in 1981, compared to over 500 today.

### *Washington state and wine*

The roots of the Washington wine industry date back to 1871, when European settlers planted the first known wine grapes in the Yakima Valley. Chateau Ste. Michelle’s history began after the repeal of Prohibition, and when Pommerelle Wine Company and the National Wine Company began making mostly sweet and fortified wines. The companies merged in 1954 to form the American Wine Growers. When domestic tastes began to shift to drier table wines, the company was the first to experiment with European varietals in Washington.

The early success of plantings of Grenache and White Riesling in the dry plains east of the Cascade Mountains attracted the attention of legendary California winemaker and consultant Andre Tchelistcheff. Under the watchful eye of the diminutive Russian-born

**“The American consumer was ready for something from a different climate, a different style of wine than produced in California – and Ste. Michelle put Washington on the map.”**

*Robert Nicholson,  
principal,  
International Wine  
Associates, an  
investment advisory  
and corporate  
development firm.*



winemaker, American Wine Growers launched a line of “Ste. Michelle Vintners” that quickly earned accolades. A 1974 blind tasting by the Los Angeles Times gave Ste. Michelle’s 1972 Riesling top honors.

Later that year, UST snapped up the rising star. But it still had a long way to climb. By the time Tchelistcheff helped launch Ste. Michelle, he had already spent nearly 30 years giving California wineries a significant head start. Hired in 1938 by Georges de Latour, owner of the Beaulieu Vineyard in the Napa Valley, Tchelistcheff did more than anyone else to influence and elevate the style of California wines, especially Cabernet Sauvignon.

California would soon widen its lead over the upstart. The 1976 Paris tasting catapulted Napa Valley wines to international prominence when they bested their French counterparts. While a boon for the U.S. wine industry, the tasting must have made some executives at UST wonder whether they had bet on the right state.

But by the 1980s, under the leadership of Allen Shoup, Chateau Ste. Michelle was beginning to rack up winery awards and generate positive press. The estate outside Seattle, which includes the 1912 “chateau” of Seattle lumber baron Frederick Stimson, became a popular tourist destination.

The estate today is also one of the most popular concert venues in the Seattle area, and is the second as tourist destination only to Seattle's soaring Space Needle.

For years, the winery's parent company was called Stimson Lane Vineyards & Estates. To better reflect its roots, the name was changed in 2004 to Ste. Michelle Wine Estates. Under Shoup, the company made several of the key strategic moves that set the stage for its rapid growth. In 1983, it opened the state's largest winery, Columbia Crest along the banks of the mighty Columbia River. The cavernous facility also houses the nation's third largest sparkling wine facility, Domaine Ste. Michelle.

### Expansion

It also opened a second Chateau Ste. Michelle facility, dedicated to reds, in 1994 in a historic streetcar garage in Walla Walla, a remote city closer to Montana than Seattle. And to supply these and other wineries, the company planted thousands of acres of vineyards along the banks of the Columbia River, vineyards with names Cold Creek, Horse Heaven Hills, Canoe Ridge, and Waluke Slope.

Each area is unique, but all benefit from a combination of less than eight inches of rainfall, well draining sandy-loam soils, northern latitudes providing up to 17 hours of sunlight, and the moderating influence of the Columbia, which limits frosts. The vineyards also cost a fraction of comparable plantings in California, a fact critical to the company's strategy of offering neither the highest end nor the cheapest wines, but the best value wines in the industry.

The company also pushed for the establishment of the vast Columbia Valley appellation, and helped launch Washington Wine Commission, the state's wine marketing council.

By the 1990s, the message was getting out and the winery was on a roll, its revenues rising steadily. While companies like E&J Gallo were struggling to transition their hidebound behemoth away from jug wines to premium wine, Ste. Michelle Wine Estates had no such baggage. America's love affair with Californian wine was still strong, but their eyes were beginning to wander.

"I think the U.S. consumer was ready for something from a different climate, a different style of wine than produced in California," says Robert Nicholson, who describes Washington's wines, particularly its best Cabernets, as "leaner" and more "sculpted" than their California counterparts.

The wine company showed an unabashed admiration for the wine styles of Europe

white varietal in the U.S., increasing 54% in three years.

The Antinori partnership resulted in the creation of Col Solare, a powerful Cabernet blend in the rebellious spirit of the Super Tuscans that aspires to be the best Cabernet Washington can muster. The latter effort has been so successful that the partners spent millions to build the \$75-per-bottle brand its own dedicated facility in the Red Mountain appellation.

"Our goal is to make Col Solare the equal of best wines in the world and building this state-of-the-art estate winery will enable us to do that," said Baseler at the time.

The remote location near Benton City is known largely for its proximity (less than 10 miles) to the Hanford Nuclear

Reservation, a sprawling decommissioned nuclear production complex. Recently, Baseler described the deepening of the company's relationship with Antinori in more colloquial terms. "Our dating was very successful, so we decided to get married," he said. The two companies renewed their vows just a few weeks after the pomp-filled opening of Col

Solare by announcing their

joint purchase of the Napa Valley winery Stag's Leap Wine Cellars for \$185m. The proximity of the two events was no coincidence. All three wine companies had worked closely with Tchelistcheff.

### Leaping into California

Stag's Leap owner Warren Winiarski, whose 1973 Cabernet won the 1976 tasting that has become known as the Judgment of Paris, is said to have sold his winery last year



and forged alliances with some its most prominent families.

Joint ventures followed with Tuscany's Piero Antinori, whose family's winemaking history reaches to the 1300s, and acclaimed Riesling estate Dr. Loosen in Germany's Mosel Valley. The Dr. Loosen partnership resulted in the high-end Riesling brand Eroica, and has helped fuel a resurgence of interest in that varietal. According to Nielsen data, Riesling is the hottest

only after becoming convinced that Antinori and Ste. Michelle Wine Estates would protect his legacy.

"This is the opposite of a hostile takeover. This is a family affair," Baseler said at the time.

### *The heir and the parent*

The idea that one of California's most successful and visionary winemakers turned outside the state - and, indeed, the nation - to find an heir surprised many in the industry. Ste. Michelle Wine Estates owns other properties in Napa such as Conn Creek and Villa Mt. Eden, but these brands paled when compared to the stature of Stag's Leap. The purchase highlighted just how far the Washington wine company had come, and just how high Baseler's star had risen.

A marketing executive who joined the company in 1984, Baseler replaced Shoup in 2000, a challenging time to take the helm of a U.S. wine company, to say the least. The gleeful rash of vineyard plantings in the late 1990s had begun to bear fruit - right as the U.S. economy headed for recession, creating an oversupply of grapes as consumers pulled back the reins. In a way, a recessionary environment played right into Baseler's hands, as cost-

conscious consumers who were looking for bargains found them in wines that consistently ranked among the nation's best values.

Ste. Michelle Wine Estate's parent company, UST, Inc. in Stamford, Connecticut, is in the smokeless tobacco business, an industry less reviled than cigarette companies, but equally tumultuous. In 1998, facing suits by states trying to recoup the costs of tobacco-related illnesses, UST agreed to a \$100m settlement over 10 years, including reducing its advertising to teenagers, who studies had shown were key customers.

In 2003, UST lost its appeal of the largest anti-trust judgment in the nation's history, a \$1.05bn verdict that stemmed from the apparent tendency of its salespeople to discard the convenience store displays of rivals. European snuff competitor Swedish Match filed a similar suit a short time later, which UST settled for \$200m.

Rumors swirled that UST would need to unload its wine division to pay the piper, but it never happened. Baseler somehow kept the UST board on board. It signed off on the purchase of Oregon Pinot Noir specialist Erath in 2006 and didn't seem to have hesitated signing off on the Stag's Leap deal last year. Fredrikson, who represented Winiarski in the sale, said

he was impressed with the degree of autonomy Baseler enjoys. He expected innumerable visits to the winery from UST executives before they would sign off on the deal, but Fredrikson said they stayed put, ultimately putting their faith in Baseler's judgment.

"Ted is one of the foremost executives in the whole wine industry," Fredrikson said. "They give him a large amount of leeway."

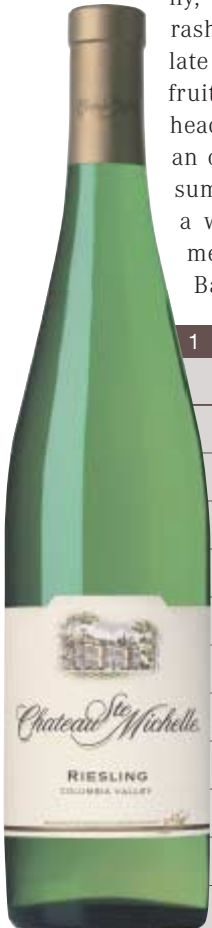
Few seem to question the wisdom of the Stag's Leap purchase. The brand's reputation and following would take decades to replicate, if it could be done at all. When combined with Ste. Michelle Wine Estate's existing wine portfolio and the Antinori brands the company now exclusively distributes in the U.S., most agree its sales people are a force to be reckoned with.

And yet while it's tough to see the Stag's Leap purchase as anything but a feather in the Washington company's cap, one has to wonder.

All those years of championing the quality of Washington wines, and the company's crowning achievement is to buy a Napa winery? The company's roots are and will stay firmly in Washington's well-drained soils, says Baseler: "I think what it really does is it gives us more objectivity and therefore more credibility about the Washington story." ■

#### 1 Revenue and profit

Revenue in '000 000 \$	Year	Profit in '000 000 \$
33	1987	-2.4
58	1990	2.7
71	1992	4.8
89	1994	8.8
123	1996	17.9
149	1998	22.1
175	2000	17.4
204	2002	30.4
226	2004	32.4
282	2006	44.1
354	2007	59.9





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