Truett-Hurst, Inc.
Form 10-K
October 13, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Fiscal Year Ended June 30, 2017

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to

Commission File Number: 001-35973

TRUETT-HURST, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	46-1561499
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification number)
125 Foss Creek Circle, Healdsburg, California	95448
(Address of principal executive offices)	(zip code)

(707) 431-4423

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Class A	The NASDAQ Capital Market

Securities registered pursuant to section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
		Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of common stock held by non-affiliates was approximately $4,856,018 based upon a total of 2,334,624 shares of Class A common stock held by non-affiliates and a closing price of $2.08 per share on June 30, 2017 for the Class A common stock as reported on The NASDAQ Capital Market. Shares held by each executive officer, director and by each person who owns 10% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 (the “Exchange Act”) subsequent to the distribution of securities under a plan confirmed by a court. Yes No

Not Applicable.

The number of shares outstanding with respect to each of the classes of our common stock, as of September 14, 2017, is set forth below:

Class	Number of shares outstanding
Class A common stock, par value $0.001 per share	4,426,789
Class B common stock, par value $0.001 per share	7

Documents incorporated by reference: The Registrant's definitive proxy statement, to be filed with the Commission not later than 120 days after June 30, 2017, is incorporated by reference in Part III of this Report.

TRUETT-HURST, INC. AND SUBSIDIARY

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Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements, which reflect the Company’s current views with respect to, among other things, the operations and financial performance. You can identify these forward-looking statements by the use of words such as “outlook,” “believes,” “expects,” “potential,” “continues,” “may,” “will,” “should,” “se “approximately,” “predicts,” “intends,” “plans,” “estimates,” “anticipates” or the negative version of these words or other comparable words. Such forward-looking statements are subject to various risks and uncertainties. Accordingly, there are or will be important factors that could cause actual outcomes or results to differ materially from those indicated in these statements. The Company believes these factors include but are not limited to those described under the section “Risk Factors” in Item 1A of this Report. Additional risk factors may be described from time to time in future filings with the Securities and Exchange Commission (“SEC”). The Company undertakes no obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise, except as required by law.

These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. The Company believes these factors include but are not limited to those described under “Item 1A. Risk Factors” such as:

- A reduction in the supply of grapes and bulk wine available from the independent grape growers and bulk wine suppliers could reduce the annual production of wine.
- The Company has a history of losses and may not achieve or maintain profitability in the future.
- The Company faces significant competition which could adversely affect profitability.
- Because a significant amount of the Company’s business is made through direct to retailer partners, any change in relationships with them could harm the business.
- The loss of key employees could damage the Company’s reputation and business.
- A reduction in access to or an increase in the cost of the third-party services used to produce wine could harm the business.
- The terms of current bank loans may restrict current and future operations, which could adversely affect the Company’s ability to respond to changes in the Company’s business and to manage operations.
- Because the founding LLC members (the “Founders”) have retained significant control over Truett-Hurst, Inc., current shareholders and new investors will not have as much influence on corporate decisions as they would if control were less concentrated.
- The Company has certain transactions with related parties, including the Founders and principal shareholders. These transactions may present conflicts of interest.
- The Company depends upon trademarks and proprietary rights, and any failure to protect intellectual property rights or any claims that the Company is infringing upon the rights of others may adversely affect competitive position and brand equity.
- The Founders have significant influence on Truett-Hurst, Inc. and their interest may differ from those of the public shareholders.
- The Company faces inventory risk, and if the Company fails to predict accurately demand for products, the Company may face write-downs or other charges.

These factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included in this report. The Company undertakes no obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

PART I

Item 1. Business

The Company is a holding company incorporated as a Delaware corporation and its sole asset is a controlling equity interest in H.D.D. LLC (the “LLC”). Unless the context suggests otherwise, references in this report to “Truett-Hurst,” the “Company,” “we,” “us” and “our” refer to Truett-Hurst, Inc. and its consolidated subsidiary. Truett-Hurst consolidates the financial results of the LLC and records a noncontrolling interest for the economic interest in the LLC it does not own. The Company’s amended and restated certificate of incorporation authorizes two classes of common stock, Class A common stock and Class B common stock.

Quantities or results referred to as “to date” or “as of this date” mean as of or to June 30, 2017, unless otherwise specifically noted. References to “FY” or “fiscal year” refer to the fiscal year ending on June 30th of the designated year. For example, “FY17” and “fiscal year 2017” each refer to the fiscal year ended June 30, 2017. This Annual Report on Form 10-K references certain trademarks and registered trademarks which may be trademarks or registered trademarks of their respective owners.

On January 25, 2016, the LLC sold its fifty percent interest in The Wine Spies, LLC (“Wine Spies”) with an effective date of December 31, 2015. The results from Wine Spies, which were previously consolidated, have been deconsolidated in the Company’s FY16 audited consolidated financial statements. The gain on the sale has been recorded in the consolidated statements of operations on the discontinued operations line.

On October 8, 2017 and for several days thereafter, significant wildfires broke out in Napa, Sonoma, and surrounding counties in Northern California. Certain of the Company’s inventory, primarily juice pressed from grapes picked during the 2017 harvest and maintained at outside production and storage facilities, may be subject to spoilage. The Company believes that any loss of inventory related to the fires is substantially covered under the Company’s insurance policies. Additionally, there may be future negative impacts on the Company’s outside production and operating arrangements, including bottling and warehousing of case goods. See Note 14, “Subsequent Events”.

General

The Company produces and sells premium, super-premium, and ultra-premium wines made generally from grapes purchased from California-based growers. In addition, the Company purchases semi-finished bulk wine under contract and opportunistically on the spot market. On a more limited basis, the Company also purchases finished goods from both foreign and domestic producers. The Company is headquartered in Sonoma County, California with a tasting room in the Dry Creek Valley. The Company owns its tasting rooms and winery in the Dry Creek Valley and leases space for wine production within a custom crush facility located in Santa Rosa, California. The wines include Pinot Noir, Chardonnay, Sauvignon Blanc, Zinfandel, Petite Sirah, Merlot, and Cabernet Sauvignon and are sold across a number of price points via two distinct distribution channels: three-tier and direct to consumer. The business model is a combination of direct to consumer sales, traditional three-tier brand sales and retail exclusive brand sales. The Company owns, designs and develops its brands, including those developed and sold on a retailer exclusive basis. The Company’s brands are differentiated and marketed through innovative packaging and label designs.

Wines in the three-tier channel are sold to distributors with programs available to the broad market or to specific retailers on an exclusive basis. The traditional three-tier distribution business consists of sales of VML, Healdsburg Ranches, Colby Red, Bradford Mountain, and Dearly Beloved branded wines. Through the retail exclusive brand model, the Company works with retail partners to develop innovative brands which resonate with their customers and are intended to increase store traffic and expand exclusive brand sales. The retail exclusive model allows the Company to own the brands it creates, which the Company believes differentiates it from the traditional private label model, and allows it the option of expanding the brands into national and international markets, thereby increasing sales and building the brand equity. The direct to consumer channel consists of sales of products produced by the Company through its tasting rooms, wine clubs and its winery websites.

Strategic Objectives

There are three primary categories into which the Company sells its wine: premium ($12 - $14 per bottle retail price), super-premium ($15 - $24 per bottle retail price), and ultra-premium ($25 - $49 per bottle retail price). The Company believes it can benefit from growth at the premium and above price points and continue to grow the business relying on its competitive strengths: its experienced and knowledgeable team; its relationships with the world's top wine distributors and retailers; and its innovative approach to distribution and brand development. The Company intends to continue growing by:

- Developing innovative retail exclusive products that meet the needs of wine retailers. The Company has a reputation for developing innovative retail exclusive brands and working with retailer partners on unique programs to support sales of those products. With branding expertise, the Company intends to continue innovation and build its market share with global wine retailers who are focused on increasing their profitability through retail exclusive offerings.
- Growing the customer base to include additional major U.S. retail chains. The Company is actively pursuing relationships with the largest retail chains in the United States.
- Expanding the direct to consumer business. The Company's wine clubs continue to grow due to growing consumer awareness of the brands from targeted public relations, exciting wine club events and advertising. The direct to consumer business generally generates higher gross margins and the Company intends to continue building this distribution channel in order to further growth.
- Marketing to key international markets. Since fiscal year 2014, the Company has had a partnership agreement with the Trialto Wine Group, LTD, based in Vancouver, Canada, to distribute the Truett-Hurst family of brands throughout Canada. The Company also continues to review selective brand development and distribution opportunities in other international markets.
- Developing new ways to engage customers and to distribute products. The Company continues to be discovery-oriented in its approach and is always looking for new innovations in and approaches to the global wine market. The Company believes that traditional wine marketing, to some degree, has stymied creativity and believes the Company's innovative branding expertise allows the Company to rapidly capitalize on evolving customer demands.

Wine Operations

Brands

The Company operates two wineries where wine is produced from many varieties of grapes principally grown or purchased in Sonoma County's Dry Creek Valley and Russian River Valley appellations. Established in 2007, Truett-Hurst was the first winery operation and brand that focuses on producing limited lots of super-premium wine from a range of varietals, including Zinfandel, Chardonnay, Sauvignon Blanc, Pinot Noir, Petite Sirah and other unique red blends from grapes sourced from local growers in the Dry Creek Valley. Established in 2011, VML was the second winery operation and brand that focuses on producing limited lots of super-premium and ultra-premium wines from grapes purchased from local growers in the Russian River Valley. The primary varietals include Pinot Noir, Chardonnay, Sauvignon Blanc, and Gewurztraminer.

Property

The Company owns a 25-acre property located at 5610 Dry Creek Road, Healdsburg, California, of which approximately 15 acres is used for growing grapes. The remainder of the property is used for the Truett-Hurst and VML tasting rooms, retail sales space, and office space for support staff. Although the Company has maintained the proper permits to build a winery at this location and there is infrastructure, such as electricity and access to water, necessary to operate a winery on the property, the Company has not made the requisite capital expenditures to construct a building to house grape-crushing equipment and wine storage tanks. The Company believes that the property can be used to expand its wine-making operations in the future and provide better control over wine quality.

The Company leases wine production space within a custom crush facility located in Santa Rosa, California. The lease commenced on April 15, 2017 and ends on June 15, 2018. The initial 14-month term may be renewed for additional periods as agreed to by both parties. Previously, the Company leased a winery located at 4035 Westside Road, Healdsburg, California, but vacated those premises prior to May 31, 2017. Certain of these facilities may have been impacted by the Northern California wildfires in October 2017. See Note 14, “Subsequent Events”.

Production

The wine production space within the custom crush facility allows the Company to crush, ferment and oak barrel age approximately 700 tons (50,000 cases) of ultra-premium grapes annually, with capacity to increase to 1,000 tons with additional capital improvements. For increased production capacity, the Company outsources to a variety of specialist wineries and bottling facilities. The Company has been able to satisfy the production requirements to date and considers its sources to be adequate at this time. However, the inability of any of the suppliers to satisfy the Company’s requirements could adversely affect operations.

Grape and Wine Contracts

The majority of annual grape requirements are satisfied by purchases from each year’s harvest which normally begins in August and runs through October. In addition to purchasing grapes, the Company supplements its needs with bulk wine purchase contracts based on sales and production requirements. Depending upon overall demand and availability of bulk wine, the Company could experience shortages and/or increased prices.

The Company enters into grape contracts with terms generally of one to four years, which requires payment of an agreed upon price per ton that varies according to the type of grape, its appellation and in certain cases, the vineyard block in which the grapes are grown. Contracts are typically terminable after a specified term, unless earlier mutually agreed by the parties.

Vineyards Owned by Founders

Certain of the Founders operate or farm vineyards. The grapes produced from these vineyards are sold to the Company at market prices, with the balances sold to other wineries. See Part II, Item 8, Note 8, “Commitments and Contingencies,” to the Consolidated Financial Statements included in this Annual Report on Form 10-K for additional details regarding related party commitments.

Sources and Availability of Production Materials

The Company utilizes glass and other materials such as corks, capsules, labels and cardboard cartons in the bottling and packaging of its products. After grape purchases and associated production overhead, glass bottle costs are the next most significant component of the cost of sales. The glass bottle industry is highly concentrated with only a small number of quality producers. The Company obtains glass requirements from a limited number of producers under supply arrangements. The Company has been able to satisfy production requirements with respect to the foregoing and consider the sources of supply to be adequate at this time. However, the inability of any of the glass bottle suppliers to satisfy the Company's requirements could adversely affect the Company's operations.

Seasonality

There is seasonality in the growing, procurement and transportation of grapes. The wine industry typically experiences increased sales in October, November and December. Sales are typically higher upon the launch of a new product into the marketplace and when retailers promote brands through in-store displays and advertisements. The Company expects these trends to continue.