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.

Company Team and Culture

The Company's team consists of seasoned professionals who have worked their way up through the industry often achieving senior level positions in noted wine companies such as the Brown-Forman Corporation, Gallo, Domaine Chandon, Kendall-Jackson, and Fetzer Vineyards.

In addition to building a seasoned team of professionals and shaping the entrepreneurial culture, an important part of the ongoing strategy is to create partnerships with the best organizations and professionals in order to leverage core competencies in the most efficient, cost effective and profitable manner. The Company is proud of the corporate partnerships that have been created throughout the sales channels and the Company believes it can build a business that can change the way consumers purchase and enjoy wine.

Sales and Marketing

The Company employs a relatively small full-time, in-house marketing, sales and customer service organization. The sales and marketing team uses a range of marketing strategies designed to build brand equity and increase sales. Strategies include, but are not limited to, market research, consumer and trade advertising, price promotions, point-of-sale materials, event sponsorship, on premise promotions, social media and public relations.

The Company's sales are comprised of three segments; Direct to Consumer ("DTC"), wholesale retail exclusive brands, and wholesale national brands. DTC sales take place in our popular Dry Creek Valley tasting rooms and through our website. The Company has developed a significant wine club membership base whose members are shipped wine four times per year in quantities ranging from 3 to 12 bottles per shipment. The growing DTC segment represents approximately 28% of the Company's net sales and 53% of the Company's gross profit. DTC sales have high margins, typically include more expensive wines, and create a "halo effect" for the Company's retail exclusive and national brands. The company's retail exclusive segment targets the top 50 on-premise (restaurants) and off-premise (grocery, drug, club) retail chains. U.S. retailers are embracing this category due to the higher margins they produce for the retailer and the exclusivity the retailers achieve with these brands. The national brand segment is comprised of brands the Company has developed and owns (VML, Dearly Beloved, Healdsburg Ranches, and the new Weight Watchers endorsed low SmartPoint ™ wine brand, Cense, as examples) and brands which the Company has partnered with others to sell and market (Colby Red). The Company sells these brands to on and off-premise regional and national chains, as well as independent restaurants, liquors stores, and grocery stores. The Company is able to compete and grow its national brand sales by differentiating its products with innovative packaging, value-priced high-quality wines, cause marketing, and by using large licensors.

Competitive Environment

All the segments the Company participates in are highly competitive. The Company competes on the basis of quality, price, brand recognition and distribution strength against domestic and multinational producers and distributors, some of which have greater resources than the Company, for consumer purchases, as well as shelf space in retail stores, restaurant presence and wholesaler attention. Further, wine competes with other alcoholic and nonalcoholic beverages.

In the retail exclusive market, the Company competes against larger wine producers, including Constellation Brands, Inc., E.&J. Gallo Winery, Bronco Wines, Winery Exchange Inc., Vintage Wine Estates, Delicato Family Vineyards, and other California and international wine producers.

There are relatively few publicly traded beverage companies with significant wine operations and most also have beer and spirits divisions.

Demand for wine in the premium, super-premium, ultra-premium and luxury market segments can rise and fall with general economic conditions. The Company's ability to respond to market demand, deliver a variety of wine styles, create and design innovative packaging combined with an effective distribution system will allow the Company to continue to penetrate the mainstream wine markets.

Intellectual Property

The Company protects proprietary rights through a variety of means and measures, including patents, trade secrets, copyrights, trademarks, contractual restrictions and technical measures. A number of brands are under registered trademarks. International trademark registrations are also maintained where it is appropriate to do so. Each of the U.S. trademark registrations is renewable indefinitely so long as the Company is making a bona fide usage of the trademark. As of September 1, 2017, the Company had 42 registered material trademarks, 3 published and 1 pending.

Regulatory Environment

The wine industry is part of the highly regulated U.S. liquor industry. While there have been significant relaxations over time, such as those arising following the Granholm v. Heald U.S. Supreme Court decision in 2005, the U.S. wine industry is still highly regulated. For example, the Company is able to ship wine directly now to consumers and businesses in 42 states, but must only work through traditional "three-tier" distributors in the remaining 8 states.

The production and sale of wine is subject to extensive regulation by the United States Department of the Treasury, Alcohol and Tobacco Tax and Trade Bureau and the California Liquor Control Commission. The Company is licensed by and meets the bonding requirements of each of these governmental agencies. Sales of wine are subject to federal alcohol tax, payable at the time wine is removed from the bonded area of the winery for shipment to customers or for sale in the Company's tasting rooms. The current federal alcohol tax rate is $1.07 per gallon for wines with alcohol content at or below 14.0% and $1.57 per gallon for wines with alcohol content above 14.0% but less than 21%; however, wineries that produce not more than 250,000 gallons during the calendar year are allowed a graduated tax credit of up to $0.90 per gallon on the first 100,000 gallons of wine (other than sparkling wines) removed from the bonded area during that year.

The Company also pays the state of California an excise tax of $0.20 per gallon for all wine sold in California. In addition, all states in which wines are sold impose varying excise taxes on the sale of alcoholic beverages. Payments of these taxes are the responsibility of the supplier or distributor depending upon the channel in which the wine is sold.

Consumer direct sales are also subject to state regulation which governs the quantity and manner in which products can be shipped, delivered and excise taxes collected.

As an agricultural processor, the Company is also regulated by Sonoma County and, as a producer of wastewater, by the state of California. The Company maintains all necessary permits.

Prompted by growing government budget shortfalls and public reaction against alcohol abuse, Congress and many state legislatures are considering various proposals to impose additional excise taxes on the production and sale of alcoholic beverages, including table wines. Some of the excise tax rate increases being considered are substantial. The ultimate effects of such legislation, if passed, cannot be assessed accurately since the proposals are still in the discussion stage. Any increase in the taxes imposed on table wines can be expected to have a potentially adverse impact on overall sales of such products. However, the impact may not be proportionate to that experienced by producers of other alcoholic beverages and may not be the same in every state.

Management is strongly focused on environmental stewardship and maintains a variety of policies and processes designed to protect the environment, the public and the consumers of its wine. Many of the expenses for protecting the environment are voluntary, however the Company is regulated by various local, state and federal agencies regarding environmental laws where the costs of these laws and requirements of these agencies are effectively integrated into regular operations and do not cause significant negative impacts or costs.

The Company believes they are in compliance in all material respects with all applicable governmental laws and regulations in the countries in which it operates. The Company also believes that the cost of administration and

compliance with, and liability under, such laws and regulations have not had a material adverse impact on the Company's financial condition, results of operations or cash flows for the fiscal year ended June 30, 2017.

Employees

As of June 30, 2017, the Company had 29 full time, 26 part time, and 4 seasonal employees. The Company hires part time and seasonal help as needed. All employees were located in the United States. The Company believes that future success will depend in large part on the ability to attract and retain highly skilled technical, managerial, and sales and marketing personnel. None of the employees are subject to collective bargaining agreements. The Company believes relations with their employees are good.

Information About the Company's Executive Officers

The information required under this Item is incorporated by reference from the Company's definitive proxy statement to be filed relating to the Company's 2017 annual meeting of shareholders.

Available Information

Principal executive offices are located at 125 Foss Creek Circle, Healdsburg, California 95448, and the telephone number is (707) 431-4423. The Company files Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and proxy statements with the SEC. The public may read and copy any materials that are filed with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549, on official business days during the hours of 10 a.m. to 3 p.m. The public may obtain information on the operation of the Public Reference Room by calling the SEC at (800) SEC-0330. The SEC maintains an internet site that contains reports, proxy and information statements, and other information regarding issues, including what the Company files electronically with the SEC at www.sec.gov. You may learn more about the Company by visiting the website at www.truetthurstinc.com. The information on the website is not part of this Form 10-K. The foregoing information regarding the website and its content is for your convenience only. The content of the website is not deemed to be incorporated by reference in this report or filed with the SEC.

Emerging Growth Company Status

The Company is an "emerging growth company," as defined in the Jumpstart Our Business Startups Act, enacted on April 5, 2012 ("JOBS Act"). For as long as the Company is an "emerging growth company," the Company may take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not "emerging growth companies," including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in the Company's periodic reports and proxy statements, and exemptions from the requirements of holding shareholder advisory "say-on-pay" votes on executive compensation and shareholder advisory votes on golden parachute compensation.

Under the JOBS Act, the Company will remain an "emerging growth company" until the earliest of:

- the last day of the fiscal year during which the Company has total annual gross revenues of $1 billion or more;
- the last day of the fiscal year following the fifth anniversary of the Company's IPO, June 30, 2018;
- the date on which the Company has, during the previous three-year period, issued more than $1 billion in non-convertible debt; and
- the date on which the Company is deemed to be a "large accelerated filer" under the Exchange Act (the Company will qualify as a large accelerated filer as of the first day of the first fiscal year after the Company has (i) more than $700

million in outstanding common equity held by the Company's non-affiliates and (ii) been public for at least 12 months; the value of the Company's outstanding common equity will be measured each year on the last day of the second fiscal quarter).

The JOBS Act also provides that an "emerging growth company" can utilize the extended transition period provided in Section 7(a)(2)(B) of the Securities Act of 1933, as amended (the "Securities Act") for complying with new or revised accounting standards. However, the Company chose to "opt out" of such extended transition period, and, as a result, the Company will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for companies that are not "emerging growth companies."

Smaller Reporting Company

The Company became subject to the reporting requirements of Section 15(d) of the Exchange Act, subject to the disclosure requirements of Regulation S-K of the SEC, as a "smaller reporting company," on the effective date of the Registration Statement. The designation of being a "smaller reporting company" relieves the Company of some of the more detailed informational requirements of Regulation S-K.

Item 1A. Risk Factors

Risks Related to the Company's Business

A reduction in the supply of grapes and bulk wine available to us from the independent grape growers and bulk wine suppliers could reduce the Company's annual production of wine.

The Company relies on annual contracts with independent growers to purchase substantially all of the grapes used in wine production. The business would be harmed if the Company is unable to contract for the purchase of grapes at acceptable prices from these or other suppliers in the future. The terms of many of the Company's purchase agreements also constrain the ability to discontinue purchasing grapes in circumstances where the Company might want to do so.

Some of these agreements provide that either party may terminate the agreement prior to the beginning of each harvest year.

The Company depends on various bulk wine suppliers for the production of several wines, particularly the direct to retailer designated labels. These contracts currently cover the 2017-2019 harvests. Extension of these contracts is not guaranteed and thus the Company may have exposure to the availability and pricing of bulk wine for its production needs which could increase the cost or reduce the amount of wine the Company is able to produce for sale in the future. This could reduce sales and profits.

The Company faces inventory risk, and if it fails to predict accurately demand for products, the Company may face write-downs or other charges.

The Company is exposed to inventory risks that may adversely affect operating results as a result of new product launches, changes in product cycles and pricing, limited shelf-life of certain of the Company's products, changes in consumer demand, and other factors. The Company endeavors to predict accurately, based on information from distributors and reasonable assumptions, the expected demand for their products in order to avoid overproduction. Demand for products, however, can change significantly between the time of production and the date of sale. It may be more difficult to make accurate predictions regarding new products. In part, the Company depends on the marketing initiatives and efforts of distributors in promoting products and creating consumer demand and the Company has limited or no control regarding its promotional initiatives or the success of their efforts.

The Company has a history of losses, and may not achieve or maintain profitability in the future.

The Company has had a limited number of quarters or years of profitability and historically raised additional capital to meet its growth needs. The Company expects to make significant investments in order to develop and expand its business, which, it believes, will result in additional sales, marketing and general and administrative expenses that will require increased sales to recover these additional costs. As a public company, the Company expects to continue to incur legal, accounting, and other administrative expenses that are material. The Company's revenue has been subject to volatility in recent periods and this volatility may cause the Company to not cover its costs and successfully compete in the highly competitive wine market.

The Company may not generate sufficient revenue to achieve profitability. The Company may incur significant losses in the future for a number of reasons, including slowing demand for its products and increasing competition, as well as the other risks described in this Annual Report on Form 10-K, and may encounter unforeseen expenses, difficulties, complications and delays, and other unknown factors in the expansion of the business. Accordingly, the Company may not be able to achieve or maintain profitability and, may incur significant losses in the future, and this could cause the price of the Class A common stock to decline.

The Company faces significant competition which could adversely affect profitability.

The wine industry is intensely competitive. The Company's wines compete in several super-premium and ultra-premium wine market segments with many other super-premium and ultra-premium domestic and foreign wines, with imported wines coming from the Burgundy and Bordeaux regions of France, as well as Italy, Chile, Argentina, South Africa and Australia. The Company's wines also compete with other alcoholic and, to a lesser degree, non-alcoholic beverages, for shelf space in retail stores and for marketing focus by independent distributors, many of which carry extensive brand portfolios. As a result of this intense competition there has been and may continue to be upward pressure on selling and promotional expenses. In addition, the wine industry has experienced significant consolidation. Many competitors have greater financial, technical, marketing and public relations resources. The Company's sales may be harmed to the extent it is not able to compete successfully against such wine or alternative beverage producers' costs. There can be no assurance that in the future the Company will be able to successfully compete with current competitors or that it will not face greater competition from other wineries and beverage manufacturers.

Because a significant amount of the Company's business is made through retail exclusive model any change in relationships with the retail partners could harm the business.

The Company's agreements with direct retail partners are informal and therefore subject to change. If one or more of the direct retail partners chose to purchase fewer products, or the Company is forced to reduce the prices, the Company's sales and profits would be reduced and the business would be harmed.

The loss of key employees or personnel could damage the Company's reputation and business.

The Company believes that success largely depends on the employment of experienced professionals in a number of key positions. Examples include Phil Hurst, Chief Executive Officer, Evan B. Meyer, Chief Financial Officer, Virginia Lambrix, Winemaker, and Kevin Shaw, an independent contractor who serves as the Creative Director. Any inability or unwillingness of these or other key management team members to continue in their present capacities could harm the business and its reputation.

A reduction in the Company's access to or an increase in the cost of the third-party services used to produce its wine could harm its business.

The Company utilizes capacity at several third-party facilities for the production of a significant portion of its wines. The inability to use these or alternative facilities, at reasonable prices or at all, could increase the cost or reduce the amount of production, which could reduce the Company's sales and profits. Certain of these facilities may have been impacted by the Northern California wildfires in October 2017. See Note 14, "Subsequent Events". The Company does not have long-term agreements with any of these facilities, and they may provide services to competitors at a price above what the Company is willing to pay. The activities conducted at outside facilities include crushing, fermentation, storage, blending, and bottling. The reliance on these third-parties varies according to the type of production activity. As production increases, the Company must increasingly rely upon these third-party production facilities. Reliance on third-parties will also vary with annual harvest volumes.

In addition, the Company has limited direct impact over the quality control and quality assurance of these third-party manufacturers. If its suppliers are not able to deliver products that satisfy the Company's requirements, the Company may be forced to seek alternative providers, which may not be available at the same price, or at all. Moving production to a new third-party service provider could negatively impact the Company's financial results.

The terms of the Company’s current bank loans may restrict current and future operations, which could adversely affect the Company’s ability to respond to changes in its business and to manage its operations.

The Company’s bank loans include a number of customary restrictive covenants that could impair the Company’s financing and operational flexibility and make it difficult to react to market conditions and satisfy ongoing capital needs and unanticipated cash requirements. The bank loans contain usual and customary covenants, including, without limitation:

- limitation on incurring senior indebtedness;
- limitation on making loans and advances;
- limitation on investments, acquisitions and capital expenditures;
- limitation on liens, mergers and sales of assets;
- minimum current assets to current liabilities ratio;
- maximum debt to effective tangible net worth ratio; and
- minimum quarterly EBITDA.

The Company’s ability to comply with the covenants and other terms of its bank loans will depend on future operating performance and, in addition, may be affected by events beyond the Company’s control, and the Company may not meet them. If the Company fails to comply with such covenants and terms, it would be required to obtain waivers from its lenders or agree with the lenders to an amendment of the facility's terms to maintain compliance under such facility. The Company was out of compliance with the debt service coverage ratio covenant on its revolving line of credit for the quarters ended December 31, 2016, March 31, 2017, and June 30, 2017, but received waivers for those periods from the Company’s lender. If the Company is unable to obtain any necessary waivers and the debt is accelerated, it would have a material adverse effect on the financial condition and future operating performance, and the Company may be required to limit activities.

Because the Founders retain 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.

As of June 30, 2017, the Founders and current officers and directors of the Company (together, “Founders and Affiliates”) control approximately 41% of the combined voting power of the Company through ownership of outstanding Class A common stock and/or Class B common stock. Prior to conversion of their LLC Units, each holder of LLC Units holds a single share of Class B common stock. Although these shares have no economic rights, they allow the existing owners to exercise voting power over Truett-Hurst, Inc., the managing member of the LLC, at a level that is consistent with their overall equity ownership of the business. As a result, Founders and Affiliates have significant influence in the election of directors and the approval of corporate actions that must be submitted for a vote of shareholders.

In addition, certain of the Founders, as well as certain trusts and other entities under their control, have entered into guarantee agreements in connection with its bank loans. For additional information related to bank guaranties, see Part II, Item 8, Note 6, “Borrowings,” to the Consolidated Financial Statements included in this Annual Report on Form 10-K.

The interests of these affiliates may conflict with the interests of other shareholders, and the actions they take or approve may be contrary to those desired by the other shareholders. This concentration of ownership may also have the effect of delaying, preventing or deterring an acquisition of Truett-Hurst, Inc. by a third-party.

The Company has certain transactions with related parties, including Founders, which may present a conflict of interest.

The Company routinely sources grapes for its products from vineyards owned by Founders and principal shareholders. The interests of these affiliates in such transactions may be contrary to those desired by shareholders. The policies in place designed to mitigate the risk associated with such transactions; however, shareholders may be harmed by self-dealing with affiliates and loss of corporate opportunity.

In addition, from time to time the Company enters into transactions for goods and services with entities in which its executive officers, directors and/or affiliates have interests, as further described under Part II, Item 8, Note 8, “Commitments and Contingencies,” to the Consolidated Financial Statements included in this Annual Report on Form 10-K.

The Company also enters into grape and bulk wine purchase agreements and bulk wine storage contracts from time to time with entities in which Founders have financial interests. During FY17, the Company entered into such arrangements with:

- Premium Wine Storage, which is owned Paul E. Dolan III (33%) and Heath E. Dolan (33%).

Paul E. Dolan and Heath E. Dolan each control approximately 5.4% of the combined voting power of the Company. Paul E. Dolan is a director of the Company, while Heath E. Dolan resigned as a director of the Company in May 2017.

The Company believes these arrangements reflect substantially the same market terms that would be received in transactions with unaffiliated third-parties. However, if the Company fails to receive market terms for these transactions or other similar transactions in the future, expenses could increase.

A failure of one or more of the Company’s key information technology systems, networks, processes, associated sites or service providers could have a material adverse impact on the business.

The Company relies on information technology (“IT”) systems, networks, and services, including internet sites, data hosting and processing facilities and tools, hardware (including laptops and mobile devices), software and technical applications and platforms, some of which are managed, hosted, provided and/or used by third-parties or their vendors, to assist in the management of the Company’s business. The various uses of these IT systems, networks, and services include, but are not limited to: hosting the internal network and communication systems; ordering and managing materials from suppliers; supply/demand planning; production; shipping product to customers; hosting the Company’s branded websites and marketing products to consumers; collecting and storing customer, consumer, employee, investor, and other data; processing transactions; summarizing and reporting results of operations; hosting, processing, and sharing confidential and proprietary research, business plans, and financial information; complying with regulatory, legal or tax requirements; providing data security; and handling other processes necessary to manage the business.

Increased IT security threats and more sophisticated cyber-crime pose a potential risk to the security of the Company’s IT systems, networks, and services, as well as the confidentiality, availability, and integrity of its data. If the IT systems, networks, or service providers fail to function properly, or if the Company suffers a loss or disclosure of business or other sensitive information, due to any number of causes, ranging from catastrophic events to power outages to security breaches, and the Company’s business continuity plans do not effectively address these failures on a timely basis, the Company may suffer interruptions in its ability to manage operations and reputational, competitive and/or business harm, which may adversely affect business operations and/or financial condition. In addition, such events could result in unauthorized disclosure of material confidential information, and the Company may suffer financial and reputational damage because of lost or misappropriated confidential information belonging to the

Company or to its partners, its employees, customers, suppliers or consumers. In any of these events, the Company could also be required to spend significant financial and other resources to remedy the damage caused by a security breach or to repair or replace networks and IT systems.

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If the Company is unable to maintain effective internal control over financial reporting in the future, the accuracy, and timeliness of its financial reporting may be adversely affected.

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP" or "GAAP").

The Company is an "emerging growth company" as defined in the JOBS Act, and as such may elect to avail itself of the certain exemptions from various reporting requirements of public companies that are not "emerging growth companies," including, but not limited to, an exemption from complying with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002, as amended, which is referred to as the "Sarbanes-Oxley Act."

The Company depends upon trademarks and proprietary rights, and any failure to protect intellectual property rights or any claims that are infringing upon the rights of others may adversely affect the competitive position and brand equity.

The Company's future success depends significantly on the ability to protect its current and future brands and products, and to defend intellectual property rights. The Company has staked out a reputation for innovation and has introduced new product innovations, including, for example, the evocative "wine wraps" and its proprietary square bottle. The Company has been granted numerous trademark registrations covering its brands and products and has filed, and expects to continue to file, trademark applications seeking to protect newly-developed brands and products. The Company cannot be sure that trademark registrations will be issued with respect to any of the trademark applications. There is also a risk that, by the Company's omission, failure to timely renew or protect a trademark, the trademark could be lost. Additionally, competitors could challenge, invalidate or circumvent existing or future trademarks issued to, or licensed by, the Company.

A reduction in consumer demand for wines could harm the Company's business.

There have been periods in the past in which there were substantial declines in the overall per capita consumption of alcoholic beverages in the United States and other markets in which the Company participates. A limited or general decline in consumption in one or more of the product categories could occur in the future due to a variety of factors, including a general decline in economic conditions, increased concern about the health consequences of consuming beverage alcohol products and about drinking and driving, a trend toward a healthier diet including lighter, lower calorie beverages such as diet soft drinks, juices and water products, the increased activity of anti-alcohol consumer groups and increased federal, state or foreign excise and other taxes on alcoholic beverage products. The competitive position of the Company's products could also be affected adversely by any failure to achieve consistent, reliable quality in the product or service levels to customers.

Changes in consumer spending could have a negative impact on the financial condition and business results.

Wine sales depend upon a number of factors related to the level of consumer spending, including the general state of the economy, federal and state income tax rates, deductibility of business entertainment expenses under federal and state tax laws, and consumer confidence in future economic conditions. Changes in consumer spending in these and other areas can affect both the quantity and the price of wines that customers are willing to purchase at restaurants or through retail outlets. Reduced consumer confidence and spending may result in reduced demand for products, limitations on the ability to increase prices and increased levels of selling and promotional expenses. This, in turn, may have a considerable negative impact upon sales and profit margins.

The market price of the Company's stock may fluctuate due to seasonal fluctuations in wine sales, operating expenses and net income.

The Company experiences seasonal and quarterly fluctuations in sales, operating expenses and net income. The Company has managed, and will continue to manage, the business to achieve long-term objectives. In doing so, the Company may make decisions that it believes will enhance long-term profitability, even if these decisions may reduce

quarterly earnings. These decisions include the timing of the release of wines for sale, the Company’s wines’ competitive positioning and the grape and bulk wine sources used to produce wines.

Bad weather, drought, plant diseases and other factors could reduce the amount or quality of the grapes available to produce the Company’s wines.

A shortage in the supply of quality grapes may result from the occurrence of any number of factors which determine the quality and quantity of grape supply, such as weather conditions and natural disasters, such as floods, droughts, frosts, earthquakes, pruning methods, the existence of diseases and pests, and the number of vines producing grapes, as well as the level of consumer demand for wine. Any shortage could cause an increase in the price of some or all of the grape varieties required for wine production and/or a reduction in the amount of wine the Company is able to produce, which could harm the business and reduce sales and profits.

Recent examples of events affecting supply include the frost in 2008 that significantly impacted the amount of grapes harvested in Mendocino County, the frost of 2011 that had a significant impact on the crop size in Paso Robles and the widespread drought which impacted parts of the United States from 2011 to 2016.

Factors that reduce the quantity of grapes may also reduce their quality, which in turn could reduce the quality or amount of wine the Company produces. Deterioration in the quality of the wine produced could harm the brand name and a decrease in production could reduce sales and increase expenses.

Adverse public opinion about alcohol may harm the Company’s business.

While a number of research studies suggest that moderate alcohol consumption may provide various health benefits, other studies conclude or suggest that alcohol consumption has no health benefits and may increase the risk of stroke, cancer and other illnesses. An unfavorable report on the health effects of alcohol consumption could significantly reduce the demand for wine, which could harm the business and reduce sales and increase expenses.

In recent years, activist groups have used advertising and other methods to inform the public about the societal harms associated with the consumption of alcoholic beverages. These groups have also sought, and continue to seek, legislation to reduce the availability of alcoholic beverages, to increase the penalties associated with the misuse of alcoholic beverages, or to increase the costs associated with the production of alcoholic beverages. Over time, these efforts could cause a reduction in the consumption of alcoholic beverages generally, which could harm the Company’s business and reduce sales and increase expenses.

Contamination of the Company’s wines would harm business.

Because the Company’s products are designed for human consumption, the Company’s business is subject to hazards and liabilities related to food products, such as contamination. A discovery of contamination in any of the Company’s wines, through tampering or otherwise, could result in a recall of products. Any recall would significantly damage the Company’s reputation for product quality, which the Company believes is one of its principal competitive assets, and could seriously harm the Company’s business and sales. Although the Company maintains insurance to protect against these risks, the Company may not be able to maintain insurance on acceptable terms, and this insurance may not be adequate to cover any resulting liability.

A decrease in wine score ratings by important rating organizations could have a negative impact on the Company’s ability to create greater demand and pricing.

Many of the Company's brands are issued ratings or scores by local and national wine rating organizations, and higher scores usually translate into greater demand and higher pricing. Although some of the Company's brands have been highly rated in the past, and the Company believes its farming and winemaking activities are of a quality to generate good ratings in the future, the Company has no control over ratings issued by third-parties which may not be favorable in the future.

Increased regulatory costs or taxes would harm the Company's financial performance.

The wine industry is regulated extensively by the Federal Tax and Trade Bureau and state and local liquor authorities and State of California environmental agencies. These regulations and laws dictate various matters, including:

- Excise taxes;
- Licensing requirements;
- Trade and pricing practices;
- Permitted distribution channels;
- Permitted and required labeling;
- Advertising;
- Relationships with distributors and retailers; and
- Air quality, storm water and irrigation use.

Recent and future zoning ordinances, environmental restrictions and other legal requirements may limit the Company's plans to expand production capacity, as well as any future development of new vineyards and wineries. In addition, federal legislation has been proposed that could significantly increase excise taxes on wine. Other federal legislation has been proposed which would prevent the Company from selling wine directly through the mail. This proposed legislation, or other new regulations, requirements or taxes, could harm business and operating results. Future legal or regulatory challenges to the wine industry could also harm business and impact the Company's operating results.

Prompted by growing government budget shortfalls and public reaction against alcohol abuse, Congress and many state legislatures are considering various proposals to impose additional excise taxes on the production and sale of alcoholic beverages, including table wines. Some of the excise tax rates being considered are substantial. The ultimate effects of such legislation, if passed, cannot be assessed accurately since the proposals are still in the discussion stage. Any increase in the taxes imposed on table wines can be expected to have a potentially adverse impact on overall sales of such products. However, the impact may not be proportionate to that experienced by producers of other alcoholic beverages and may not be the same in every state.

An increase in the cost of energy or the cost of environmental regulatory compliance could affect the Company's profitability.

The Company has experienced increases in energy costs, and energy costs could continue to rise, which would result in higher transportation, freight and other operating costs. The Company may experience significant future increases in the costs associated with environmental regulatory compliance, including fees, licenses and the cost of capital improvements to the Company's operating facilities in order to meet environmental regulatory requirements. Future operating expenses and margins will be dependent on the ability to manage the impact of cost increases. The Company cannot guarantee that it will be able to pass along increased energy costs or increased costs associated with environmental regulatory compliance to its customers through increased prices.

In addition, the Company may be party to various environmental remediation obligations arising in the normal course of business or in connection with historical activities of businesses that may be acquired. Due to regulatory complexities, uncertainties inherent in litigation and the risk of unidentified contaminants at current and former properties, the potential exists for remediation, liability and indemnification costs to differ materially from the costs that have been estimated. The Company cannot guarantee that the cost in relation to these matters will not exceed

projections or otherwise have an adverse effect upon the Company's business reputation, financial condition or results of operations.

Climate change, or legal, regulatory or market measures to address climate change, may negatively affect the Company's business, operations or financial performance, and water scarcity or poor water quality could negatively impact production costs and capacity.

The Company's business depends upon agricultural activity and natural resources. There has been much public discussion related to concerns that carbon dioxide and other greenhouse gases in the atmosphere may have an adverse impact on global temperatures, weather patterns and the frequency and severity of extreme weather and natural disasters. Severe weather events and climate change may negatively affect agricultural productivity in the regions from which the Company presently sources agricultural raw materials such as grapes. Decreased availability of raw materials may increase the cost of goods for the Company's products. Severe weather events or changes in the frequency or intensity of weather events can also disrupt the supply chain, which may affect production operations, insurance cost and coverage, as well as delivery of products to wholesalers, retailers and consumers.

Water is essential in the production of the Company's products. The quality and quantity of water available for use is important to the supply of grapes and the Company's ability to operate its business. Water is a limited resource in many parts of the world and if climate patterns change and droughts become more severe, there may be a scarcity of water or poor water quality that may affect production costs or impose capacity constraints. Such events could adversely affect results of operations and financial condition.

Natural disasters, including earthquakes or fires, could destroy the Company's facilities or the Company's inventory, and/or negatively impact contracted third-party production and storage capacity and availability.

The Company must store its wine in a limited number of locations for a period of time prior to its sale or distribution. Any intervening catastrophes, such as an earthquake or fire, that result in the destruction of all or a portion of its wine would result in a loss of investment in, and anticipated profits and cash flows from, that wine. Such a loss would seriously harm business and reduce sales and profits. See Note 14, "Subsequent Events".

From time to time the Company may become subject to litigation arising in the ordinary course of business. Uninsured judgments or a rise in insurance premiums may adversely impact business, financial condition and results of operations.

In the ordinary course of business, the Company may become subject to legal and regulatory proceedings. Any claims raised in such proceedings, whether with or without merit, could be time consuming and expensive to defend and could divert management's attention and resources. Additionally, the outcome of such proceedings may differ from expectations because outcomes are often difficult to predict reliably. Various factors can lead to changes in estimates of liabilities and other costs and may require the Company to make new or additional estimates. A future adverse ruling, settlement or unfavorable development could result in charges that could have a material adverse effect on results of operations in any particular period.

In accordance with customary practice, the Company maintains insurance against some, but not all, potential claims. In the future, the Company may not be able to maintain insurance at commercially acceptable premium levels. In addition, the levels of insurance the Company maintains may not be adequate to fully cover any and all losses or liabilities. If any significant judgment or claim is not fully insured or indemnified against, it could have a material adverse impact on the business, financial condition and results of operations.

Risks Related to the Company's Organizational Structure

Truett-Hurst, Inc.'s only material asset is its interest in the LLC, and it is accordingly dependent upon distributions from the LLC to pay taxes, make payments under the tax receivable agreement or pay dividends.

The Company is a holding company and has no material assets other than its controlling member equity interest in the LLC. It has no independent means of generating revenue. The Company will cause the LLC to make distributions to its unit holders in an amount sufficient to cover all applicable taxes at assumed tax rates, payments

under the tax receivable agreement (which the Company expects to be substantial) and dividends, if any, declared by the Company. To the extent that the Company needs funds, and the LLC is restricted from making such distributions under applicable law or regulation or under the terms of its financing arrangements, or is otherwise unable to provide such funds, it could materially adversely affect the liquidity and financial condition of the Company.

The Founders have significant influence on Truett-Hurst, Inc. and their interests may differ from those of the public shareholders.

As of June 30, 2017, the Founders and Affiliates control 41% of the combined voting power through their ownership of the outstanding Class A common stock and/or Class B common stock. Because the Founders and Affiliates hold a majority of their ownership interest in the business through the LLC (approximately 94% of their ownership), rather than through the public company, the Founders and Affiliates may have conflicting interests with holders of shares of the Class A common stock. For example, the Founders and Affiliates may have different tax positions from the Company which could influence their decisions regarding whether and when to dispose of assets, whether and when to incur new or refinance existing indebtedness, especially in light of the existence of the tax receivable agreement that the Company entered in to, and whether and when the Company should terminate the tax receivable agreement and accelerate the obligations thereunder. In addition, the structuring of future transactions may take into consideration the Founders' and Affiliates' tax or other considerations even where no similar benefit would accrue to the Company. The tax receivable agreement also provides that upon certain mergers, asset sales, or other forms of business combinations, substantial payment obligations to the Founders and Affiliates will accelerate.

The Company will be required to pay the counterparties to the tax receivable agreement for certain tax benefits the Company may claim arising in connection with current exchanges, future purchases or exchanges of LLC Units and related transactions, and the amounts the Company may pay could be significant.

The Company entered into a tax receivable agreement with the pre-IPO owners that provides for the payment by Truett-Hurst, Inc. to these parties of 90% of the benefits, if any, that Truett-Hurst, Inc. is deemed to realize as a result of the increases in tax basis resulting from its purchases or exchanges of LLC Units and certain other tax benefits related to it entering into the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement.

The Company expects the payments that it may make under the tax receivable agreement will be substantial. There may be a material negative effect on the Company's liquidity if, as a result of timing discrepancies or otherwise, the payments under the tax receivable agreement exceed the actual benefits realized in respect of the tax attributes subject to the tax receivable agreement and/or distributions to Truett-Hurst, Inc. by the LLC, or if LLC funds are not sufficient to permit Truett-Hurst, Inc. to make payments under the tax receivable agreement after it has paid taxes. The payments under the tax receivable agreement are not conditioned upon the continued ownership of the Company by the counterparties to the tax receivable agreement. The tax receivable agreement also provides that upon certain mergers, asset sales, or other forms of business combinations, substantial payment obligations to the Founders and Affiliates will accelerate.

The Company is required to make a good faith effort to ensure that it has sufficient cash available to make any required payments under the tax receivable agreement. The operating agreement of the LLC requires the LLC to make "tax distributions" which, in the ordinary course, will be sufficient to pay the actual tax liability and to fund required payments under the tax receivable agreement. If for any reason the LLC is not able to make a tax distribution in an amount that is sufficient to make any required payment under the tax receivable agreement or the Company otherwise lacks sufficient funds, interest would accrue on any unpaid amounts at LIBOR plus 500 basis points until they are paid. If the Company breaches any of its material obligations under the tax receivable agreement, substantial payment obligations will generally be accelerated and due as if the Company had exercised its right to terminate the agreement

In the event that the Company and an exchanging LLC Unit holder are unable to resolve a disagreement with respect to the tax receivable agreement, the Company is required to appoint either an expert in the relevant field or an arbitrator to make a determination, depending on the matter in dispute.

In certain cases, payments under the tax receivable agreement to the existing owners may be accelerated and/or significantly exceed the actual benefits realized in respect of the tax attributes subject to the tax receivable agreement.

The tax receivable agreement provides that upon certain mergers, asset sales, other forms of business combinations or other changes of control, or if, at any time, Truett-Hurst, Inc. elects an early termination of the tax receivable agreement, Truett-Hurst, Inc.'s (or its successor's) obligations with respect to exchanged or acquired LLC Units (whether exchanged or acquired before or after such transaction) would be based on certain assumptions, including that the corporate taxpayer would have sufficient taxable income to fully utilize the deductions arising from the increased tax deductions and tax basis and other benefits related to entering into the tax receivable agreement. As a result, (i) the Company could be required to make payments under the tax receivable agreement that are greater than or less than the specified percentage of the actual benefits realized in respect of the tax attributes subject to the tax receivable agreement and (ii) if the Company elects to terminate the tax receivable agreement early, the Company would be required to make an immediate payment equal to the present value of the anticipated future tax benefits, and this upfront payment may be made years in advance of the actual realization of such future benefits. Upon a subsequent actual exchange, any additional increase in tax deductions, tax basis and other benefits in excess of the amounts assumed at the change in control will also result in payments under the tax receivable agreement. In these situations, the Company's obligations under the tax receivable agreement could have a substantial negative impact on its liquidity. There can be no assurance that the Company will be able to finance its obligations under the tax receivable agreement.

Payments under the tax receivable agreement are based on the tax reporting positions that the Company determines. Although the Company is not aware of any issue that would cause the IRS to challenge a tax basis increase, Truett-Hurst, Inc. will not be reimbursed for any payments previously made under the tax receivable agreement. As a result, in certain circumstances, payments could be made under the tax receivable agreement in excess of the benefits that Truett-Hurst, Inc. actually realizes in respect of (i) the increases in tax basis resulting from exchanges of LLC Units and (ii) certain other tax benefits related to entering in to the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement.

Risks Related to the Company's Class A Common Stock

The Company's failure to meet the continued listing requirements of The NASDAQ Capital Market could result in a delisting of the Class A common stock.

If the Company fails to satisfy the continued listing requirements of The NASDAQ Capital Market, such as the requirement that it maintain a share price of at least $1.00 per share, NASDAQ may take steps to de-list the Class A common stock. Such a delisting would likely have a negative effect on the price of the Class A common stock and would impair your ability to sell or purchase the Company's Class A common stock when you wish to do so. In the event of a delisting, the Company would expect to seek to take actions to restore compliance with NASDAQ's listing requirements, but the Company can provide no assurance that any such action taken would allow the Class A common stock to become listed again, stabilize the market price or improve the liquidity of the Class A common stock or prevent the Class A common stock from dropping below the NASDAQ minimum bid price requirement in the future.

The Company does not intend to pay any cash dividends in the foreseeable future.

The Company does not expect to pay any dividends in the foreseeable future. Payments of future dividends, if any, will be at the discretion of the board of directors after taking into account various factors, including the business, operating results and financial condition, current and anticipated cash needs, plans for expansion and any legal or contractual limitations on the Company's ability to pay dividends. As a result, capital appreciation in the price of the Class A common stock, if any, may be the only source of gain on an investment in the Class A common stock.

Even if the Company decides in the future to pay any dividends, Truett-Hurst, Inc. is a holding company with no independent operations of its own except its controlling member equity interest in the LLC. As a result, Truett-Hurst, Inc. depends on LLC and its affiliates for cash to pay its obligations and make dividend payments. Deterioration in the financial condition, earnings or cash flow of LLC and its affiliates for any reason could limit or impair its ability to pay cash distributions or other distributions to us. In addition, the Company's ability to pay dividends in the future is dependent upon receipt of cash from LLC and its affiliates. LLC and its affiliates may be restricted from sending cash to the Company by, among other things, law or provisions of the documents governing the Company's existing or future indebtedness.

If securities or industry analysts stop publishing research or reports about the Company's business, or if they downgrade their recommendations regarding the Company's Class A common stock, the stock price and trading volume could decline further.

As a small-cap company, our common stock has limited liquidity. The market price and trading volume of shares of the common stock are volatile and are likely to continue to fluctuate substantially in response to various factors, many of which are beyond our control and may not be related to operating performance. The trading market for the Company's Class A common stock is influenced by the research and reports that industry or securities analysts publish about the Company or its business. The Company has limited research coverage for its stock and it is difficult to attract research coverage for small-cap companies like ours. If any of the analysts who cover the Company downgrades the Company's Class A common stock or publishes inaccurate or unfavorable research about the Company's business, its Class A common stock price may decline further. If analysts cease coverage of the Company or fail to regularly publish reports on the Company, the Company could lose visibility in the financial markets, which in turn could cause the Class A common stock price or trading volume to decline further and the Class A common stock to be less liquid.

The market price and trading volume of the Company's common stock are volatile and may be affected by market conditions beyond the Company's control.

As a small-cap company, our common stock has limited liquidity. The market price and trading volume of shares of the common stock are volatile and are likely to continue to fluctuate substantially in response to various factors, many of which are beyond our control and may not be related to operating performance. These fluctuations could cause investors to lose part or all of their investment in shares of the Company's common stock. In addition, operating results could be below the expectations of the public market analysts and investors due to a number of potential factors, including variations in quarterly operating results, departures of key management personnel, failure to meet analysts' earnings estimates, publication of research reports about the industry, litigation and government investigations, changes or proposed changes in laws or regulations or differing interpretations or enforcement thereof affecting the Company's business, adverse market reaction to any indebtedness the Company may incur or securities the Company may issue in the future, and other factors. You may be unable to resell your shares of Class A common stock at or above the price you originally paid. In addition, as a result of the Company's market capitalization, among other factors, there is limited liquidity in the market for the Company's common stock. As a result, even if you choose to sell your shares of Class A common stock, you may find it difficult to do so.

In past years, stock markets have experienced extreme price and volume fluctuations. In the past, following periods of volatility in the overall market and the market price of a company's securities, securities class action litigation has often been instituted against these companies. This litigation, if instituted against the Company, could result in substantial costs and a diversion of its management's attention and resources.

You may be diluted by the future issuance of additional Class A common stock in connection with the Company's incentive plans, acquisitions or otherwise.

As of June 30, 2017, the Company had an aggregate of 10.6 million shares of Class A common stock authorized but unissued, including approximately 2.76 million shares of Class A common stock issuable upon exchange of outstanding LLC Units and 0.1 million shares reserved for issuance under its 2012 Incentive Plan. See Part II, Item 8, Note 10, "Stock-based Compensation" to the Consolidated Financial Statements included in this Annual Report on Form 10-K. The certificate of incorporation authorizes the Company to issue these shares of Class A common stock and restricted stock rights relating to Class A common stock for the consideration and on the terms and conditions established by the board of directors in its sole discretion. Any Class A common stock that is issued, including under the 2012 Incentive Plan or other equity incentive plans that the Company may adopt in the future, would dilute the percentage ownership held by then existing holders of Class A common stock.

The Company incurs increased costs and demands upon management as a result of complying with the laws and regulations that affect public companies, which could materially adversely affect results of operations, financial condition, business and prospects.

As a public company, the Company incurs significant legal, accounting and other expenses that it did not incur as a private company, including costs associated with public company reporting and corporate governance requirements. These requirements include compliance with Section 404 and other provisions of the Sarbanes-Oxley Act, as well as rules implemented by the SEC and NASDAQ. In addition, the management team will also have to adapt to the requirements of being a public company. The Company expects compliance with these rules and regulations will substantially increase its legal and financial compliance costs and will make some activities more time-consuming and costly.

The increased costs associated with operating as a public company will decrease the Company's net income or increase its net loss, and may require the Company to reduce costs in other areas of its business or increase the prices of its products or services. Additionally, if these requirements divert management's attention from other business concerns, they could have a material adverse effect on the Company's results of operations, financial condition, business and prospects.

However, for as long as the Company remains an "emerging growth company" as defined in the JOBS Act, the Company may take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not "emerging growth companies" including not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in the Company's periodic reports and proxy statements and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and shareholder approval of any golden parachute payments not previously approved. The Company may take advantage of these reporting exemptions until it is no longer an "emerging growth company."

The Company will not be required to comply with certain provisions of the Sarbanes-Oxley Act for as long as it remains an "emerging growth company."

For as long as the Company remains an emerging growth company, it may take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not emerging growth companies including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in its periodic reports and proxy statements, and exemptions from the requirements of holding a non-binding advisory vote on executive compensation. The Company may take advantage of these reporting exemptions until it is no longer an emerging

growth company. The Company will remain an emerging growth company until the beginning of FY19 unless it no longer qualifies for such status prior to that time. After the Company is no longer an emerging growth company, it expects to incur additional expenses and devote substantial management effort toward ensuring compliance with those requirements applicable to companies that are not emerging growth companies.

Reduced disclosure requirements applicable to emerging growth companies may make the Company's common stock less attractive to investors.

As an "emerging growth company," the Company takes advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not "emerging growth companies" including not being required to comply with the auditor attestation requirements of section 404 of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in its periodic reports and proxy statements and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and shareholder approval of any golden parachute payments not previously approved. The Company cannot predict if investors will find its common stock less attractive as it relies on these exemptions. If some investors find the common stock less attractive as a result, there may be a less active trading market for the Company's common stock and its stock price may be more volatile.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

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 two 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 facility 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. In June of 2016, the Company settled outstanding litigation related to this tasting room and winery production facility lease in exchange for payment of $1.0 million to the LLC, quitclaimed certain rights, and modified its lease such that the Company vacated the tasting room portion of the property prior to December 31, 2016, and vacated the winery production portion prior to May 31, 2017. The Company received a series of settlement payments totaling $1.0 million in fiscal year 2017. The entire $1.0 million was recorded as a gain in other income on the consolidated statement of operations in FY17. The gain was offset by a reserve for abandoned assets in the amount of $0.1 million. The $0.1 million represents the book value of assets that were left at the property when the Company vacated the premises in December 2016.

The Company leases approximately 2,500 square feet for administrative offices at 125 Foss Creek Circle, Healdsburg, California. In June 2016, the Company renewed the lease for an additional three years. The renewed lease term is November 1, 2016 through October 31, 2019. The Company also leases approximately 1,600 square feet for executive and administrative offices at 165 Foss Creek Circle, Healdsburg, California. The lease commenced on September 1, 2016 and ends on October 31, 2019.

The Company considers these facilities to be suitable and adequate for the management and operation of its business. For additional information related to leases, see Part II, Item 8, Note 8, "Commitments and Contingencies."

Item 3. Legal Proceedings

The Company may be subject to various litigation matters arising in the ordinary course of business from time to time. Other than the matters discussed below, the Company is not aware of any current pending legal matters or claims, individually or in the aggregate, that are expected to have a material adverse impact on its consolidated financial position, results of operations, or cash flows.

In January 2016, Mendocino Wine Group ("MWG") filed a complaint against Phil Hurst and the LLC. The complaint alleges that, prior to January 2012, Phil Hurst and the LLC aided and abetted Paul Dolan in his alleged breach of fiduciary duties to MWG and that they interfered with Paul Dolan's contract with Thornhill Management Company (the manager of MWG), and aided and abetted Paul Dolan's interference with MWG's economic advantage. Phil Hurst and the LLC deny the claims, deny all wrongdoing, and deny that they caused any harm to MWG. In November 2016, the Sonoma County Superior Court granted MWG's Motion to Consolidate the Hurst/LLC case with a second complaint MWG filed against a law firm for legal malpractice and breach of fiduciary duty. The Court ruled the cases were sufficiently related and should be tried together. A new trial date has been set for November 2017. No amount has been recorded in the consolidated financial statements related to this suit. In October 2017, the Sonoma County Superior Court granted the Company's summary judgement motion and dismissed the case against Phil Hurst and the LLC. The plaintiff, MWG, has 60 days to appeal the Court's decision. If such an appeal is filed, the process may take 9 to 18 months to obtain a final resolution.

In June 2016, the Company settled outstanding litigation with the Hambrecht Wine Group, L.P. related to the lease of one of its tasting rooms and a winery production facility located at 4035 Westside Road, Healdsburg, California, in exchange for payment of $1.0 million to the LLC, quitclaimed certain rights, and modified its lease such that the Company vacated the tasting room portion of the property prior to December 31, 2016, and vacated the winery production portion prior to May 31, 2017. The Company received a series of settlement payments totaling $1.0 million in fiscal year 2017 and recorded a net gain of $0.8 million related to the lease termination in the Company's consolidated statement of operations for the fiscal year ended June 30, 2017.

Indemnification Obligations

The Company's certificate of incorporation and bylaws provide that the Company shall indemnify directors and executive officers and shall indemnify other officers and employees and other agents to the fullest extent permitted by law. The Company believes that indemnification under the bylaws covers at least negligence and gross negligence on the part of indemnified parties. The Company's bylaws also permit us to secure insurance on behalf of any officer, director, employee or other agent for any liability arising out of his or her actions in this capacity, regardless of whether the bylaws would permit indemnification.

The Company believes that these provisions are necessary to attract and retain qualified persons as directors and executive officers. Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers or persons controlling the company pursuant to the foregoing provisions, the opinion of the SEC is that such indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable.

In addition, the Company maintains standard policies of insurance under which coverage is provided to its directors and officers against loss arising from claims made by reason of breach of duty or other wrongful act, and to the Company with respect to payments which may be made by it to such directors and officers pursuant to the above indemnification provisions or otherwise as a matter of law. The Company maintains a Directors and Officers liability insurance policy which enables it to recover a portion of future indemnification claims paid, subject to retentions, conditions and limitations of those policies. In addition, the Company makes available standard life insurance and accidental death and disability insurance policies to its employees.

Item 4. Mine Safety Disclosures

Not Applicable.

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PART II

Item 5. Market for Registrant’s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

Market Information and Holders

The Company’s Class A common stock is traded on The NASDAQ Capital Market under the symbol “THST.” As of June 30, 2017, there were 19 holders of record of Class A common stock and 7 holders of record of Class B common stock. The following table sets forth, for the quarterly periods indicated, the high and low sales prices per share for the Class A common stock, as reported on The NASDAQ Capital Market:

Fiscal 2016	Low Price	High Price
Quarter ended 9/30/2015	$.91	$2.84
Quarter ended 12/31/2015	$.20	$4.50
Quarter ended 3/31/2016	$.92	$1.93
Quarter ended 6/30/2016	$1.20	$1.71

Fiscal 2017	Low Price	High Price
Quarter ended 9/30/2016	$1.55	$2.34
Quarter ended 12/31/2016	$1.58	$1.92
Quarter ended 3/31/2017	$1.74	$2.54
Quarter ended 6/30/2017	$2.00	$2.36

As of September 14, 2017, the last reported sale price on The NASDAQ Capital Market for the Company’s common shares was $2.20 per share. The Company’s Class B common stock is not publicly traded.

Dividend Policy

The Company has never declared or paid any cash dividends on its capital stock. The Company currently anticipates that it will retain all future earnings for use in the expansion and operation of its business and does not anticipate paying any cash dividends in the foreseeable future. Any future determination to declare cash dividends will be made at the discretion of the board of directors, subject to applicable law and will depend on the Company’s financial condition, results of operations, capital requirements, general business conditions and other factors that the board of directors may deem relevant.

The Company is a holding company and has no material assets other than its controlling member equity interest in the LLC. The Company intends to cause the LLC to make distributions in an amount sufficient to cover cash dividends, if any, declared by the Company. If the LLC makes such distributions to the Company, the other holders of LLC Units will be entitled to receive equivalent distributions.

Item 6. Selected Financial Data

The Company is a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and is not required to provide the information required under this Item.

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of the financial condition and results of operations should be read in conjunction with the Consolidated Financial Statements and the related notes included elsewhere in this Annual Report on Form 10-K. In addition to historical consolidated financial information, the following discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions as described under the “Forward-Looking Statements” section that appears earlier in this Annual Report on Form 10-K. Actual results could differ materially from those anticipated by these forward-looking statements as a result of many factors, including those discussed under Item 1A, “Risk Factors,” and elsewhere in this Annual Report on Form 10-K.

Unless the context suggests otherwise, references in this report to “Truett-Hurst,” the “Company,” “we,” “us” and “our” refer (1) prior to the June 2013 initial public offering (“IPO”) of Truett-Hurst Inc. and related transactions, to the LLC and (2) after our IPO and related transactions, to Truett-Hurst Inc.

Overview

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 two tasting rooms on its property 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 brands are differentiated through innovative packaging and label designs and marketed using highly targeted efforts in retailer stores (through tastings with consumers and displays and advertisements).

Wines in the three-tier channel are sold to distributors with products available to the broad market or to specific retailers on an exclusive basis. The traditional three-tier “national brand” distribution business consists of sales of VML,Colby Red, Dearly Beloved,and Healdsburg Ranchsbranded 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, improve gross margins, 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.

Formation Transactions

On June 19, 2013, the limited liability company agreement of the LLC was amended and restated to, among other things, modify its capital structure by replacing the different classes of interests previously held by the Company’s then-existing owners with a single new class of units that are referred to as “LLC Units.” The Company and the Company’s then-existing owners also entered into an exchange agreement under which (subject to the terms of the exchange agreement) they have the right to exchange their LLC Units for shares of Class A common stock on a one-for-one basis, subject to customary conversion rate adjustments for stock splits, stock dividends and reclassifications.

In connection with the IPO, one share of Class B common stock was distributed to each existing holder of LLC Units each of which provides its owner with no economic rights but entitles the holder, without regard to the number of shares of Class B common stock held by such holder, to one vote on matters presented to the Company's shareholders for each LLC Unit held by such holder. Holders of Class A common stock and Class B common stock vote together as a single class on all matters presented to the Company's shareholders for their vote or approval, except as otherwise required by applicable law.

At June 30, 2017, there were 2.76 million LLC Units held by parties other than THI which upon exercise of the right to exchange would exchange for Class A common stock on a one-for-one basis. At June 30, 2017, the Company's Founders and Affiliates control 41% of the voting power of the outstanding Class A common stock and the outstanding Class B common stock. Prior to conversion of their LLC Units, each holder of LLC Units holds a single share of the Class B common stock. Accordingly, the Founders and Affiliates have significant influence on the election of the members of the board of directors, and thereby of the management and affairs.

Exchange and Tax Receivable Agreement

The Company has an exchange agreement with the existing owners of the LLC, several of whom are directors and/or officers. Under the exchange agreement, each LLC member (and certain permitted transferees thereof) may (subject to the terms of the exchange agreement), exchange their LLC Units for shares of Class A common stock of the Company on a one-for-one basis, subject to customary conversion rate adjustments for stock splits, stock dividends and reclassifications, or for cash, at the Company's election. As a holder exchanges their LLC Units, the Company's interest in the LLC will be correspondingly increased. Through June 30, 2017, certain LLC members have exchanged 1.3 million LLC units, on a one-for-one basis, for shares of Class A common stock of the Company, under the exchange agreement.

In connection with the exchange agreement, the Company also has tax receivable agreement ("TRA") with the LLC members. The agreement provides for the payment from time to time, as "corporate taxpayer," to holders of LLC Units of 90% of the amount of the benefits, if any, that the corporate taxpayer is deemed to realize as a result of (i) increases in tax basis resulting from the exchange of LLC Units and (ii) certain other tax benefits related to the Company entering into the agreement, including tax benefits attributable to payments under the agreement. These payment obligations are obligations of the corporate taxpayer and not of the LLC. For purposes of the agreement, the benefit deemed realized by the corporate taxpayer will be computed by comparing the actual income tax liability of the corporate taxpayer (calculated with certain assumptions) to the amount of such taxes that the corporate taxpayer would have been required to pay had there been no increase to the tax basis of the assets of the LLC as a result of the exchanges, and had the corporate taxpayer not entered into the agreement. The term of the agreement will continue until all such tax benefits have been utilized or expired, unless the corporate taxpayer exercises its right to terminate the agreement for an amount based on the agreed payments remaining to be made under the agreement or the corporate taxpayer breaches any of its material obligations under the agreement in which case all obligations will generally be accelerated and due as if the corporate taxpayer had exercised its right to terminate the agreement. In addition, the tax receivable agreement provides that upon certain mergers, asset sales, or other forms of business combinations, substantial payment obligations to the Founders and Affiliates will accelerate.

LLC has made an election under Section 754 of the Internal Revenue Code (the "Code") effective for each taxable year in which an exchange of LLC Units for shares of Class A common stock as described above occurs, which may result in an adjustment to the tax basis of the assets of LLC at the time of an exchange of LLC Units. As a result of these exchanges, Truett-Hurst Inc. will become entitled to a proportionate share of the existing tax basis of the assets of LLC. In addition, the purchase of Holdings Units and subsequent exchanges are expected to result in increases in the tax basis of the assets of LLC that otherwise would not have been available. Both this proportionate share and these increases in tax basis may reduce the amount of tax that Truett-Hurst, Inc. would otherwise be required to pay in the future. These increases in tax basis may also decrease gains (or increase losses) on future dispositions of certain capital assets to the extent tax basis is allocated to those capital assets.

RESULTS OF OPERATIONS

Factors Affecting Operating Results

Net sales are affected by advertising, discounts and promotions, merchandising, packaging and in the wholesale segment, the availability of display space at retailers, all of which have a significant impact on consumers' buying decisions. Continued growth of net sales and profits will depend, substantially, on the continued popularity of new and existing brands, the ability to effectively manage the sales channels, and the ability to maintain sufficient product supply to meet expected growth in demand.

Cost of sales for the wholesale and direct to consumer segments includes wine-related inputs, such as grapes and semi-finished bulk wine, bottling materials, such as bottles, capsules, corks and labeling materials, labor and overhead expenses, including inbound and outbound freight, storage and barrel depreciation.

Comparison of the Fiscal Year 2017 and 2016

The following table compares the financial results by reporting segment:

	Fiscal Years Ended June 30, (in thousands, except percentages)					
	Wholesale		Direct to Consumer		Total	
	2017	2016	2017	2016	2017	2016
Net Sales	$15,576	$20,011	$5,960	$5,772	$21,536	$25,783
Cost of Sales	12,161	15,450	2,153	2,046	14,314	17,496
Gross Profit	$3,415	$4,561	$3,807	$3,726	$7,222	$8,287
Gross Profit %	21.9 %	22.8 %	63.9 %	64.6 %	33.5 %	