Economic Development Board
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Local Economic Report Series

Winter 2004

Presented By
Sonoma County Economic Development Board
in partnership with
Sonoma County Workforce Investment Board

January 2004

The Sonoma County Economic Development Board, in partnership with the Sonoma County Workforce Investment Board, is pleased to present the Winter 2004 edition of the *Sonoma County Local Economic Report*. This report has two sections. The first gives a general overview on the local economy; the second is a new section on stock performance.

The first section suggests that Sonoma County's economy is past the worst of its downturn, although a clear recovery is not yet in sight. The vitality of Sonoma County's driving industries is still shaky. Key highlights from the report include:

- Positive indicators include a solid pace of house-price appreciation, decling office vacancy rates, and a fall in the number of business bankrupcies.

- Biotech and telecom are stabalizing and will bolster the local economy as capital investment flows back into technology.

- The weak dollar is positive for Sonoma County businesses. Particularly, it will help Sonoma County wines compete both with imports as well as in overseas markets.

- Office vacancies, while still high, show improvement. Firms appear ready for expansion, and new business services are entering the area.

- Long term, Sonoma County will be an above-average performer.

The second section shows how the Sonoma sector of the North Bay Stock Index outperformed the general market. This section shows publicly traded businesses in Sonoma County that are strong performers in the stock market.

Economy.com produces the first section in the Local Economic Report Series for the EDB. Brad Zigler has written the summary on Sonoma County stocks. Thank you for your continuing interest in the local economy.

Yours sincerely,

Ben Stone

Ben Stone
EDB Director

SONOMA COUNTY

EMPLOYMENT GROWTH

2002-04

257

2002-07

78

Best=1 Worst=325

MSA LIFE CYCLE PHASE
Growth/Mature

VITALITY

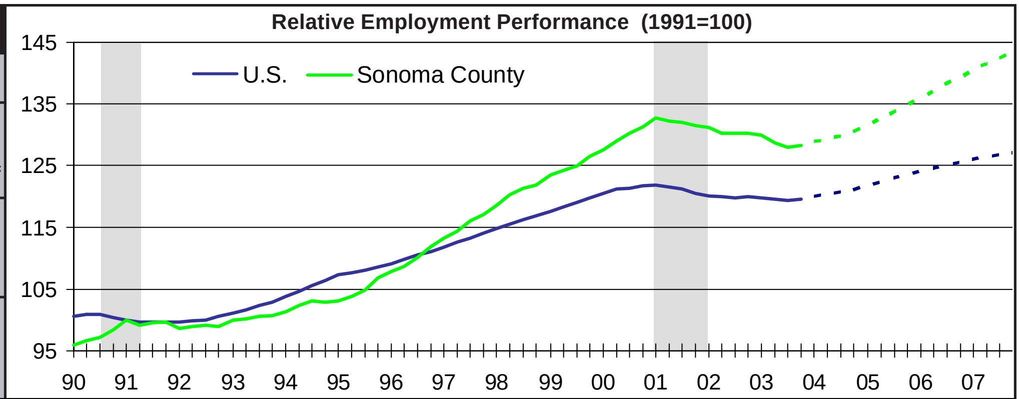
Best= 1 **225** Worst= 325

COST OF DOING BUSINESS

U.S. = 100% **118%**

COST OF LIVING

U.S. = 100% **128%**



1996	1997	1998	1999	2000	2001	2002	Indicators	2003	2004	2005	2006	2007
9.9	10.9	11.8	12.7	14.3	14.3	14.5	**Gross Metro Product, C$B**	14.9	15.3	15.9	16.6	17.3
4.6	*9.8*	*8.1*	*7.5*	*12.6*	*0.3*	*1.6*	*% Change*	*2.1*	*3.0*	*3.6*	*4.6*	*4.3*
157.5	165.4	173.0	179.3	186.1	189.8	187.4	**Total Employment (000)**	184.8	186.0	191.2	197.7	203.8
4.8	*5.0*	*4.6*	*3.6*	*3.8*	*2.0*	*-1.3*	*% Change*	*-1.4*	*0.7*	*2.7*	*3.4*	*3.1*
4.4	3.8	3.3	2.7	2.6	2.9	4.5	**Unemployment Rate**	4.8	4.7	4.4	4.1	3.9
6.4	8.4	8.1	6.2	13.4	-0.2	-0.7	**Personal Income Growth**	1.9	5.3	6.3	6.4	6.2
428.4	437.1	445.9	453.4	460.4	466.5	468.4	**Population (000)**	471.1	477.1	486.3	497.3	507.4
1,412	1,785	2,098	2,348	2,013	1,717	1,350	**Single-Family Permits**	1,564	2,023	1,839	1,895	1,887
75	176	964	688	492	866	578	**Multifamily Permits**	571	644	608	688	739
214.7	224.7	245.3	274.8	324.4	362.4	395.1	**Existing Home Price ($Ths)**	439.0	464.3	482.1	496.1	513.1
2,458	2,839	5,163	4,499	3,990	8,651	10,546	**Mortgage Originations ($Mil)**	13,929	5,508	3,536	3,806	4,125
4.3	7.0	7.1	6.0	5.3	4.1	-0.3	**Net Migration (000)**	0.2	3.5	6.5	8.3	7.1
2,011	2,090	2,173	1,627	1,158	1,183	1,223	**Personal Bankruptcies**	1,262	1,109	976	949	981

STRENGTHS & WEAKNESSES

STRENGTHS

- High per capita income.
- Weak dollar supports SON's export-based industries such as wine and technology.
- Attractive environment.

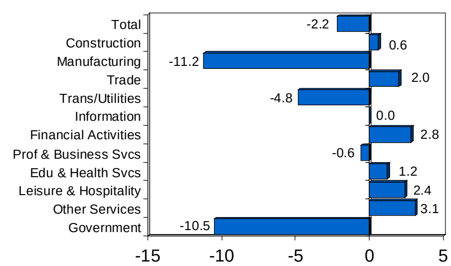
WEAKNESSES

- Global wine prices still weak.
- High cost of living.
- Complex regulatory environment.
- Local government finances constrained by state budget crisis.

CURRENT EMPLOYMENT TRENDS

November 2003 Employment Growth

% Change Year Ago



FORECAST RISKS

SHORT TERM ↓ LONG TERM ↑ RISK-ADJUSTED RETURN, '02-07 **0.73%**

UPSIDE

- Business investment quickly accelerates for high-tech telecom and optical equipment.
- Turnaround in tourism boosts hospitality and wine industries.

DOWNSIDE

- Housing market suffers price correction as interest rates rise, diminishing homeowners' equity.
- Vineyard prices fall, hindering financial condition of the industry and generating further consolidation.

ANALYSIS

Recent Performance. The economy of Sonoma County (SON) is past the worst of its downturn, although a clear recovery is not yet in sight. Employment has nearly leveled off and the unemployment rate is holding steady, but there still is little vitality in SON's driving industries. New hiring at some firms continues to be offset by cutbacks elsewhere, such as at Medtronic, where several hundred jobs will be lost soon when production is shifted overseas. Positive indicators for the economy, however, include a solid pace of house-price appreciation, declining office vacancy rates, and a fall in the number of business bankruptcy filings.

Tech. Demand and price conditions are past their worst for biotech and telecom. Employment cutbacks are slowing and, while it is only half its peak level of two years ago, employment in the medical device industry has leveled off. Firms that survived the shakeout are positioned for growth. TriVascular, for example, hopes to hire 100 workers this year, with more later depending on approvals for new stent grafts. Some venture capital is also flowing to biotech.

Telecom markets are finally stabilizing with an acceleration in nationwide business investment. Demand for DSL equipment by major phone networks, and upgrades of telephone technology support local equipment suppliers. Venture capital is also trickling back to telecom. For example, Triformix received a new funding round in last year's fourth quarter. Expect tech industries to bolster the local economy, although further potential for some large scale production to be shifted overseas dampens employment prospects.

Tourism. The outlook for tourism activity is good, as income growth nationwide and in California is improving. Combined with nationwide pent-up demand for high-end goods and services, resort and spa destinations are expected to see improved demand this year. Pricing may still be a problem as supply of such services has expanded, but occupancy rates will be stronger.

Wine. The wine and viticulture industries will be the last to recover among the area's most important drivers due to the global competition that generates still-rising supplies of grapes and wine, but the worst conditions for the industry are now likely past. Factors supporting tourism, income growth and demand for high-end goods, will also provide a boost to wine sales this year. Also, the size of the recent grape harvest was below expectations, but of good quality, which should support prices of the vintage. Further, red wine now being released from SON's 2001 vintage is of particularly good quality. Finally, the weak dollar allows domestic wines to compete more easily with imports and in overseas markets.

Pricing remains the weakest component of the industry, forcing winemakers to focus most on cost containment and marketing. Thus, capital investment will remain weak in the near term, limiting local demand in related industries that supply grape growers and winemakers.

Real estate. Office markets in SON show signs of improvement, with an average vacancy rate of 15.3% in the third quarter according to Keegan & Coppin, down from a peak of over 19% at the end of 2002. Firms appear ready to plan for expansion, and new business services are entering the area. While employment in business and professional services is down over the year, it has risen from a low in early 2003. SON's industrial market is much healthier, with the industrial vacancy rate near 8%, well below the national average.

Sonoma County's outlook is improving and 2004 will see the first positive job growth since the 2001 recession. The pace of recovery will be slow at first, as all of its major driver industries still face pricing pressures and excess production in their respective markets. Longer term, however, SON will regain its pace to become an above average performer.

Steven G. Cochrane
January 2004

EMPLOYMENT & INDUSTRY

TOP EMPLOYERS

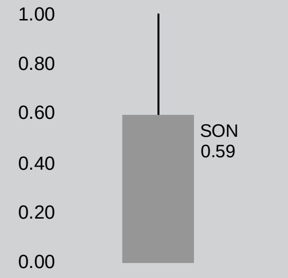
Agilent Technologies, Inc.	2,600
Sonoma State University	1,799
Medtronic, AVE	1,400
Optical Coating Laboratory	1,300
St. Joseph Health System	1,225
JDS Uniphase Corporation	1,200
State Farm Insurance Company	822
Kendall-Jackson Wine Estates	820
Sutter Medical Center	752
Target Corporation	724
Amy's Kitchen	700
Longs Drug Stores, Inc.	700
Kaiser Permanente	675
Washington Mutual	650
Hansel Dealer Group	606
Advanced Fibre Communications	600
Cisco Systems, Inc.	600
SBC Communications, Inc.	600
Albertson's, Inc.	590
Macy's	550

Source: North Bay Business Journal, February 2003
The Santa Rosa Press Democrat, June 2003

Public

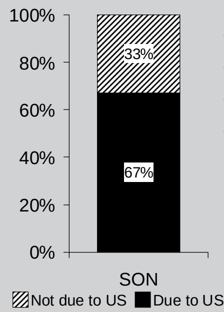
Federal 1,808
State 5,708
Local 20,843
2002

INDUSTRIAL DIVERSITY

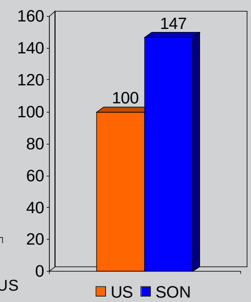


EMPLOYMENT VOLATILITY

DUE TO U.S. FLUCTUATIONS



RELATIVE TO U.S.

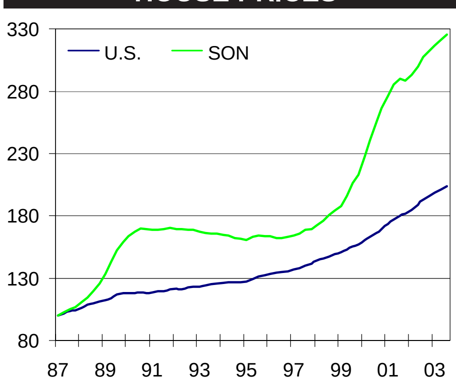


COMPARATIVE EMPLOYMENT AND INCOME

Sector	% of Total Employment SON	CA	US	Average Annual Earnings SON	CA	US
Construction	7.2%	5.3%	5.2%	$50,463	$47,877	$39,845
Manufacturing	14.2%	11.3%	12.0%	$52,640	$55,970	$48,756
Durable	*62.0%*	*64.3%*	*62.0%*	*nd*	*$63,121*	*$50,404*
Nondurable	*38.0%*	*35.7%*	*38.0%*	*nd*	*$42,646*	*$45,969*
Transport/Utilities	2.2%	3.4%	3.6%	$39,995	$47,311	$44,972
Wholesale Trade	3.2%	4.5%	4.4%	$44,017	$52,350	$51,842
Retail Trade	12.9%	10.9%	11.7%	$25,949	$27,420	$22,635
Information	2.3%	3.4%	2.6%	$57,463	$83,422	$69,569
Financial Activities	5.6%	5.9%	6.0%	$27,675	$40,394	$41,740
Prof. & Business Services	10.3%	14.7%	12.4%	$39,583	$48,046	$43,053
Education & Health Services	12.7%	10.4%	12.5%	$33,147	$36,158	$34,032
Leisure & Hospitality Services	10.6%	9.5%	9.0%	$17,930	$23,238	$19,135
Other Services	3.6%	3.5%	3.9%	$22,955	$21,695	$19,842
Government	15.1%	16.9%	16.2%	$43,588	$48,959	$42,939

Source: Percent of total employment - Economy.com & BLS, 2002; Average annual earnings - BEA, 2001

HOUSE PRICES



Source: OFHEO, 1987Q1 = 100, NSA

CREDIT QUALITY

FITCH	MOODY'S
N/A	COUNTY Aa2

LEADING INDUSTRIES

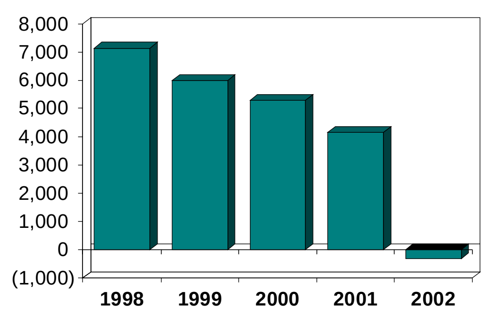
NAICS	Industry	Employees (000)
7222	Limited-Service Eating Places	5.7
FR	Farms	5.3
4451	Grocery Stores	4.8
3345	Nav., Meas., Electro., & Con. Instru. Manuf.	4.8
2360	Construction of Buildings	3.9
PH	Private Household Workers	3.9
7211	Traveler Accommodations	3.3
5511	Management of Companies and Enterprises	2.9
2383	Building Finishing Contractors	2.5
3391	Medical Equipment and Supplies Manufacturing	2.5
2381	Foundation, Struc., & Bldg. Ext. Contractors	2.1
3119	Other Food Manufacturing	2.0
4441	Building Material and Supplies Dealers	2.0
8111	Automotive Repair and Maintenance	2.0
7139	Other Amusement and Recreation Industries	1.8
	High-tech employment	13.6
	As % of total employment	6.9

Source: BLS, Economy.com, 2002

MIGRATION FLOWS

Into Sonoma County	Number of Migrants	Median Income
San Francisco	3,599	38,234
Oakland	1,178	33,343
Vallejo	777	27,593
San Jose	729	42,030
Los Angeles	607	26,211
Sacramento	499	25,688
San Diego	349	20,681
Riverside	219	21,407
Orange County	206	21,590
Seattle	192	24,109
Total Inmigration	14,772	27,943
From Sonoma County		
San Francisco	1,815	32,083
Sacramento	1,438	32,738
Vallejo	1,009	34,661
Oakland	918	28,425
Los Angeles	461	19,860
San Diego	407	17,642
San Jose	396	31,183
Redding	348	32,777
Riverside	329	23,096
Phoenix	325	27,249
Total Outmigration	17,735	26,583
Net Migration	**-2,963**	**1,360**

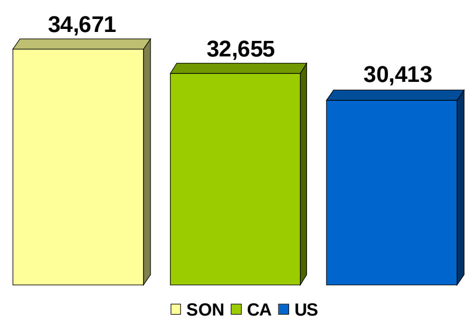
Net Migration, SON



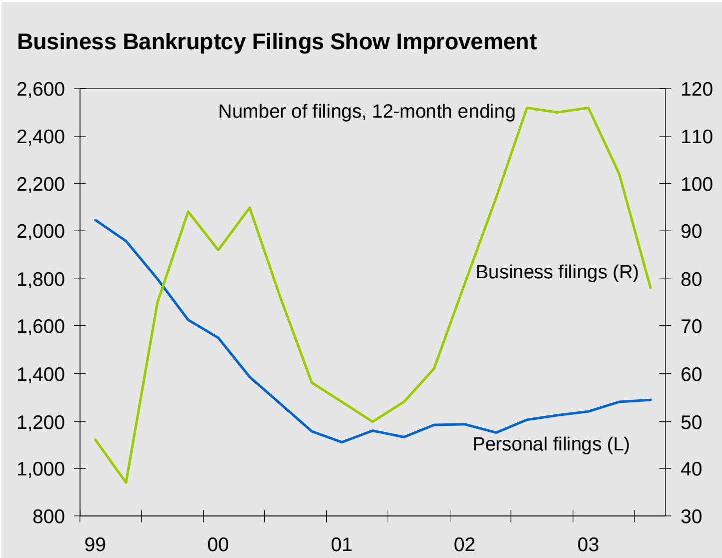
	Domestic	Foreign	Total
1998	3,862	3,269	7,131
1999	2,929	3,055	5,984
2000	2,260	3,020	5,280
2001	1,096	3,054	4,150
2002	-3,360	3,049	-311

Source: IRS (top), 2002; Economy.com & Census Bureau, 2002

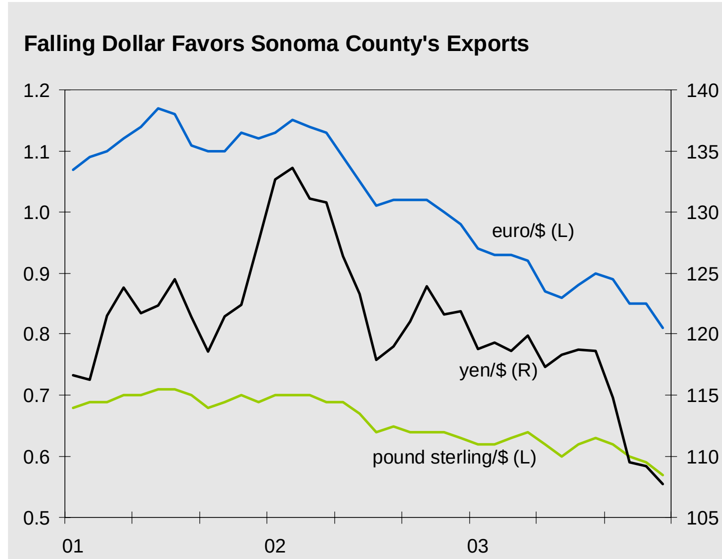
PER CAPITA INCOME



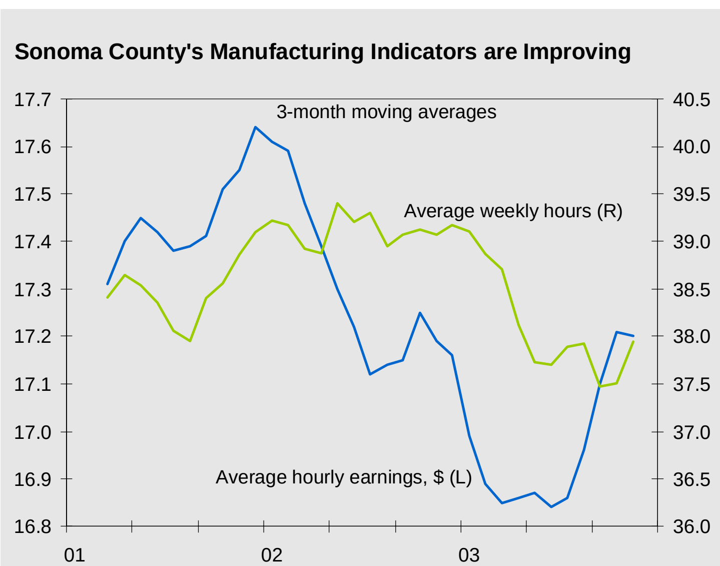
Source: Bureau of Economic Analysis, 2001



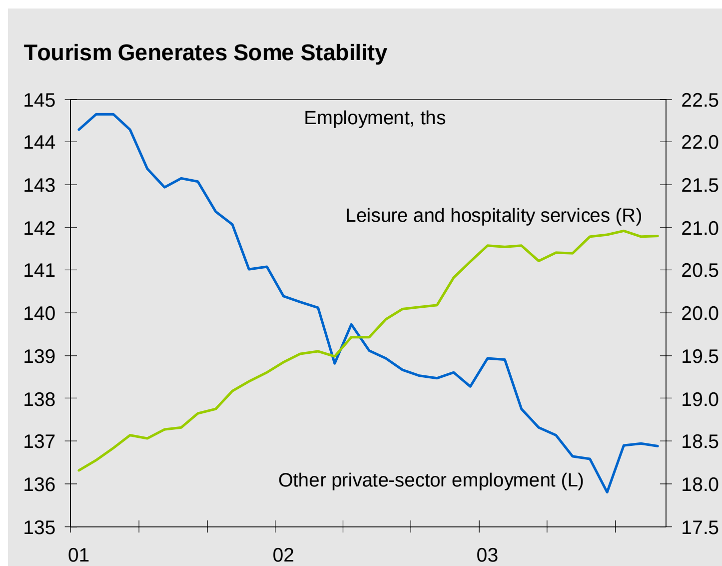
Filings for business bankruptcies are finally falling. This is a good sign for the near-term outlook, as it should translate into fewer personal filings in the near future as payroll cutbacks subside. With business investment nationwide improving, SON's tech-based industries will see improved demand in 2004. Financial pressure, however, may remain within the grape growing and wine industries, as product prices are weak and vineyard values still remain low, indicating further consolidation. For homeowners, however, rising home equity—house-price appreciation remains in the mid-teens—still helps to create a financial cushion that supports consumer spending and confidence.



One of the most important factors supporting SON's economy is the weak U.S. dollar. Export markets for wine and tech products improve when the weak dollar prices them more competitively. Similarly, imported wine in the U.S. becomes more expensive. SON is also less expensive for foreign tourists. Given the broad exposure to international trade in SON, the fall in the dollar is very favorable. The dollar has fallen less versus the pound than it has against other currencies unfortunately, given that the United Kingdom is a major wine market for SON, but still, the dollar/pound exchange rate has weakened by a considerable 20% since mid-2001.



Manufacturing in SON is showing some moderate signs of improvement. Average hourly earnings in manufacturing have risen this year for the first time since the 2001 recession and the number of hours worked per week has stabilized. Employment still has not stabilized, after falling by more than 25% from its peak in early 2001, but with earnings up, hours stable, and a number of firms planning expansions in the coming year, the downturn in manufacturing payrolls should be near an end.

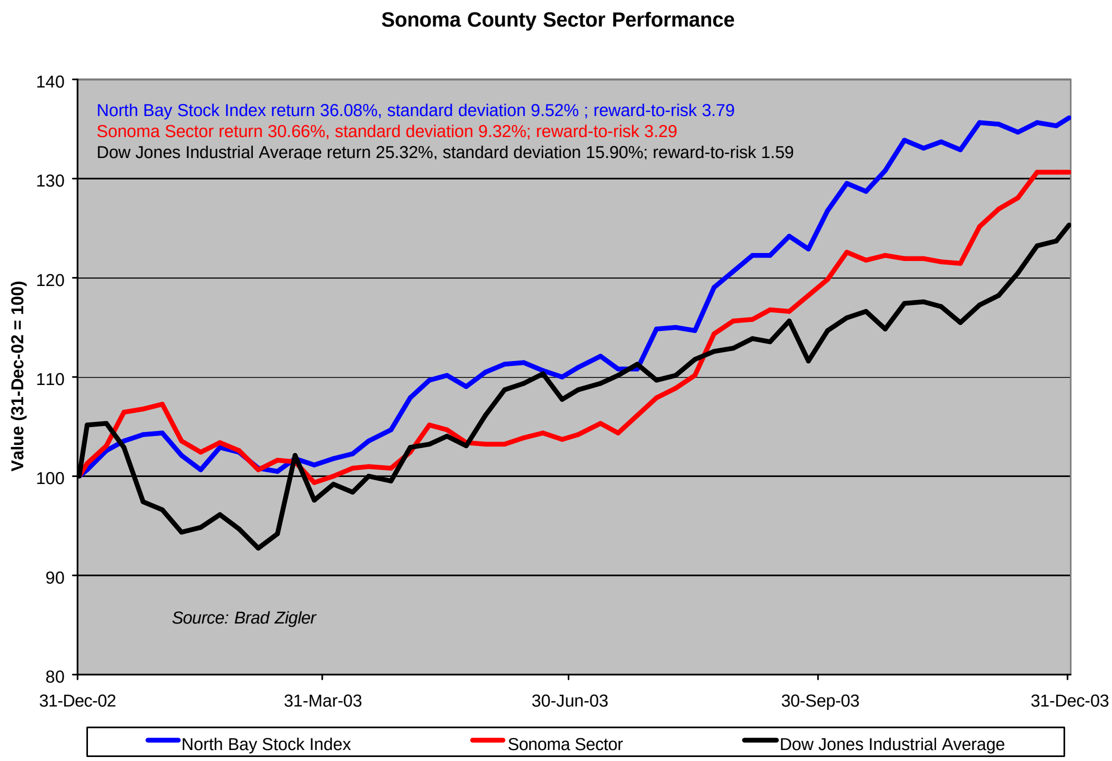


Tourism has been a stabilizing force for the economy throughout SON's recession. It is one of the few industries that has continually added to payrolls. But, even the growth rate of leisure and hospitality employment has slowed in recent months. The local and regional market can sustain the industry for only so long until it must begin to rely once again on visitors from elsewhere in the U.S. and abroad. This is expected to happen this year as income growth and confidence improve in the U.S., and the weak dollar makes U.S. tourist destinations attractive to overseas visitors.

Sonoma stocks outperformed the broad market in 2003

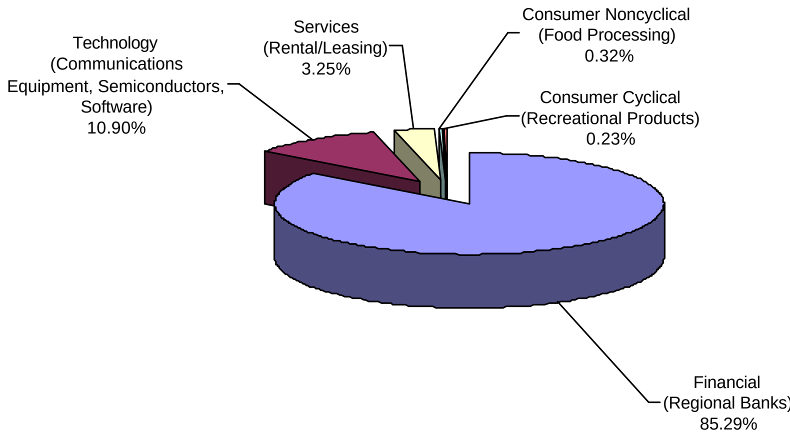
BY BRAD ZIGLER

Sonoma County stocks outperformed the broad market in 2003, with nearly every market measure steadily increasing throughout the year. The Sonoma Sector of the North Bay Stock Index (SBSI) finished the year up 30.66%, while the Dow Jones Industrial Average rose only 25.32%. Local technology stocks bounced back from early-year lows, contributing to the upswing in Sonoma County Sector performance. The best performing industry leaders were Burst.com Inc. (BRST), Advanced Fibre Communications, Inc. (AFCI), and Tegal Corp (TGAL). Collectively, these stocks contributed 3.34% to the Sonoma Sector's rise. Financial stocks also ascended steadily in 2003, accounting for 25.15% of the Sonoma Sector's return. Financial leaders included Redwood Empire Bancorp (REBC), Northern Empire Bancshares (NREB), Exchange Bank-Santa Rosa (EXSR), and Sonoma Valley Bancorp (SBNK).



Only one issue in the ten-stock universe of Sonoma Sector stocks posted a loss for the year. The median Sonoma County stock rose 47.36% year-over-year. Technology issues, ricocheting from early-year lows, contributed greatest to the Sonoma Sector's bounce, balanced by the steady-state ascent of financial stocks.

Sonoma County Sector by Industry (Price-Weighted)



Source: Brad Zigler

Financials

Regional banks accounted for 26.15% of the Sonoma Sector's return, led by:

Redwood Empire Bancorp (REBC) - Up 47.35% on the year, the holding company for National Bank of the Redwoods split its stock 3-for-2 in August and got itself a new CEO.

Northern Empire Bancshares (NREB) - Sonoma National Bank's parent opened a Sonoma branch and split its stock 2-for-1 as shares appreciated 28.15%.

Exchange Bank-Santa Rosa (EXSR) - Launching 2003 with a new CEO, Sonoma County's largest bank opened a lending office in the Sacramento region. The bank's stock rose 25.53% year-over-year.

Sonoma Valley Bancorp (SBNK) - Assets of the two-branch bank rose to $200 million by the third quarter, but a surge in loan delinquencies kept a lid on share price growth. The bank's stock struggled to eke out a 1.53% gain for the year.

Technology

Leading technology's 3.34% contribution to the Sonoma Sector's rise were:

Tegal Corp. (TGAL) - Capital infusions and cost cutting improved the Petaluma-based circuit etcher's prospects as its stock rose 592.50% for the year.

Burst.com Inc. (BRST) - After languishing for most of the year, Burst.com Inc. stock closed out the year 465.00% higher, boosted by developments in its patent infringement suit against Microsoft Corp. (MSFT).

Advanced Fibre Communications, Inc. (AFCI) - AFCI toyed with the notion of being a $20 stock until definitively breaking through resistance in late summer and finishing the year 47.36% higher.

Services

The services sector chipped in 1.00% of the Sector's 2003 return due to the performance of:

SonomaWest Holdings, Inc. (SWHI) - News of a large shareholder's privatization pitch to the SWHI board inflated the share price, by year's end, 47.81%.

Consumer Noncyclicals

Staples provided a scant .10% of the Sonoma Sector's performance:

Spectrum Organic Products, Inc. (SPOP) - Before-tax earnings improvement, despite being partially offset by a spike in the natural oils producer's operating expenses, propelled the company' stock upward 176.67%.

Consumer Cyclical

Alternative energy vehicle distribution brought .07% to the Sonoma Sector's bottom line:

ZAP (ZAPZ) - The only loser in the Sonoma Sector's 2003 roster, ZAPZ creatively financed the purchase of its Santa Rosa headquarters while its stock ratcheted 51.20% lower.

Despite the apparent high volatility of individual components, Sonoma Sector stocks as a group were less risky than their large market brethren. The Dow's volatility, measured by the standard deviation of its weekly returns, was 15.90% while that of the Sonoma Sector was only 9.32%. Standard deviation represents the expected variance from the benchmark's average price a year out. Assuming a continuation of last year's trend, there's now about 2/3 odds Sonoma Sector issues collectively will finish 2004 up or down about 9% from their average prices while the expected whipsaw in the Dow is nearly 16%.

Considering the risks undertaken, local stocks produced returns twice as efficiently as blue chips last year.

Sonoma County Sector Components

	Industry	2003 Gain/Loss	Volatility	Reward/Risk Ratio	31-Dec-02 Price	Liquidity Ratio
Tegal Corp. (TGAL)	Semiconductor Equipment	592.50%	113.27%	5.23	$2.77	$521,684
Burst.com Inc. (BRST)	Software	465.00%	31.83%	14.61	$1.13	$27,053
Spectrum Organic Products, Inc. (SPOP)	Food Processing	176.67%	113.18%	1.56	$0.83	$7,647
SonomaWest Holdings, Inc. (SWHI)	Rental/Leasing	47.81%	75.33%	0.63	$8.50	$2,962
Advanced Fibre Communications, Inc. (AFCI)	Communications Equipment	47.36%	55.94%	0.85	$20.15	$44,330,421
Redwood Empire Bancorp (REBC)	Regional Bank	47.35%	17.94%	2.64	$26.12	$57,144
Northern Empire Bancshares (NREB)	Regional Bank	28.15%	25.87%	1.09	$17.30	$18,245
Exchange Bank-Santa Rosa (EXSR)	Regional Bank	25.53%	16.52%	1.55	$118.00	$14,396
Sonoma Valley Bancorp (SBNK)	Regional Bank	1.53%	19.12%	0.08	$29.65	$16,075
ZAP (ZAPZ)	Recreational Products	-51.60%	105.24%	-0.49	$0.61	$2,617
Median		**47.36%**	**43.89%**	**1.32**	**$12.90**	**$17,160**

Source: Brad Zigler

Liquidity

One of the risks of holding local stocks is their inherent illiquidity. With fewer investors aware of the existence of these issues, the trading marketplace is necessarily limited. Only one Sonoma Sector issue, in fact, is a Standard & Poor's benchmark component: Advanced Fibre Communications, Inc. (AFCI) claims membership in the S&P 400 MidCap Index. With index funds as a natural market, it's no surprise that AFCI earned the top rank for its liquidity ratio. The liquidity ratio measures the size of a transaction necessary to move the stock's price by 1% - the higher the ratio, the more liquid the issue's market. Low-priced and volatile issues like Tegal Corp. (TGAL) and Burst.com Inc. (BRST) exhibited surprisingly high liquidity.

Insider transactions

Sales of Sonoma Sector stocks by officers and directors outstripped purchases by a factor of 2.47-to-1 in 2003. However, because insiders at three of the seven reporting companies were net buyers, the median selling ratio was only 1.13-to-1.

Insider transactions are considered to be a bellwether of future stock performance, though not necessarily a guaranty. Insider selling is not necessarily worrisome as officers and directors often sell to raise cash for home purchases, college tuition or simply to reduce the risk of holding concentrated positions in their companies' stock.

Insider selling was most pronounced at Redwood Empire Bancorp (REBC) and Sonoma Valley Bancorp (SBNK).

Sonoma Sector Insider Transactions

	Sales	Buys	Ratio
REBC	$1,103,116	$176,750	6.24
SBNK	$218,817	$101,518	2.16
AFCI	$2,055,615	$1,303,250	1.58
TGAL	$62,740	$92,550	0.68
SWHI	$0	$76,020	0.00
SNTK	$0	$9,400	0.00
SPOP	$908,400	$0	nm
Total	**$4,348,688**	**$1,759,488**	

Source: Brad Zigler

Research reports on the North Bay Stock Index, including the components of its Sonoma Sector, can be found online in the *North Bay Stock Review* at ResearchStock.com.

Author Brad Zigler developed the North Bay Stock Index and its subsector benchmarks for the North Bay Business Journal in 2002. He holds positions in the securities mentioned in this article.

Note:
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