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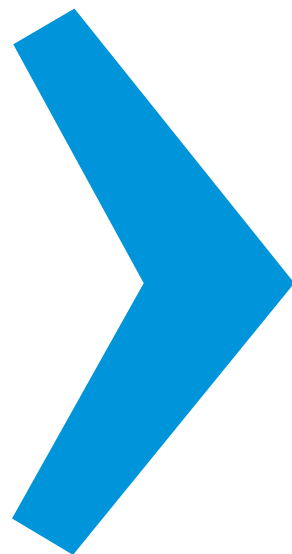


Silicon Valley Bank



# State of the US Wine Industry 2020

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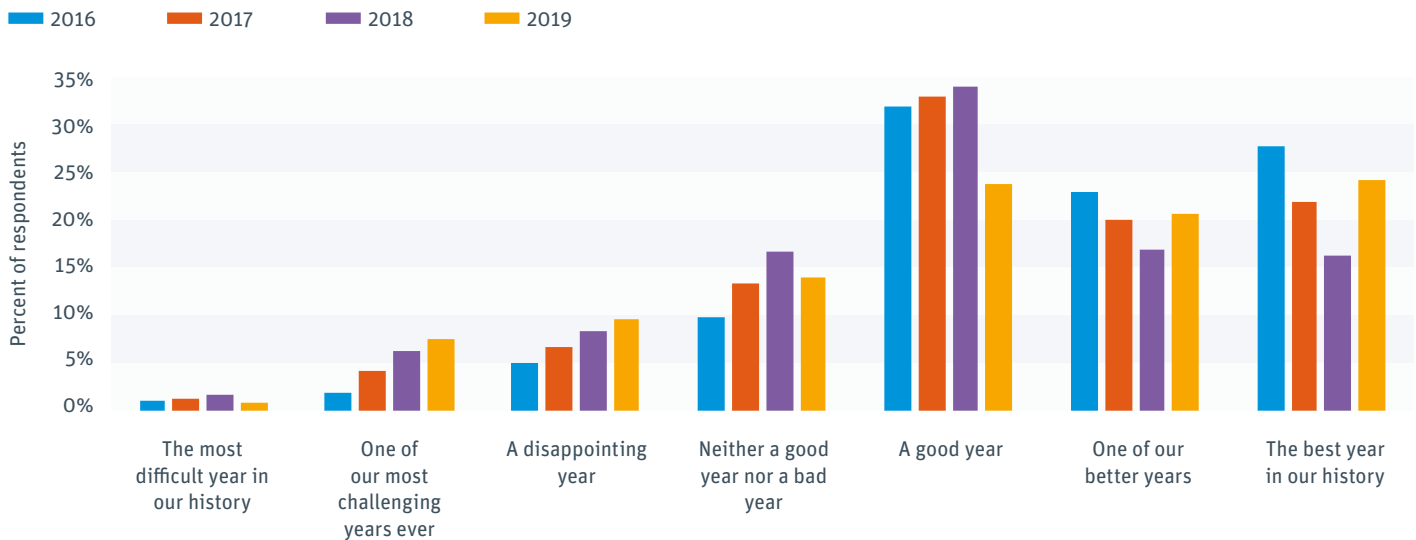


# 1

## Introduction

“We must not think because we put a price on grapes and the people do not take it, that we are therefore overproducing. When we put this product into the consumer’s hands at a reasonable price, we will find that the production will not meet the demand of the consumer, that there will be a demand for every pound of fruit we can produce.”

Hon. A. M. Drew, Fresno. Official Report of the 18th Fruit Growers’ Convention of the State of California, November 23, 1894.

Figure 1: **How was your year?**

Source: SVB State of the Wine Industry Survey

Yes, we are at a point of oversupply in the business cycle. It's not our first. When the industry was in a similar state in 1894, the Honorable A. M. Drew from Fresno, while opining on grape pricing, had an interesting point of view: When we deliver what the consumer wants at the right price, there is no such thing as oversupply.

That's a great place to launch into the report this year because our current oversupply in California and Washington isn't due to speculative overplanting. It's due to the wine industry's growing miss in not providing consumers what they want. That's not an adverse statement about the quality of what our industry produces. We've never made better wine. But based on the industry's current results, making great wine isn't good enough for the consumer today. We are increasingly missing the mark on consumer expectations, and our results show it.

That said, I think the speaker at the 1894 convention was too focused on price and missed the nuance of how marketing and branding affect demand. Evaluating the process of how a consumer places value on something and then buys it involves far more than looking only at the sticker price. But there's a truth in that statement we should contemplate nonetheless. And this year we should ask ourselves many new questions:

- Why is the growth rate of wine by volume entering a period of decline?
- Why are lower-priced segments still showing negative growth in both volume and sales dollars (value)?

- Why are the higher-priced segments that have produced most of the growth of sales dollars we've seen for the past 25 years flattening out?
- Is premiumization ending for the wine business, and if so, why?
- Why are price increases so hard to come by?
- How long will the current supply excess last?

Those are difficult questions to face. But despite these melancholy thoughts, the current operating environment isn't a complete calamity because macro views don't tell the whole story, and the mood of the industry is mixed.

Most of the industry will remember 2019 as a pretty good year despite the challenges, with almost a quarter of the industry reporting that 2019 was their best year in history! How can that be, given the headwinds?

If we look more closely at the trends, we see a bifurcation of performance. More wineries are reporting great performance or record years, and at the same time, an increasing number of wineries are reporting poor results (see figure 1).

The past 25 years was an era where the rising tide of consumer demand lifted the boats of everyone in the wine business. We consistently saw increasing volumes and prices for premium wine during that period, and throughout it, every business model seemingly worked. But as we evolve into this new era where the

Figure 2: **Sales growth rates of family wineries**

Quartile 1	-7.82%
Quartile 2	3.59%
Quartile 3	11.29%
Quartile 4	22.34%

Source: SVB Peer Group Analysis Database

tide is slack or receding, all boats won't float, and we will have winners and losers.<sup>1</sup>

In the 1990s, the dominant competitive issue was wine. If you made good wine, it would sell itself. In the 2000s, that shifted to sales. You needed to evolve your sales channels — your path to market — and you still had to make good wine.

As we move into a low-growth environment in 2020, the dominant competitive issue will shift to efficiencies. Now, you will not only need to continue to make great wine and incessantly evolve your sales channels, but you will also need to run your business as efficiently as possible so your margins are better than your peers'. In a low-growth environment, there are likely to be winners and losers, and you want to be on the correct side of that ledger.

Much like the wineries' reports of their year in figure 1, we see bifurcated results from the financial statements of wineries (see figure 2).

In bottom-quartile performers, the average growth rate in sales is negative 7.82 percent, but in the upper quartile, we see growth rates averaging a staggering 22.34 percent! Looking at the quartiles qualitatively, we see no trend based on case sales volume, years in business, location or business model. Each quartile has a similar mix of wineries. What really seems to define success is the management team. As a winery owner or manager, that's something to reflect upon today.

How is your management team? Is everyone in the right seat on the bus? As a leader, are you focusing on the most important things? Does your business culture embrace continuous improvement? Is failure an accepted part of learning in your culture? Are you training and developing depth and talent? Are you empowering people to make quick decisions without second-guessing them? Have you focused on your organization's culture and its impact on staff, customers and the earth? Are you retaining your most important people? Do you champion smart people in your organization who have different views and include them in problem-solving? Do you seek diversity on your teams? Do you have the right information to run your business? Are you paying someone to mine data? What can you outsource? Are your outside advisors — your CPA, attorney and banker — experienced, and are they adding value?<sup>2</sup>

Those are each important questions by themselves and part of a deeper evaluation you should consider this year. But once you do that, what problems will you need to address?

Our review of the components that drive the wine business reveals that retiring wine-loving baby boomers are being replaced by more frugal spirits-loving millennials and now Gen Zers, who consume less alcohol than prior generations. We need to attract those young consumers, but we are doing a poor job of that. Why?

- **Substitutes:** The young consumer is adopting substitutes in the form of spirits, craft beer, foreign wine, spiked seltzers and to some extent cannabis, instead of domestic wine.
- **Price:** Wine is more expensive than beer or spirits per serving, and frugal young consumers are voting with their wallets.
- **Neo-prohibition:** As an industry, we've allowed the impact of paid science from anti-alcohol groups to gather momentum. The cumulative impact of that messaging is gaining traction with health-conscious consumers. We've done little to counter their agenda for the past 20 years.
- **Regulatory change:** Legislators armed with preordained conclusions from anti-alcohol studies are authoring increasingly restrictive laws and regulations.
- **Marketing:** We have been too slow in adapting to this consumer change. We aren't yet effectively marketing to young consumers and creating resonance with their values. We aren't doing a good enough job of giving them a reason to buy wine.

The adage that change creates opportunity is true even in a difficult market. The winners of tomorrow will be the wineries that understand the evolving consumer profile, critically evaluate their organization's capacity to react, develop solutions and execute quickly, then evaluate their success or failure to continuously improve. Those companies will take sales from those that continue to run their businesses the way they have for the past 25 years and stick with strategies that have always worked before. The winners tomorrow will be intrepid and willing to try new approaches and change the status quo.

We believe this report will inform your team's thinking about the particular niche you occupy within the wine business. We hope it will also inspire you to get creative about possibilities with your strategic planning and that engaging in that process will help you improve your chances of success in the year ahead.



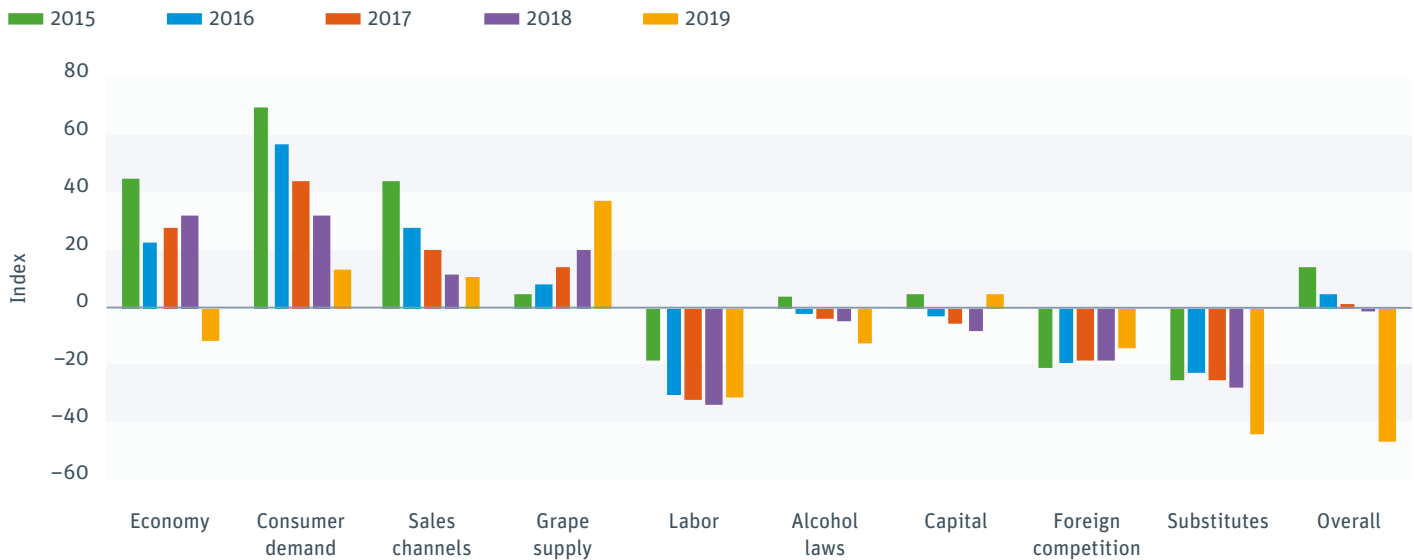
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## Executive summary

In January 2018, we said, “Sales growth forecasts for the next five years should be tempered. The fundamental underpinnings that created the industry growth are changing, which means the tactics that were relied upon to ride this wave of success to this point will slowly prove flawed without business adaptation.” In January 2019, we said, “Overall supply is long in California. Grape and bulk prices will drop noticeably in the California market.” Both statements have proven accurate.

Figure 3: **Trends of industry sentiments**

(Total “Positive” responses to each category minus total “Negative” responses to each category)



Source: SVB State of the Wine Industry Survey

With winery growth estimates not meeting plans and coming off the historic 2018 crush, 2019 started with full tanks, and buyers for grapes and juice were on the sidelines while price for supply was seeking, but never quite found, a bottom. By April, distributors, who were noting consumer sluggishness, started asking wineries for even higher promotional allowances. Growers in the meantime kept lowering prices to attract buyers and sell uncontracted fruit. But by harvest, there were grapes left without a home across all regions of California.

Today, the supply chain is stuffed. This oversupply, coupled with eroding consumer demand, can only lead to discounting of finished wine, bulk wine and grapes. While many in the business don't like to read those types of comments, at this point those aren't mere predictions because discounting is already taking place across each point in the supply chain.

When the data are assembled, the 2019 harvest will likely produce normal to slightly below normal yields in California and below normal yields in Oregon and Washington. That's not sufficient to correct the supply problem.

Total on-premise sales from wholesale depletion data and other information sources show that wine sales in restaurants are now showing negative volume growth. Most information sources show off-premise and total wine volume turned negative in 2018, while total value sales of wine are still showing slightly positive growth.

*Discounting is already taking place across each point in the supply chain.*

If we segment demand, the below \$9 wines off-premise are still showing negative volume and value growth, and above \$9 wines are still showing modest sales growth on volume and value.

The segment above \$20 is more likely to be in the direct-to-consumer (DTC) game. Using our database of winery financial statements, we believe the smaller family-run wineries will show sales growth averaging between 3 percent and 7 percent at year-end 2019. But that good news isn't satisfying to most winery owners, who can now see the impact of consumer change clearly and are sensing the looming challenges ahead.

In 2018, the overall Winery Owners' Confidence Index<sup>3</sup> dropped a scant few percentage points into negative territory for the first time since the index was created. But in 2019, overall confidence dropped precipitously, with 49 percent of respondents taking a pessimistic view of market conditions (see figure 3).

Grape supply<sup>4</sup> and consumer demand are the largest positive contributors of owners' confidence. Grape supply is viewed by wineries as being more positive than other issues impacting the business today, while labor, alcohol laws and substitutes elicit increasingly negative responses. Labor issues and substitutes are now the largest concerns, while capital turned slightly positive, most likely reflecting the Federal Reserve's interest rate easing during the year and the large and growing number of financial institutions competing for the industry's business.

### Seven headwinds:

1. Baby boomers, who control 70 percent of US discretionary income and half of the net worth in the US, are moving into retirement and declining in both their numbers and per capita consumption, while millennials aren't yet embracing wine consumption as many had predicted.
2. The industry has reached the point of acute oversupply due to diminishing volumes sold. That will lead to vineyard removals — and fallowing in some cases — and reduced returns for growers.
3. Absent offsetting promotion of the health benefits of moderate wine consumption, the cumulative impact of negative health messaging will continue to cast a shadow over consumption, particularly for the young consumer.
4. Wine imports and substitutes are a real and growing threat for mindshare among emerging wine consumers.
5. A lag in innovating alternative DTC strategies beyond the tasting room and club models is limiting DTC growth for family wineries.
6. Wine companies aren't addressing the values of the young consumer in their marketing. We aren't giving them a reason to buy wine over spirits.
7. Labor availability is limited, and the price for labor is increasing.

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*The trend and mantra of premiumization that pushed volume and price higher for the past 25 years is nearing an end.*

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With an oversupply and the fact that price increases are nearly impossible against the backdrop of slowing sales, the trend and mantra of premiumization that pushed volume and price higher for the past 25 years is nearing an end.

For the family winery, the dominant competitive issues are no longer making good wine and finding a sustainable path to sell it to the consumer. The latter has been the dominant competitive issue since 2001, but today both are rudimentary industry expectations.

As we look forward, in an emerging era of lower growth, the dominant competitive issues will shift to management strength and the decision-making ability of teams and organizations.

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## Seven tailwinds:

1. With a good 2019 US economy, Gen Xers and boomers are demonstrating spending resilience and still increasing their purchases of wine above the \$9 bottle price. That created another year of record US wine sales by value in 2019.
2. The large millennial population hasn't begun to embrace wine. While that's a negative, if we look at it from the other side, it's also the wine industry's largest opportunity.
3. Acute oversupply will allow for better-quality juice in lower-priced bottles, which improves value and will provide an incentive for some millennials to become more consistent wine buyers.
4. The better-quality regions of Oregon and Washington remain on a strong double-digit growth path.
5. Producers with long-established brands and those with good distributor relationships continue to perform above their peers.
6. The number and diversity of retail concepts and locations selling wine continue to grow to record numbers.
7. The business is developing both strategies and tactics around the DTC channel and continues to show sales growth through this path to the consumer.

With most wineries reporting that 2019 was a good year, it would be easy for winery owners to just keep doing what they do now, hoping the multitude of challenges creating the current retail sluggishness will be solved. This would include the consumer

finding more discretionary income, labor and immigration issues becoming disentangled, digital platforms and strategies emerging to unravel the many problems and opportunities in the DTC sales channel — and the young consumer growing up and starting to discover wine.

None of us would be in business without a certain amount of hope. But none of us would stay in business if we used hope as a strategy.

Despite the modestly positive year in 2019 and 25 years of great growth for the US wine business, the current industry trends are signaling difficult times ahead, and the Industry Sentiment Index reflects that.

In January 2019 we noted that the fundamental underpinnings that created the industry growth were changing and that the tactics previously used to ride the wave of success were proving flawed. Now it's clear: The US wine industry needs to adapt and change its focus and direction.

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*The US wine industry needs  
to adapt and change its  
focus and direction.*

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# 3

## 2019 predictions in review

We have been extensively researching the wine business since 1991 and making public forecasts for close to 20 years. Some years, we properly characterize a market change. In other years, our findings might be off in timing or even wrong,<sup>5</sup> but we always review the forecasts made the prior year just to keep score.

## Our lead statement last year was the following:

*2018 was a good year for wine. Total wine sales for the year set a record, restaurant sales of wine were higher and premium wine sales ended up as well. Strong consumer confidence and a very good US economy contributed to the improved performance, but changes to long-term trends are telling us that we are at a transition point as an industry.*

## That was an accurate statement.

### What we got right

- We predicted sales growth of 4 percent to 8 percent for the premium wine segment, compared to the prior 2018 full-year actual growth rate of 5.3 percent.
  - › Silicon Valley Bank's Peer Group Analysis (PGA) Database<sup>6</sup> shows a nine-month year-to-date sales growth rate of 7.2 percent, meaning we should finish 2019 near the high end of the range.
- For the off-premise retail store channel, we said sales would grow between 0.5 percent and 2.5 percent.
  - › We were correct with predicting sales growth in value. Nielsen Beverage reported retail store sales for 52 weeks through October 5, 2019, were up 0.94 percent.
- We said that the M&A market would slow noticeably in 2019 as many of the major buyers would continue to digest their purchases and execute on new brand strategies. We said there would still be some foreign purchases of US wineries and significant transactions for vineyard properties in 2019. For wineries, the real M&A would be reserved for iconic properties that might come up and sell for the full price, but to the extent wineries were changing hands, that would more likely result from sales by fatigued owners who could see the flat business conditions ahead and opt out.
  - › We were accurate in this case. The total number of M&A transactions dropped by 43 percent according to our accounting. Louis Roederer purchased Merry Edwards Winery<sup>7</sup> for the only foreign purchase in 2019, and most of the announced deals included vineyards or were large blocks of vineyards sold to funds and strategic buyers (see figure 47 on page 63).
- We expected California would produce a record volume of grapes. We predicted the harvest to come in at 4.4 million tons in California and that the Pacific Northwest harvests would set records in terms of yield.
  - › California did produce a record crop in 2018 at 4.3 million tons. Oregon and Washington both produced harvest yields at or near records, with 79,685 and 261,000 tons picked respectively, according to crop reports.
- We said overall supply was long in California and that grape and bulk prices would noticeably drop in the California market in 2019. We said that Washington, with its large expected harvest in 2018, was tipping to oversupply but that Oregon would be able to sell its large harvest, as the demand for Oregon pinot noir continued to accelerate.
  - › This prediction was accurate but slightly over-optimistic. We believed that prices would drop but never expected to see so many tons of California grapes go unharvested. Even though many called this forecast needlessly pessimistic, the harvest in California brought clarity, as prices never found a bottom on the spot market and grapes went unharvested in every region in the state. Washington is indeed long in regions producing for lower bottle prices. Oregon continues as the darling of the wine industry, still selling everything it produces.
- We believed that California vineyard prices in premium regions would flatten compared with the strong growth seen for the past several years.
  - › From all that we can tell from discussions with appraisers, this was an accurate prediction but leaning toward overly optimistic, since some price drops have taken place.

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*Changes to long-term trends are telling us that we are at a transition point as an industry.*

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2019 started with firm prices that softened into the spring in secondary and tertiary areas. In Napa and Sonoma, the best properties held full value, while lesser regions within Napa and Sonoma saw deterioration in values. Iconic properties don't lose value and haven't in the past year.

- We said Washington vineyard prices would moderate in the face of oversupplied conditions for the larger producers and that premium producers in Eastern Washington would see modest growth in land prices.
  - › Washington land prices did soften in 2019, and diversified farmers started replanting other crops in some cases. From discussions with appraisers, we believe that most regions producing premium wine in Eastern Washington held firm or increased slightly in value.
- We wrote that premiumization was nearing its apex as a trend, as indicated by the slowdowns in total sales volume, the decline in premium sales growth rates and the difficulty in passing price increases on to consumers.
  - › Based on those factors cited and the continued softening in demand, that appears to be accurate.
- We again observed that millennials weren't engaging with wine as hoped and lacked financial capacity due to lasting impacts from the Great Recession and the delayed entrance into their careers. We noted they preferred premium spirits and craft beer and that cannabis could also be playing a small role.
  - › This continues to be an accurate observation. Millennial market share of wine consumption from our data shows they made no progress in taking market share away from boomers.
- We noted that we entered a period where the cumulative negative messaging about alcohol and health was impacting demand from young consumers and they stalled in growing a preference for wine.
  - › Bank research shows that millennials have made no move in taking share from boomers in several years. The anti-alcohol movement is gaining strength and contradicting all prior US government findings about improved health outcomes from moderate consumption.
- We believed bottle price increases would be very difficult to pass through in 2019 as the industry worked through sluggish volume growth and a surplus of wine. We believed the excess supply would show up in both négociant and value-priced private-label products, and wine below \$9 would continue to shrink in volume and value.
  - › This was an accurate prediction.

## What we got wrong

- We believed off-premise volumes would continue to be challenged, and we forecasted growth between negative 0.5 percent and positive 1.5 percent.
  - › Nielsen Beverage reported that retail store sales by volume for 52 weeks through October 5, 2019, were negative 1.4 percent. So we missed to the high side and were overly optimistic in our call on volume.
- We thought imports would gain market share at the expense of domestic production.
  - › Through October, there was no change in import share versus domestic sales according to Nielsen. It was a statistical tie. A second data source we use had difficulty verifying tax records this year, so that information was unavailable.
- We believed Oregon vineyards would continue to see high interest from larger wine companies but that Oregon vineyard prices might stabilize.
  - › With the acute excess supply of grapes in California, the California buyers lost any immediate interest in buying Oregon vineyards. Vineyard pricing in Oregon still seems to have modest upside.
- We thought we would see some limited price reductions in bottles priced in the middle teens in 2019. The prediction was based on the belief that the supply excess would drive lower pricing.
  - › We have to call this a miss. Though we did see increased demands from distributors for additional allowances through the year, which should have driven lower bottle prices in theory, we can't find evidence of that.



# 4

## 2020 US wine business predictions and observations



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*We predict a sales value growth range between 3 percent and 7 percent for the premium wine segment, down about 1 percent from the 2019 sales growth estimate. For the off-premise retail store channel, value will fall between negative 2 percent and 0 percent. Volume will fall in a range between negative 1 percent and negative 3 percent.*

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- Making predictions about the US economy amid the uncertainties of trade wars and a US presidential election is more than a little difficult, so we aren't making any predictions about the national and world economies. Our 2020 forecast is made with the expectation that the US economy will remain steady, without a recession.
- We predict a sales value growth range between 3 percent and 7 percent for the premium wine segment, down about 1 percent from the 2019 sales growth estimate. For the off-premise retail store channel, value will fall between negative 2 percent and 0 percent. Volume will fall in a range between negative 1 percent and negative 3 percent. With the current supply excess, the hope is that those volumes will show up in better volume growth versus the current trend.
- The consumer will discover unprecedented wine values in 2020.

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*The consumer will discover unprecedented wine values in 2020.*

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### Supply

- When 2019 totals are calculated, we are guessing that California will have crushed 3.95 million tons, down from the record 2018 harvest of 4.24 million tons. Once the 2019 harvest is tallied, the Pacific Northwest harvests that were challenging will come in lower in yield than any of the previous four vintages.
- Supply in California is acutely long. We will see early replants, removals and the fallowing of vines in every region, particularly in Monterey and Paso Robles.
- Grape and bulk prices will fall to lower levels than we've seen in the past five years. It will be well beyond 2020 before we see grape prices stabilize.
- Washington is oversupplied in heavy-production vineyards and will see vineyard removals. Supply in Oregon will remain a bright spot for the industry.
- California vineyard prices in premium regions will flatten in the best areas and see declines in secondary regions.

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*Grape and bulk prices will fall to lower levels than we've seen in the past five years. It will be well beyond 2020 before we see grape prices stabilize.*

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*In the next six years, 27.9 million Americans will cross the normal retirement age of 66, while 30.3 million will turn 40.*

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## Demand

- Retiring baby boomers seem to have a long tail and fortunately aren't quick to run to pasture. They continue to buy wine at all price points, but their buying seems to be moderating, both on price and volume, as they age. The rotation to younger consumers is not an even trade on an economic basis, but we have no choice except to market to them. In the next six years, 27.9 million Americans will cross the normal retirement age of 66, while 30.3 million will turn 40. That is a lot of buying power to ignore.
- Premiumization is nearing its apex as a trend, indicated by the decline in total wine sales volume, the decline in premium wine growth rates and the difficulty in passing price increases on to consumers.
- Millennials aren't engaging with wine as hoped. They lack financial capacity, having been slow to get into their careers after the financial crisis. They have a current preference for premium spirits and craft beers. Cannabis demand skews to younger males today, and that is also likely playing a small role in the cohort's delayed appreciation for wine.
- We have entered a period where the cumulative negative messaging about alcohol and health is impacting demand from young, health-conscious consumers, and they are stalling in growing a preference for wine.

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*Millennials aren't engaging with wine as hoped.*

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## Price

- Bottle price increases will be rare in 2020. Overall pricing should be slightly lower as the industry works through sluggish volume growth and a surplus of wine. The added supply will show up in both négociant and value-priced private-label products at lower prices. Wine priced below \$11 is now in jeopardy of joining the below \$9 segment and declining in both volume and value.
- Routinely increasing both volume and price, as has occurred over the past 20 years, is a thing of the past until the industry addresses the root causes of inventory excess, which in this case is diminished demand.
- As an industry, we're transitioning to a period of flat to negative sales volume growth, low to negative sales value growth and a surplus of grapes that will take several years to normalize. That will force grape prices lower.

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*We're transitioning to a period of flat to negative sales volume growth, low to negative sales value growth and a surplus of grapes that will take several years to normalize. That will force grape prices lower.*

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# 5

## Grape and wine supply

Last year in this report, we said, “Overall supply is long in California. Grape and bulk prices will drop noticeably in the California market.” Washington was noted as being slightly oversupplied, and Oregon was singled out for being more in balance.



In an industry that isn't good at processing bad news, there were vocal dissenters when we made those predictions, but a year later our view has become universally acknowledged. In 2019, we have seen notable price declines for wine grapes, and an undefinable amount of tonnage was left unharvested across all California regions. What happens next? Is this just a speed bump?

It would be great if there were perfect knowledge regarding the existing supply of wine grapes. That would allow us to make informed decisions regarding planting, fallowing and the best time to enter into or renegotiate a contract and get all that done at the perfect market-clearing price. But that information doesn't and will never exist. Consequently, decisions at the production end of the business are made on less-than-ideal data, which leads to a delayed realization of current circumstances, late reactions and increased volatility.

At its simplest, grape pricing is a factor of supply and demand. The practical problem is coming up with a useful model that adequately defines either variable with precision and then predicts future changes.

But understanding real supply would have to encompass the entire supply chain. It would start with a view of all varieties the region produced, acres in the ground by varietal and region, amount of non-bearing acreage by varietal and region, harvest volumes by varietal and price, bulk juice in winery tanks or coming into port sorted by varietal and intended price point, bottled wine volume in winery inventory and bottled wine in distribution and at the point of retail sale. And no good model is useful without a demand forecast because you need to know how quickly wine is being drawn down. Plainly stated, the supply chain is complex, which puts a premium on people with accurate and street-level intelligence about it.

With what we know, we can say today that we are at a position of oversupply across the entire supply chain. That extends through retail and every growing region in California at every price point. For California, this is the worst combination of market conditions for growers since at least 2001 and perhaps of all time.

The questions everyone wants answers for now are: How long will this oversupply last, how deep will it be and what options are there? Looking at the 2001 planting bubble gives some clues.

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*We are at a position of oversupply across the entire supply chain. That extends through retail and every growing region in California at every price point. For California, this is the worst combination of market conditions for growers since at least 2001 and perhaps of all time.*

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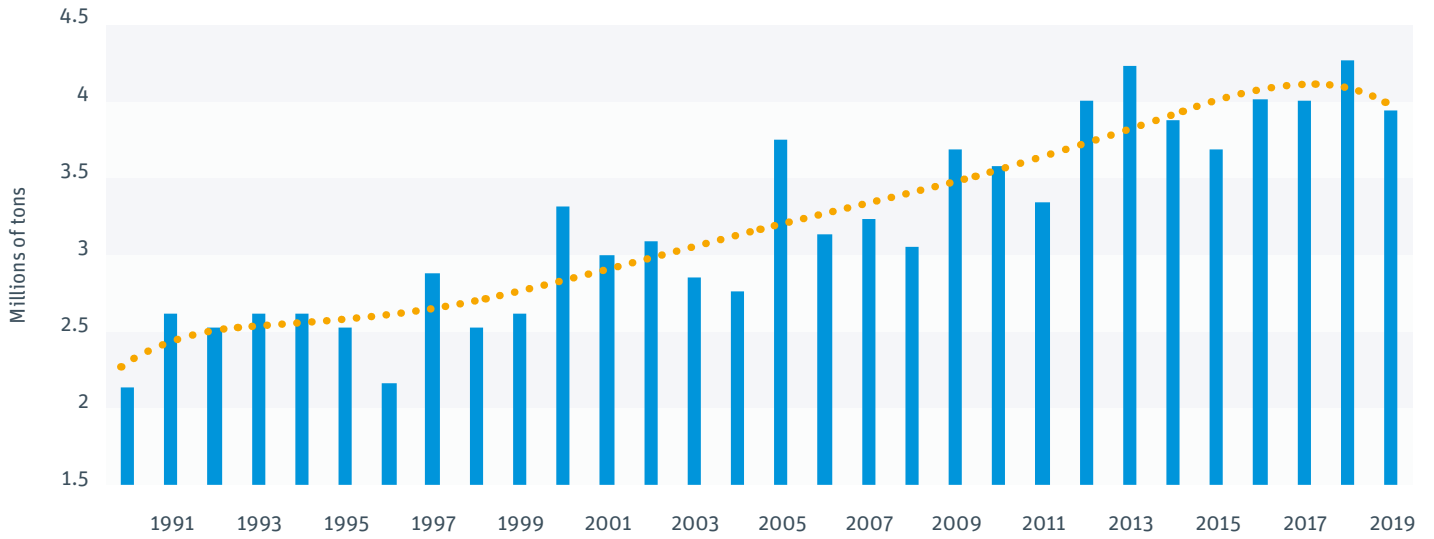
### **The 2001 planting bubble**

Starting in the early 1990s, California exhibited explosive growth in premium wine sales, particularly from wine produced on the North Coast. The growth led to an initial acute grape shortage, inducing growers to plant grapes in a wide range of new regions to catch up with the heavy demand.<sup>8</sup>

It takes five years for a vineyard to hit a fully mature yield. So while there were tens of thousands of new acres of grapes going into the ground between 1991 and 1999, grape supply was flat through the period, with the exception of a very short 1996 vintage and a very large 1997 vintage that balanced each other out (see figure 4). Figure 5 shows that the amount of non-bearing acreage continued to grow. That forced grape prices higher, as we can see in the "Demand growth" segment in figure 6.

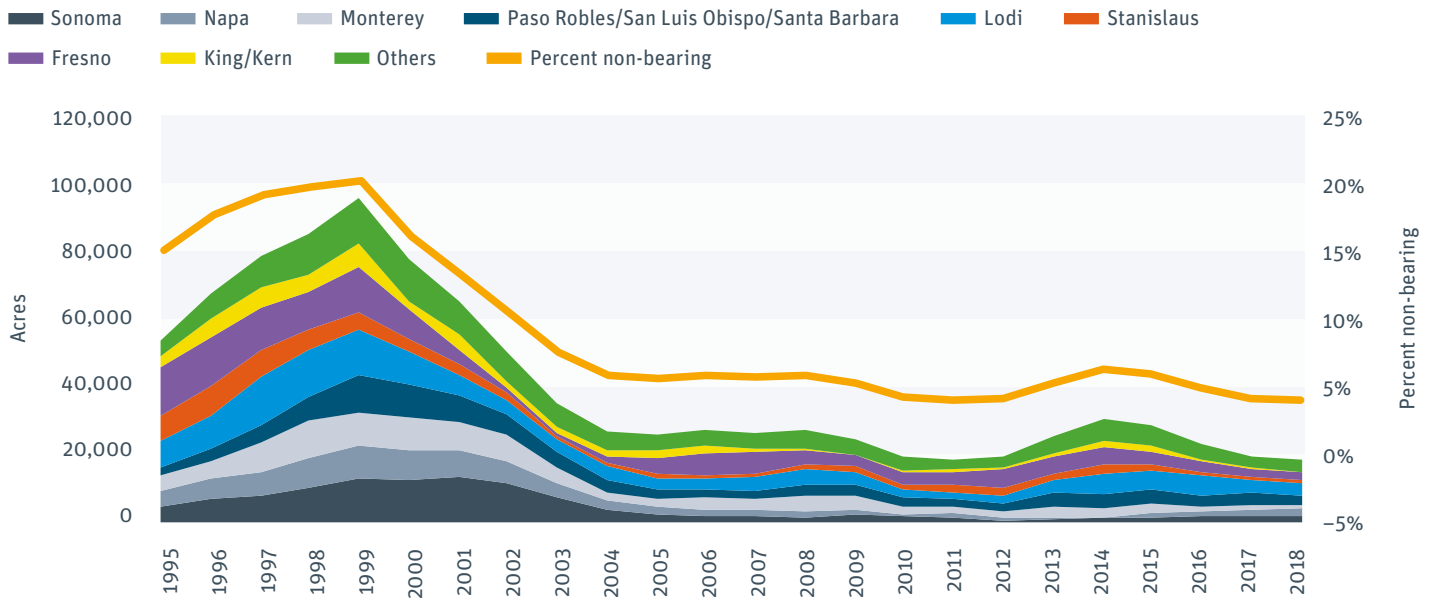
The grape shortage was mirrored on the North Coast by wineries quickly raising bottle prices. Many ran out of supply well before the year was complete or a new release could be offered for sale. Out-of-stock situations were routine. The running joke in the era was that bottle aging was done on the truck. Unlike today, distributors then knocked on every small wine producer's door they could find, begging for anything to sell.

Figure 4: California crush of wine grapes



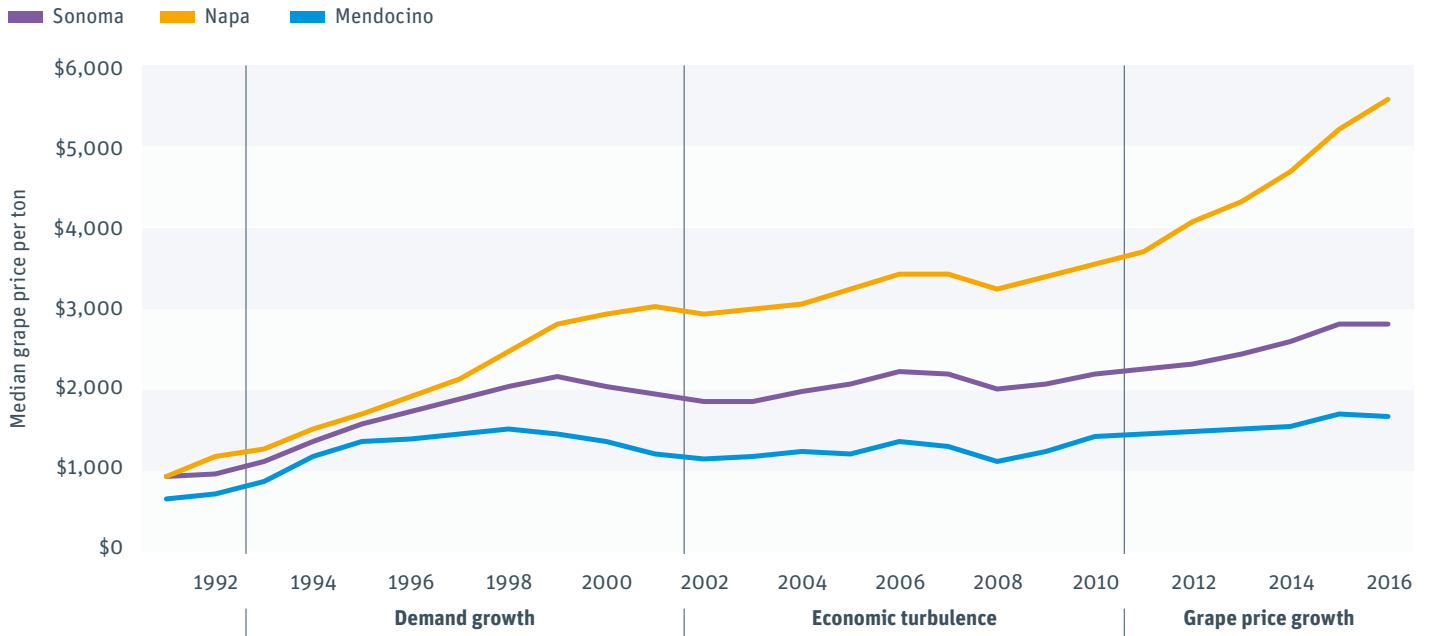
Estimated data for 2019  
 Source: California Department of Food and Agriculture

Figure 5: California non-bearing acreage by district



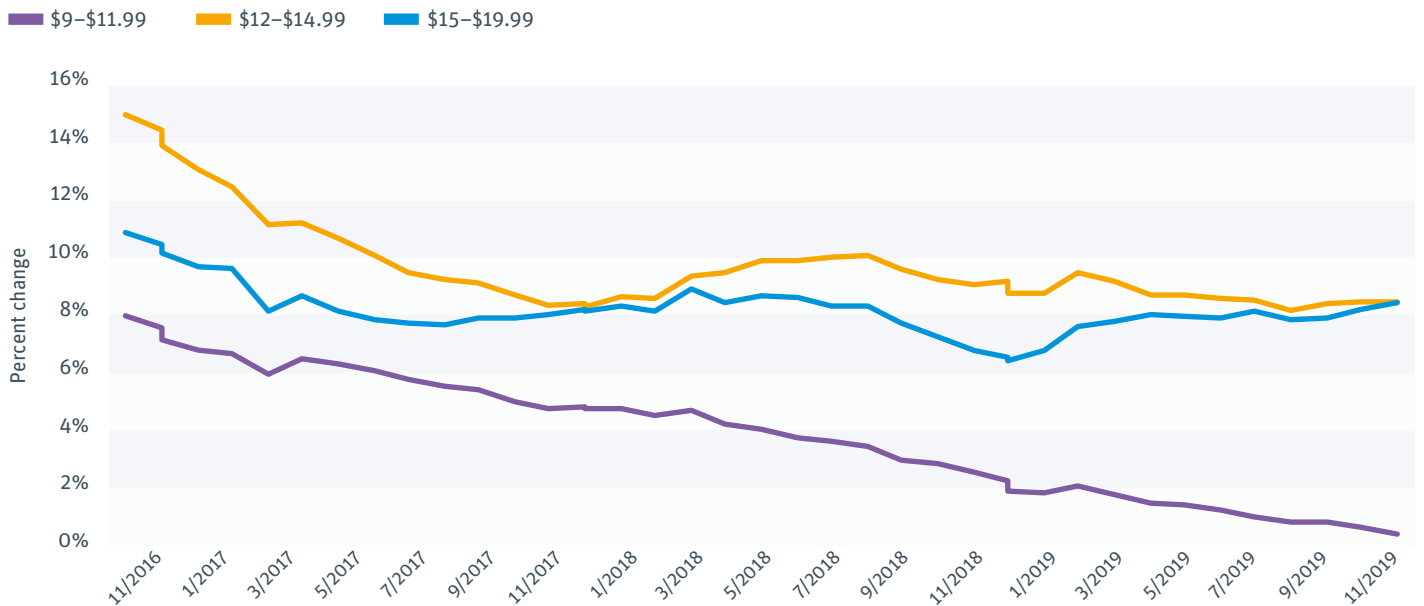
Source: USDA National Agricultural Statistics Service

Figure 6: North Coast median grape prices



Source: USDA NASS Grape Crush Report

Figure 7: Rolling 52-week growth rate in wine between \$9 and \$19.99



Source: Nielsen Beverage Group

All the newly planted acres finally produced a record yield with the 2000 vintage (see figure 4), but that was right as the dot-com crash<sup>9</sup> hit, popping the planting bubble. The weak recession cooled consumer demand, which quickly backed up into the supply chain. Grape prices flattened in regions with strong growth in consumer demand, and grape prices dropped in the regions that had weaker demand, to the point of being uneconomic in many cases. The North Coast, which had strong growth, paused in planting, held onto the new acres without pulling vines and waited for demand to absorb new supply. The Central Valley of California had to remove vines (see figure 6, the “Economic turbulence” segment).

In the wake of the 2001 grape supply bubble, the supply chain was like a mile-long train stopping in the desert. Consumers slowed their buying, retailers stopped restocking, distributors stopped taking wine from wineries and asked for price reductions, and wineries changed their growth forecasts and reduced their purchases of grapes.

Concentrate and distillation were emergency options to eliminate unsold grapes and juice. But without good domestic buyers for everything, some sales of bulk wine went to China at less than \$0.50 a gallon. There were also outright disposals of bulk wine, and in some instances, unsold cased goods were destroyed to clear the supply chain.

## The 2020 grape market — have we been here before?

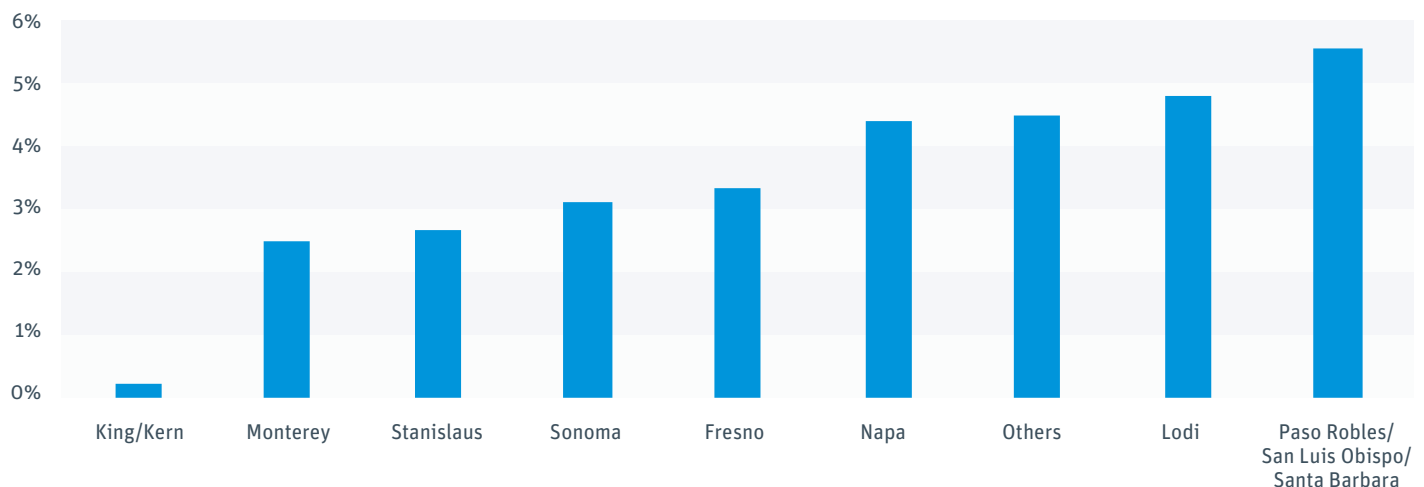
The modest single-digit growth rate in sales for premium wine over the past five years coincided with grape price increases that started in 2009 (see figure 6, the “Grape price growth” segment). The persistent growth in grape pricing over the past decade seems much like the pattern in the late 1990s, when there was double-digit growth in consumer demand for premium wine.

Grape prices trending higher over the last decade should indicate some combination of an emerging supply shortage or demand increase, but neither is the case. The gradual price rise of grapes starting in 2011 was due to overestimated sales growth forecasts by the wineries.

While the growth in consumer demand was starting to slip, wineries with a long history of higher levels of growth had a difficult time believing what they were seeing. The wineries didn’t want to miss out on possible opportunities and continued to forecast modestly higher-than-achievable sales each year, which today has resulted in heavy winery inventories and stagnant bottle prices.

The 2001 planting bubble was a reaction to overplanting. It was a classic boom-and-bust farming cycle. But the key that drove speculative planting in the first place was very strong consumer demand for premium wine. At the peak of the bubble, we had almost 20 percent of the total planted acreage as non-bearing (see figure 5).

Figure 8: **Percentage of non-bearing acreage by district in 2018**



Source: NASS Grape Acreage Report, 2018

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*The reality is that we have never seen these market conditions. We've never experienced excess inventory because of declining consumer demand. Prior periods of excess have always been due to overplanting.*

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We have been in acute oversupply before, but today's imbalance isn't due to large vintages, nor is it due to speculative overplanting. We've experienced those events.

The current market conditions are due to three things:

1. A secular change with lower consumer demand
2. The overestimation of sales growth rates by wineries, leading to an inventory bubble
3. The record 2018 harvest, which popped the bubble

The reality is that we have never seen these market conditions. We've never experienced excess inventory because of declining consumer demand. Prior periods of excess have always been due to overplanting.

Unlike 2001, this time we don't have the winds of substantially increasing consumer demand at our backs. Strong demand was the key factor allowing the premium segments to work out of the oversupply quickly and stabilize grape pricing.

It is indeed good news that non-bearing acreage today is currently 3.8 percent in California in total, and not 20 percent as in the 2001 imbalance. That will limit the pain, but it won't prevent it.

Unless we focus on boosting consumer demand, we have too many acres of grapes planted today in California, and some will need to be removed, mothballed or replanted early in almost every growing region in California.

How long will this last? It depends on several things: your region, demand for wine at your price point, activities by distributors and wineries to move excess wine, the number of acres removed, the speed at which they're removed and annual harvest variation.

My view is that with very low growth or negative growth rates in consumer demand, we probably won't see conditions that will create another harvest like the record in 2018. At this stage, there aren't enough buyers.

Many buyers in 2019 gave notice to growers that they don't intend to renew their contracts past 2020. That will make this year an important transition point and will come with a few hard choices many growers will need to make over the next several years.

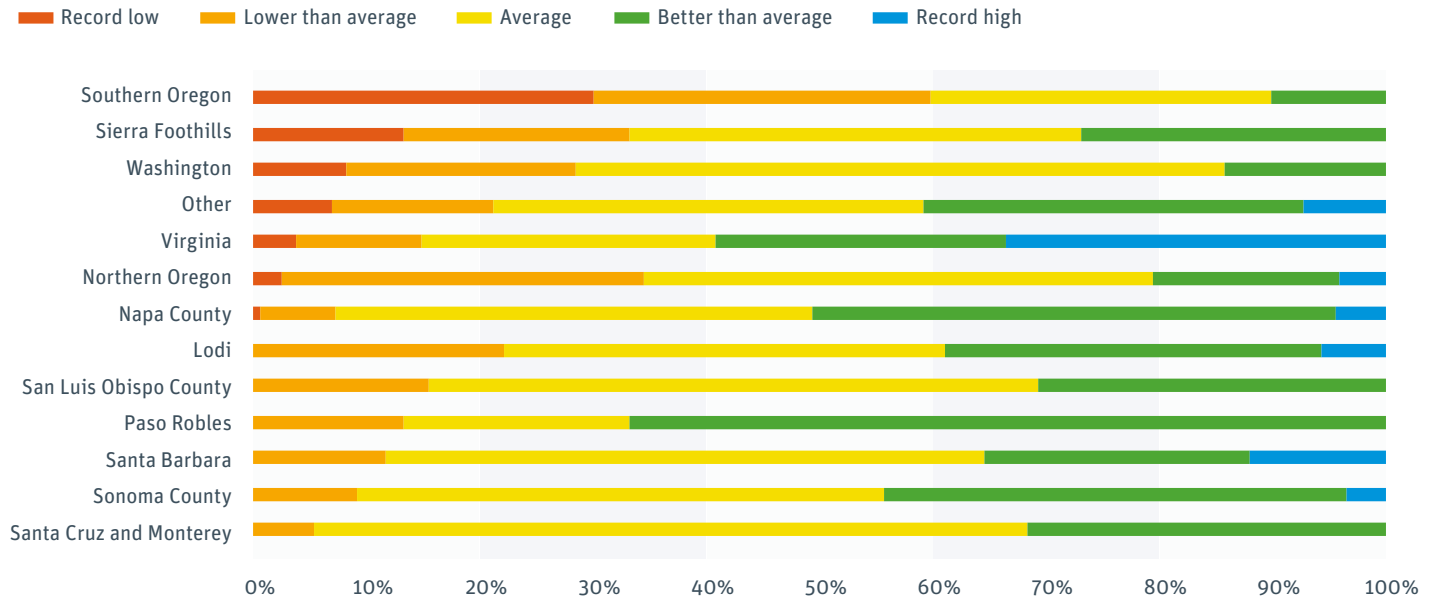
The good news is that the 2019 harvest will come in smaller than 2018, though guessing a final yield will be more difficult than normal due to the unknown volume of unharvested fruit across all regions of California. Our guess is that the yield will come in at 3.95 million tons (see figure 4). Napa, Virginia and Paso Robles reported higher-than-normal yields in our survey, while Oregon and Washington reported average harvests (see figure 9).

The Central Valley harvest will likely be slightly larger, while the Central Coast will come in smaller in part due to vine removals that started prior to harvest. The North Coast, with the additions of Lake and Mendocino counties, and Lodi should come in average to slightly lighter than last year without everything getting picked and with overages not finding buyers.

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*Unless we focus on boosting consumer demand, we have too many acres of grapes planted today in California, and some will need to be removed, mothballed or replanted early in every growing region in California.*

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Figure 9: **Harvest yield by region in 2019**

Source: SVB State of the Wine Industry Survey

## The bulk wine market

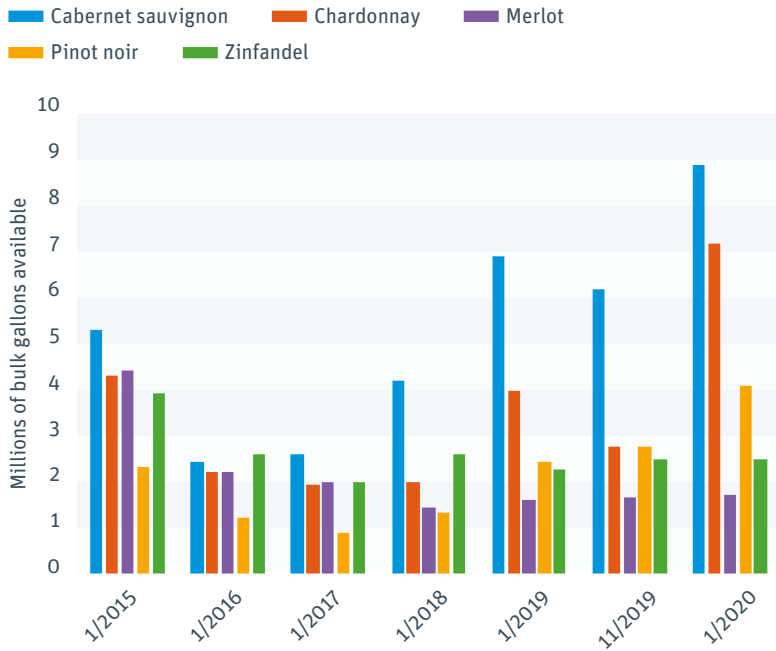
During the 2001 market imbalance, the premium regions were the top of the food chain, a fact that provided an exit opportunity for supply, though at reduced prices. Premium wineries responded to the recession by selling off juice and cutting back their grape contracts. The North Coast responded over the ensuing years by selling down excess bulk wine into lower-priced wine labels. Prices for those sales were uneconomic in many cases.

The Charles Shaw<sup>10</sup> label — aka “Two-Buck Chuck” — that debuted in January of 2002 was one example of the creative measures employed at the time. Thanks to several brands launching super-value price points during that period and the emergence of a private-label industry, the swell of excess bulk wine in the North Coast was soon right-sized.

Figure 10 shows estimates for January 2020 bulk supply in California. The estimate is much higher than November’s actual supply, because wineries will have to sort their own needs out before putting up their extra wine for sale. Also, with little market activity in the winter and with the low prices offered, many wineries will decide to wait before listing their wine for sale.

Because not everything was picked in 2019, the real bulk supply might end up lower than estimated in figure 10, but the key in right-sizing volume in the final analysis will be bringing grape acreage back into balance with reduced consumer demand.

Figure 10: California bulk wine inventory



Estimated data for January 2020  
Source: Ciatti Brokerage

Total gallons

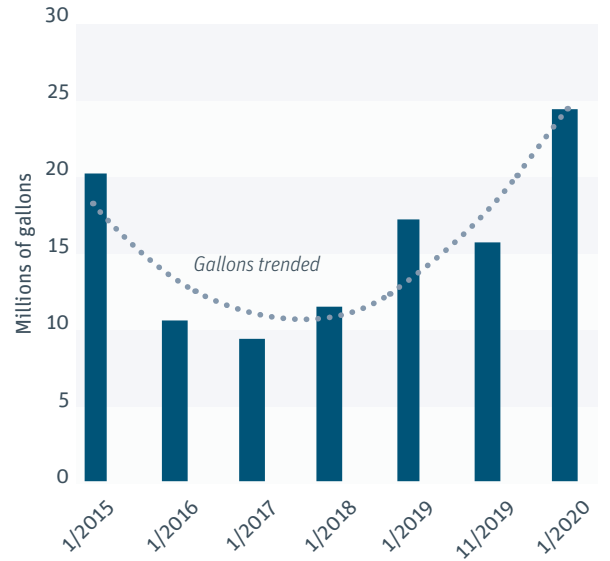
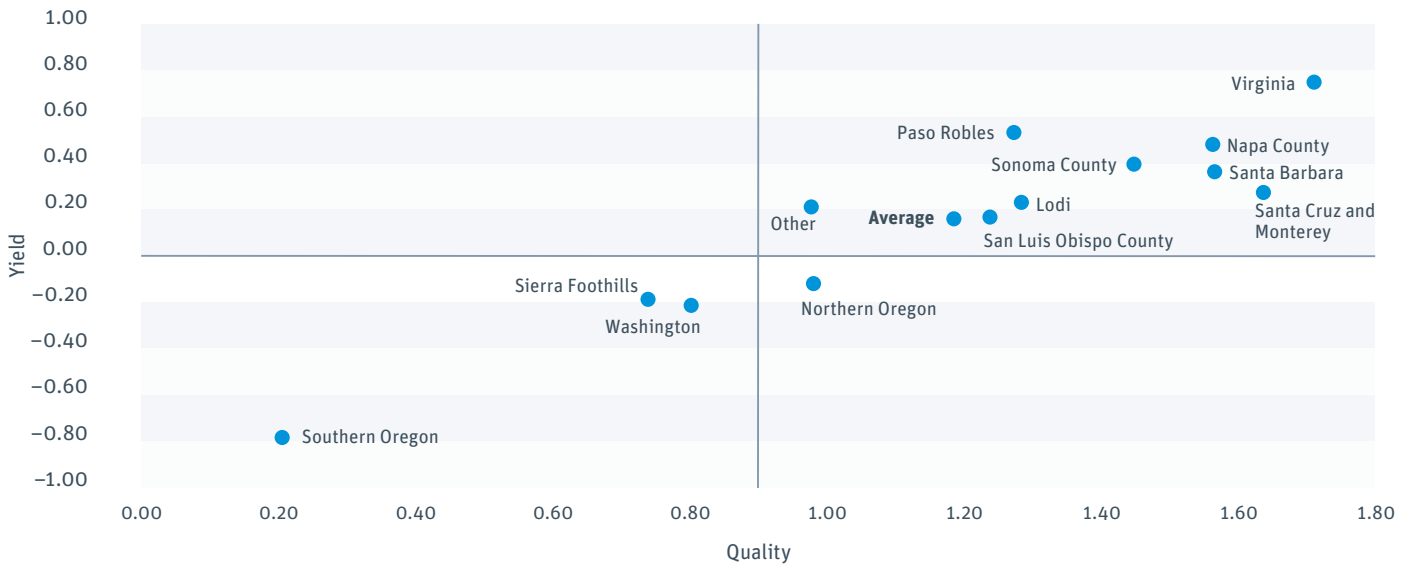


Figure 11: Harvest rating by region in 2019



Source: SVB State of the Wine Industry Survey

The 2019 growing year contained reversals of past harvest trends in several growing areas and more variable results than usual for growers. The average yield as reported in figure 11 is from Silicon Valley Bank survey respondents who did harvest grapes. But in both California and Washington, some grapes were left on the vine and never found a home.

While there is no way to get a precise read on the volume left unpicked, our own guess is about 5 percent. Grapes that aren't picked don't show up in crop reports when the final yields are calculated, which will make crush reports from this vintage a little less reliable and less representative of potential harvest yield from planted vines.

It was nice to see Virginia rebound in the recent harvest. In 2018, Virginia had summer hurricanes that ruined both the yield and the quality of the year. "Disastrous" is what all that wet and moldy vintage could be called. But a year later, Virginia had ideal growing conditions and limited rain, leading to one of their best harvests in decades and giving Virginia the prize for the top spot for best vintage in 2019.

California had exceptional growing conditions through harvest, producing excellent quality across all regions, with minor exceptions in microclimates. The Sierra Foothills were an outlier this year with a snowy winter, cool spring, windy and wet conditions during flower and unpredictable harvest weather.

Oregon has benefited from a string of dry harvests in the past five years, but the recent 2019 vintage reversed the trend, returning the region to the cool and wet pattern for which it's renowned. At the end of veraison, when dry and warm weather was needed to elevate sugars, the rain hit — September saw rainfall that was close to 300 percent of normal. Some areas within Oregon, especially Southern and Eastern Oregon, had to deal with spring and fall frost issues, hail damage, mold from the wet September and consecutive days of freezing temperatures in October.

Washington also returned to a familiar and challenging old pattern not seen for many years. While the 2018 vintage was described as near-ideal, the 2019 vintage was wet in September, spurring disease and rot, and was followed by hard freezes the nights of October 10 and 11 that plunged temperatures into the low 20s, froze bunches, killed leaves and halted ripening.

## Implications for 2020

1. The regions with the highest-quality fruit will get first chance at filling gaps in supply but at reduced prices from prior years.
2. Wineries can use this period to lock in their best growers with lower pricing in cases. In exchange, the growers get the safety of a longer contract in a turbulent time.
3. Some wineries will have the opportunity to get better-quality fruit from top-tier growers, who had a long line of suitors in the past.
4. In regions producing grapes where there is flat or negative demand growth, pulling vines and replanting will have only a temporary benefit in reducing the imbalance. Unless wineries can improve demand, when those additional acres begin to produce, there will be few homes for the fruit at sustainable economic prices. That will only extend the supply imbalance and reduce future returns. Fallowing might be a better strategy for those wanting to stay in the grape market. Replanting an alternative crop might prove a better option, especially for diversified farming operations. Clearing market excess in those regions will depend upon the speed of removals, making it difficult to predict the timing of a return to balance. That said, according to county filings, that process has already started, with the exception of Napa at this point.
5. For California wineries owning their own acreage, there will be unique choices ahead that only happen during periods of acute oversupply. If the market continues soft in regions with better-quality fruit than what your owned or leased vineyards produce, you should seriously consider dropping your own fruit and buying lower-priced grapes in better appellations. If you want to give that strategy a try, it's a numbers exercise that should include modeling in the tax consequences.
6. California wineries with region-flexible brands are in the unique position to evaluate what they have in tank and consider buying up better juice at lower prices, then selling juice currently owned and taking a write-down on it. There are tax considerations that should be factored into that decision as well, and it's a transaction that has to have both sides of the equation locked down, or at least the selling part of the transaction completed. You don't want to buy more juice only to have an agreement to sell juice fall apart.



7. Private-label and négociant operations will provide lift to the bulk juice problem. That is a segment that is showing good demand growth. Bulk juice will have to be discounted across all regions to fit into those programs, however. The positive news is that well-marketed and branded private labels will be filled with better-quality wine and will reach new consumers, providing a silver lining to the industry.
8. Growers producing in Monterey and Paso Robles will have a difficult time in this cycle. Already long on supply prior to harvest, Paso Robles also displays one of the heavier non-bearing positions among all regions (see figure 8). Both counties will need to remove acres from production to get back into balance. Some may find alternative crops such as pistachios a worthwhile option.

Both Paso Robles and Monterey have luxury wine-producing American Viticultural Areas (AVAs) that will be slightly more insulated than the growers producing for lower price points.

9. Most growers in the North Coast will get through this supply issue intact. Some growers, however, will have difficult choices ahead, and there will be some casualties.

The region has had decades of increasing volume that has been in the sweet spot of consumer demand. That will make instinct developed from past experience less useful in this type of environment.

In 2019, a larger-than-expected number of buyers gave notice of their intentions to cancel, which will make the next few years disorienting, especially in the face of down-shifting consumer demand. The majority of grape growers will still find homes for fruit, albeit at reduced prices. Some will find offers unpalatable, though, and some offers will be below a sustainable price. Those vineyards that are currently showing only marginal profitability — older vineyards, lower-yielding vines or smaller owners with no cash in reserve — are at the greatest risk.

Alternative crop options are few in the North Coast. While at one time the region had pears, walnuts, prunes and apples planted, those aren't viable economic options anymore.<sup>11</sup> Making the decision to fallow a vineyard is a difficult strategy for smaller operators who have bank debt securing the vineyard. That may prove to be the best financial option, however.<sup>12</sup>

Without many alternatives, there is a greater likelihood that marginal, small or debt-heavy operators on the North Coast will be more inclined to try and wait out the cycle. That may extend the market excess. The positive news is that those who are unable to find contracts from local wineries may find interest from larger-production wineries, albeit at very low prices, which may in turn force the decision to farm for higher volume.

Not to be forgotten, there is still a small amount of volume growth in consumer demand on the North Coast, and 2019 will probably not produce huge yields or add significantly to the existing oversupply in the supply chain. Positive consumer demand will help. Farmers in Lake and Mendocino counties will have a more difficult time waiting this cycle out than those in Napa and Sonoma.

Clearing this market excess will probably take more than three years in Napa and Sonoma if demand stabilizes and longer in Mendocino and Lake counties. Grape pricing will stabilize at much lower levels compared to the past five years.

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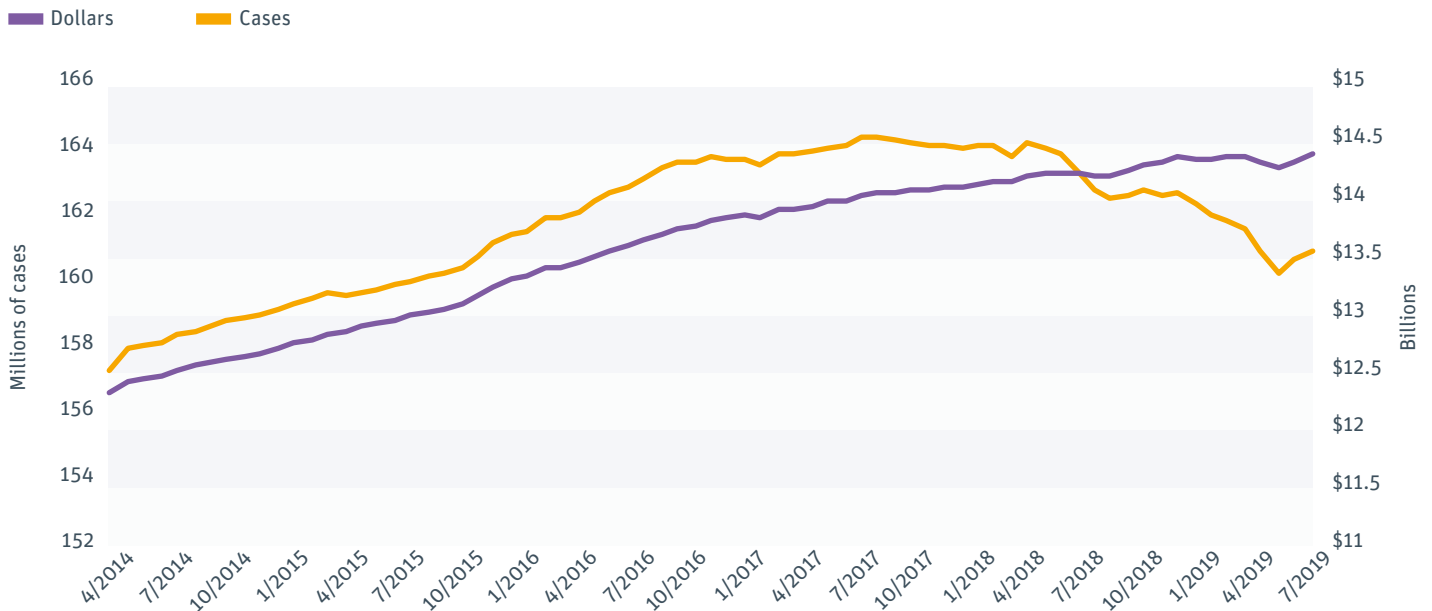
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# 6

## Wine sales

Sales are the capacity to make profit and the most critical component to diagnose industry success factors. With strong industry sales growth, you have a better chance to have healthy and sustained profits. With weak or negative industry growth, your only opportunity for growth is at the expense of other producers.

Figure 12: **Rolling 52-week off-premise retail sales**

Source: Nielsen Beverage Group

There is no perfect information in the wine business. So truly understanding what's happening with wine sales requires the review of several sources to check for consistency, to understand market segmentation and to cover gaps in data collection.

The high-level view of off-premise US wine sales reveals that total industry dollar-denominated sales have landed in a flattening period, and growth in total volume rolled over, tipping into a declining trend last year (see figure 12). That trend in volume declines continued to accelerate through 2019.

When we delivered the bad news on volume declines in 2018, there was widespread disbelief. But that's a normal response to getting information that is unexpected. We hadn't seen volume declines since 1993. Some suggested that Nielsen's data set was an aberration from market truth explained by channel shifting, noting that Nielsen misses some of the value chains like Aldi, Lidl and the largest wine retailer, Costco. Furthermore, restaurants and the still-growing DTC channel aren't included in Nielsen data, so Nielsen is not a full-market indicator.

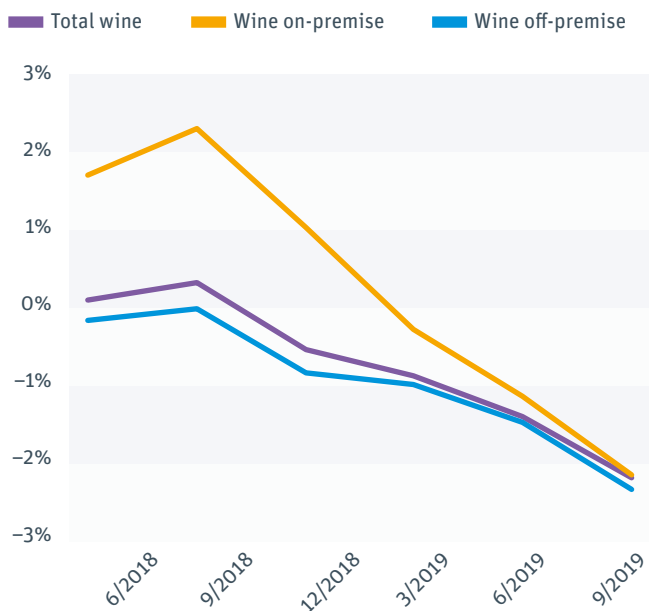
*Total industry dollar-denominated sales have landed in a flattening period.*

The Wine & Spirits Wholesalers of America (WSWA)<sup>13</sup> has solved some of that and consolidated the depletion-level data from several distributors<sup>14</sup> to give new insights and close some of the perceived holes in Nielsen's information.

Wholesale depletion trends from SipSource, which include some of the outlets missing in Nielsen, such as Costco,<sup>15</sup> are in general agreement with Nielsen's reported trends, pointing to the off-premise decline starting in December 2018. The information consolidated from wholesalers in figure 13 shows total sales growth of wine by volume accelerated the negative trajectory through 2019.

To give you added color, on-premise restaurant sales showed declines in the growth rate from positive 2.3 percent in September of 2018 to negative 2.2 percent as of September 2019. Total wine sold by volume has turned negative in both on- and off-premise channels as of June 2019 on a trailing 12-month basis. The speed of the decline indicates the trend will continue into 2020.

Figure 13: **Wine growth by volume**



Source: SipSource

## Winery shipments

Gomberg-Fredrikson and Vintage Economics shipment data come at sales trends from a different perspective than Nielsen and SipSource. Gomberg-Fredrikson and Vintage Economics get their data from public tax documents, whereas Nielsen and SipSource data are from retail sales, as well as information from warehouses. While there is crossover, the data set from Nielsen and SipSource excludes wine shipped from companies, such as Constellation, that own their own warehouses. A large portion of DTC shipments are included in the Gomberg-Fredrikson information.

Volume shipment trends from Vintage Economics in Washington (see figure 14) and Gomberg-Fredrikson (see figure 15) also draw remarkably similar conclusions to each other in the display of their data, showing recent flattening trends followed by near-term volume declines.

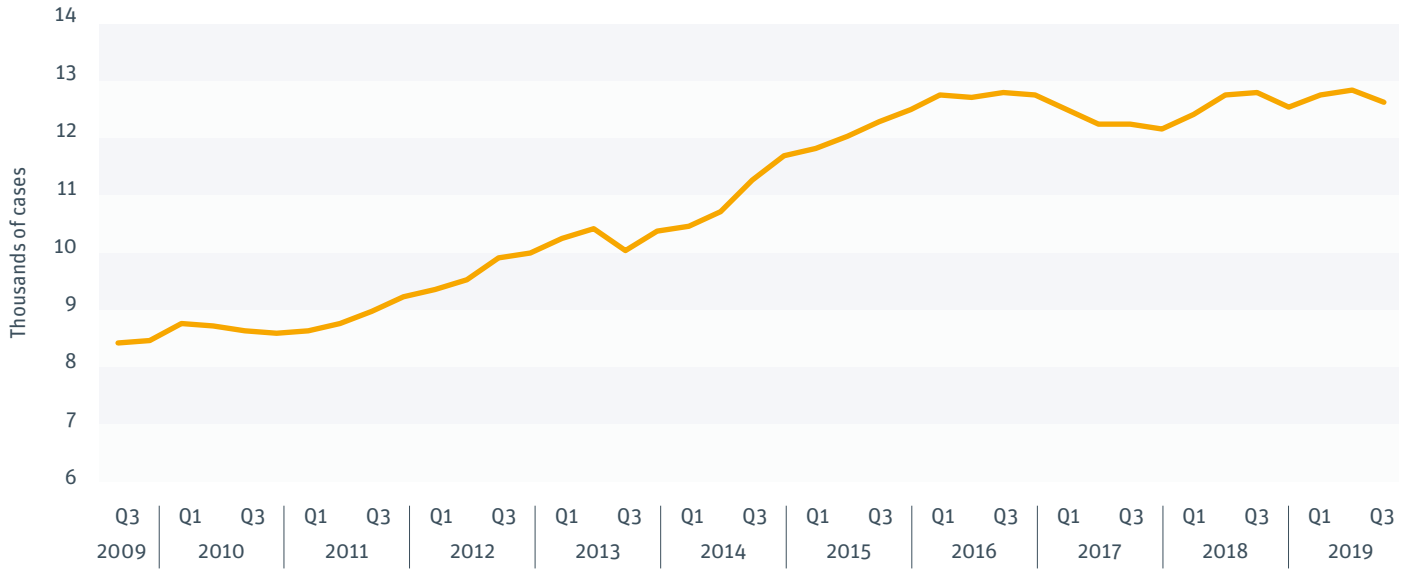
Using the most current information as of July 2019, figure 16 shows that wine shipments from warehouses slowed starting in August 2015, which slightly precedes Nielsen's reporting of a slowdown. But this should be expected since shipments from warehouses have to predate sales at retail in the supply chain.

Shipments trended higher at the end of 2017 but have dropped off steeply in 2018 and into 2019, though the degree of decline has improved slightly, starting in April.

A weakness in this warehouse shipment-trend data is that when large wineries buy brands, they move this volume into their own warehouses. When that happens, movement within large winery warehouses is counted in Nielsen data but not in Gomberg-Fredrikson warehouse shipment data. So we would show a decline in shipments in figure 16 if a sizable brand were removed from reporting public warehouses.

Gomberg-Fredrikson produces a separate view of those larger producers, as represented in figure 17. That gives us another check using tax records and, in this case, direct calls and data checks with large wineries to assemble the information.

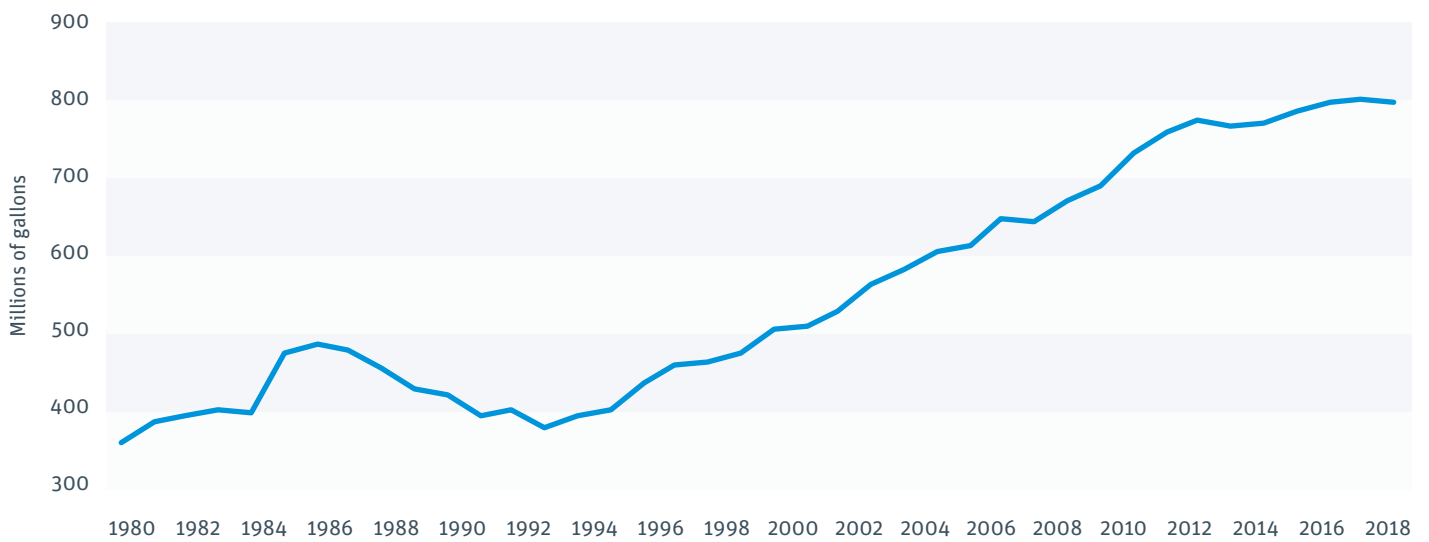
Figure 14: **Rolling 12-month Washington wine shipment volume**



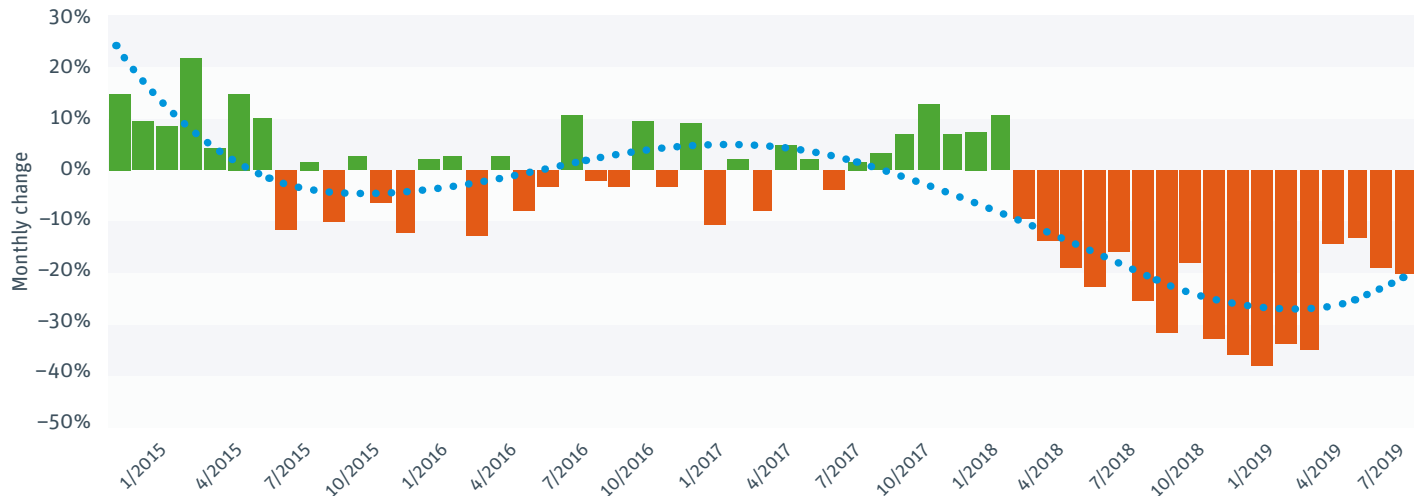
Source: Vintage Economics

Figure 15: **US table wine consumption**

Volume



Source: California Wine Institute

Figure 16: **Warehouse shipment trends**

Source: Gomberg-Fredrikson

Figure 17: **Shipments from the seven largest California producers**

Seven months ended July 2019

Winery	Millions of gallons	Year-over-year change	Percent change
Gallo	40,374	-2,138	-5.30%
The Wine Group	25,007	1,116	4.46%
Constellation Brands	18,322	-2,247	-12.26%
Trinchero Family Estates	10,539	-170	-1.61%
Treasury Wine Estates	6,292	-387	-6.15%
DFV Wines	6,669	297	4.45%
Bronco Wine Company	4,306	82	1.90%
	<b>111,509</b>	<b>-3,447</b>	<b>-3.09%</b>

Source: Gomberg-Fredrikson

The seven-month performance of the seven largest California wineries, which should typically account for about 68 percent to 70 percent of total annual US wine sales, shows 3 million fewer gallons shipped, which is a 3.09 percent decline (see figure 17).

It is important to note Constellation's overweighed weakness in this. Most blame this situation on the stalled sale of the 30 Constellation brands to Gallo, which as of this writing in early December 2019 has still not closed and continues to cause market instability.

### Generics and wines below \$9 – still declining

Over the past 50 years, we've watched generic wines, which have no story or attachment to a place, fall out of favor with consumers. The dated strategy of "make it cheaper and sell it for less," which appealed to the mature generation, had an expiration date, and in recent history we saw the result as lower-priced segments consistently declined in their growth rate alongside the aging of the mature generation, while higher-priced premium wine advanced.

But through November 2019, almost 70 percent of wine sold by volume and 45 percent by dollars still traded below \$9 retail, making this lower-priced segment critically important to the industry. The under \$9 segment should be a fundamental entry point for the frugal young consumer. We have seen a few millennial branding success stories over the past 20 years.

The short moscato boom promoted by recognizable hip-hop stars such as Kanye West and Lil' Kim was an early favorite with entry-level consumers. Like the post-wine cooler baby boomer, the post-moscato millennial seemed to be evolving to favor more complex, albeit lower-priced, red blends such as Apothic Red, which entered the scene in 2000 and has remained a red blend category leader. More recently, the Josh brand has done well, as have sweet wine brands Roscato and Stella Rosa. The 3-liter premium box wine and Tetra Pak formats show well in these lower-priced segments and are a likely source of growth in 2020 as higher-priced premium wine is sold down into lower-priced brands and formats. Rosé and Italian pinot grigio also are doing well in this segment.

On April 3, 2019, Constellation and E. & J. Gallo entered into an asset purchase agreement for 30 Constellation wine brands for \$1.7 billion. The brands sold represented about 23 million cases and carried suggested selling prices of \$11 and below, falling into this important price category. The sale included the Mark West, Wild Horse, Clos du Bois, Black Box, Estancia, Franciscan and Ravenswood brands, along with five winemaking facilities.

There was an important quote in the Gallo press release<sup>16</sup> from Joseph E. Gallo, who said, “We see a tremendous opportunity with this acquisition to bring new consumers into the wine category.” Gallo’s marketing muscle directed at younger consumers is important for industry growth.<sup>17</sup>

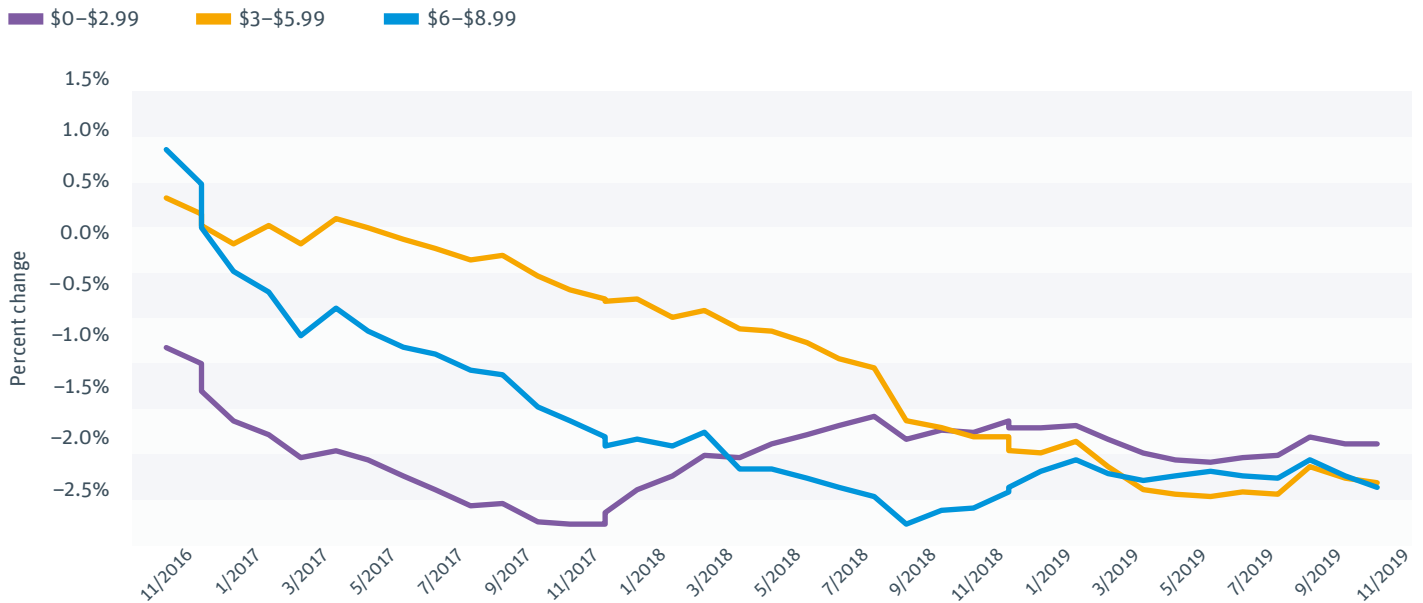
Unlike boomers, who moved through entry-level wines and into premium varietal wine in the 1990s, millennials appear to be trying wine in the broad segment under \$9 but not finding the quality for the price. With exceptions, they are largely making the decision to drink spirits instead. The fact that the under \$9 segment is continuing to slump is not a positive sign for the wine industry (see figure 19).

Figure 18: **Rolling 12-month off-premise sales**

	12-month value ending 10/5/19	Value change vs. a year ago	Value percent change vs. a year ago	Volume 9-liter equivalent	Volume change vs. a year ago	Volume percent change vs. a year ago
	\$14,419,579,138	\$134,625,984	0.94%	160,314,610	-2,295,760	-1.4%
\$0-\$2.99	\$689,155,707	-\$16,817,032	-2.38%	23,630,640	-972,213	-4.0%
\$3-\$5.99	\$3,591,851,730	-\$102,355,551	-2.77%	62,879,827	-2,350,818	-3.6%
\$6-\$8.99	\$2,159,697,504	-\$61,215,438	-2.76%	23,962,219	-866,323	-3.5%
\$9-\$11.99	\$3,389,878,023	\$27,858,890	0.83%	27,467,823	164,534	0.6%
\$12-\$14.99	\$1,797,550,760	\$133,678,382	8.03%	11,277,260	878,006	8.4%
\$15-\$19.99	\$1,419,201,686	\$92,176,109	6.95%	7,042,958	536,781	8.3%
\$20-\$29.99	\$764,962,054	\$40,758,027	5.63%	2,867,242	199,761	7.5%
\$30-\$49.99	\$380,556,398	\$15,686,059	4.30%	868,217	63,956	8.0%

Source: Nielsen Beverage Group, October 5, 2019

Figure 19: Rolling 52-week off-premise growth rate in wine below \$9



Source: Nielsen Beverage Group

## Mid-price premium – growth, but declining growth

Premium wine between \$9 and \$19.99 delivers virtually the same total sales dollars on-premise as the entire \$9 and below segment (45 percent) but accomplishes that on only 28 percent of total wine volume, compared to nearly 70 percent of volume in the under \$9 category.

This broad price category is where most of the growth is found today, expanding at 6.5 percent on value and 7.6 percent on volume in off-premise sales through October, which is a change in pattern from prior years, when value growth exceeded volume growth. That is one of the many signs that premiumization is breaking down for wine. Another clue is shown in figure 20, where declining sales growth in this segment has become a clear trend. The \$9 to \$11.99 sub-segment is showing a new level of weakness, closing in on zero growth on a trailing 52-week basis, and it is already negative on a current-period basis.

This price range attracts larger, efficient operators, with most of this segment's volume moving through the three-tier system and

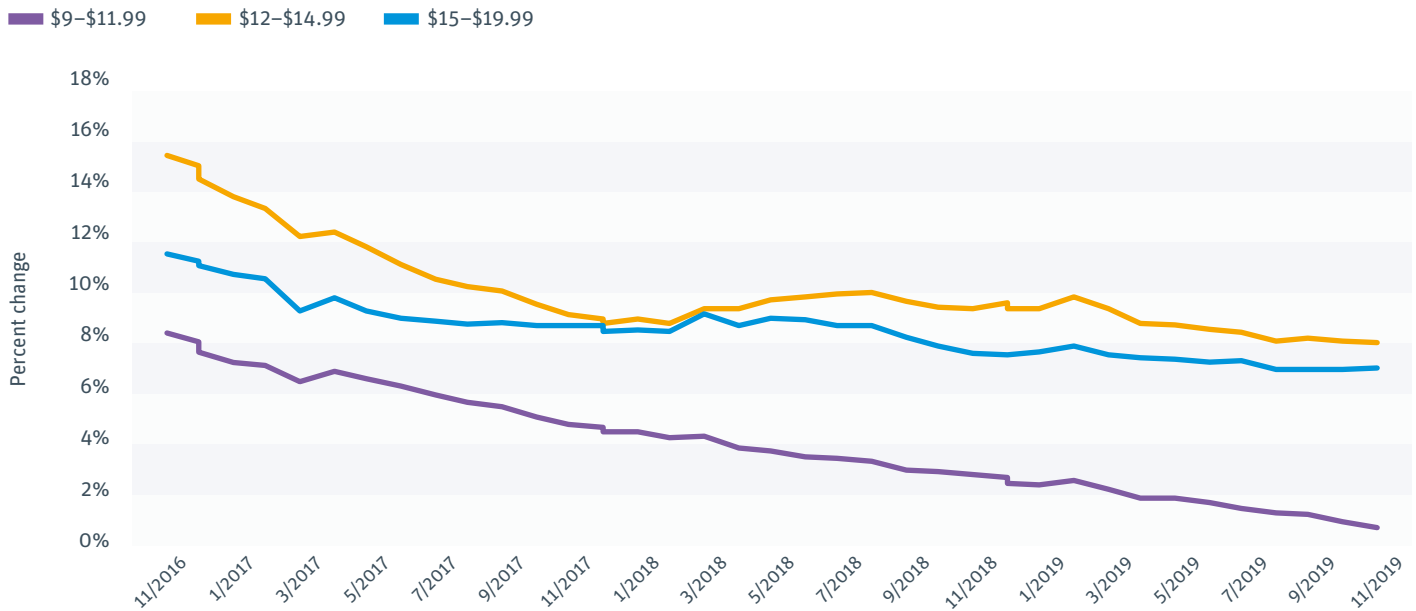
only small amounts through the DTC channel, where the added overhead and shipping costs make profitable sales a challenge.

Within this affordable premium category are several emerging retail sales concepts trying to layer in different experiences with service, and their numbers are expanding, which should provide lift. Today you can buy wine and other alcohol at Bed Bath & Beyond, Starbucks, Burger King, movie theaters, taprooms, barbershops, laundromats and even libraries on occasion.<sup>18</sup>

Newer entrants, discounters and private labelers with their own brands are showing good growth in the price range. So too are the traditional US discounters like Kroger, Walmart and Target, which are each competing for private-label share with an increasingly thrifty consumer.

With the current excess in wine supply, this should be a broad wine segment that will support growth in rebranded and private-label sales over the next several years, perhaps pulling in some younger consumers. This is a segment where we could see some modest positive changes in 2020 if marketing dollars are put toward wine by the large wine companies.



Figure 20: **Rolling 52-week growth in wine value between \$9 and \$19.99**

Source: Nielsen Beverage Group

## Luxury wine – threats and opportunities

Luxury wine has a vastly different production and distribution model than wine priced below \$20. Two of the greatest strengths of the wineries making super-premium and luxury wine are their myriad approaches to production and the sheer number of wineries focused on making world-class wine. And at the same time, the mass of producers is one of the greatest weaknesses. It's a weakness that adds a level of confusion for the consumer, and it's not one that the spirits industry suffers.

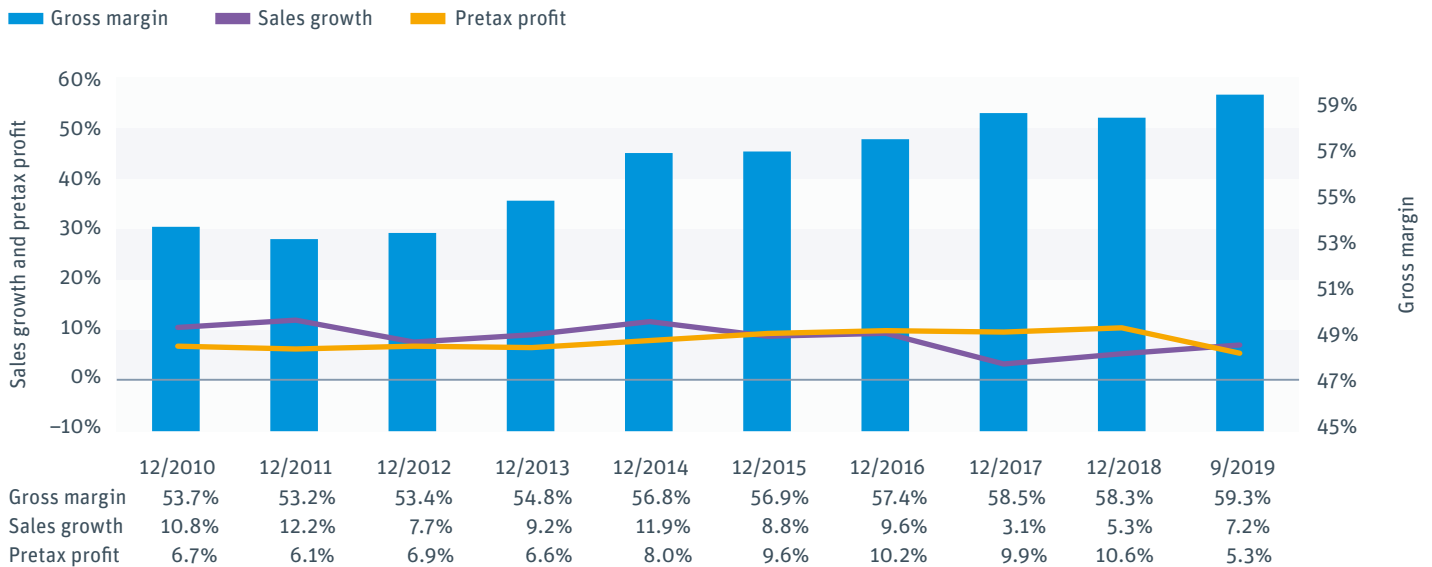
Getting luxury wine to the consumer is no easy task. As late as 2000, only about 15 percent of wine was sold directly to consumers by an average small family winery. Wholesale consolidation changed that as the large distributors went upmarket to focus on more profitable and larger wine producers.

Today DTC sales are required in this segment, representing 60 percent of an average winery's sales, 28 percent from the tasting room and 23 percent from the wine club. Three-tier distribution is still a necessity, but the average small winery today is selling

only 34 percent through wholesale channels and at the lowest gross margin of all channel options.

How are the smaller luxury wineries performing? Today we see a greater separation between successful and unsuccessful businesses. I expect that divide will widen over the next five years, with demand showing no sign of reversing current weakening trends. But there are pockets of sustainable success: wineries with strong brands that have wholesale representation, true cult wineries still able to sell using an allocation approach, businesses with professional and experienced management teams, those with a proven strategy that is pulling in younger consumers and keeping older ones, and many that use different branding approaches and themes and focus on the consumer experience using benchmarks and metrics in their events, wine club and tasting room efforts.

Winery financial statements are another source to verify the wine trends. Silicon Valley Bank has collected financial statements as part of our daily routine for decades. We then aggregate the data and provide our clients gratis consulting and benchmarking. We

Figure 21: **Financial performance of premium wineries**

Source: SVB Peer Group Analysis Database

also use the information to track larger-scale industry moves of premium wine.

Our database reflects the wine industry overall by numbers and includes hundreds of wineries, overwhelmingly from the US West Coast. Average case production in the database is 27,886, with a range of 1,000 to 750,000 cases. The average retail bottle price is about \$28. Our database excludes the largest wineries, which are captured elsewhere in syndicated data.

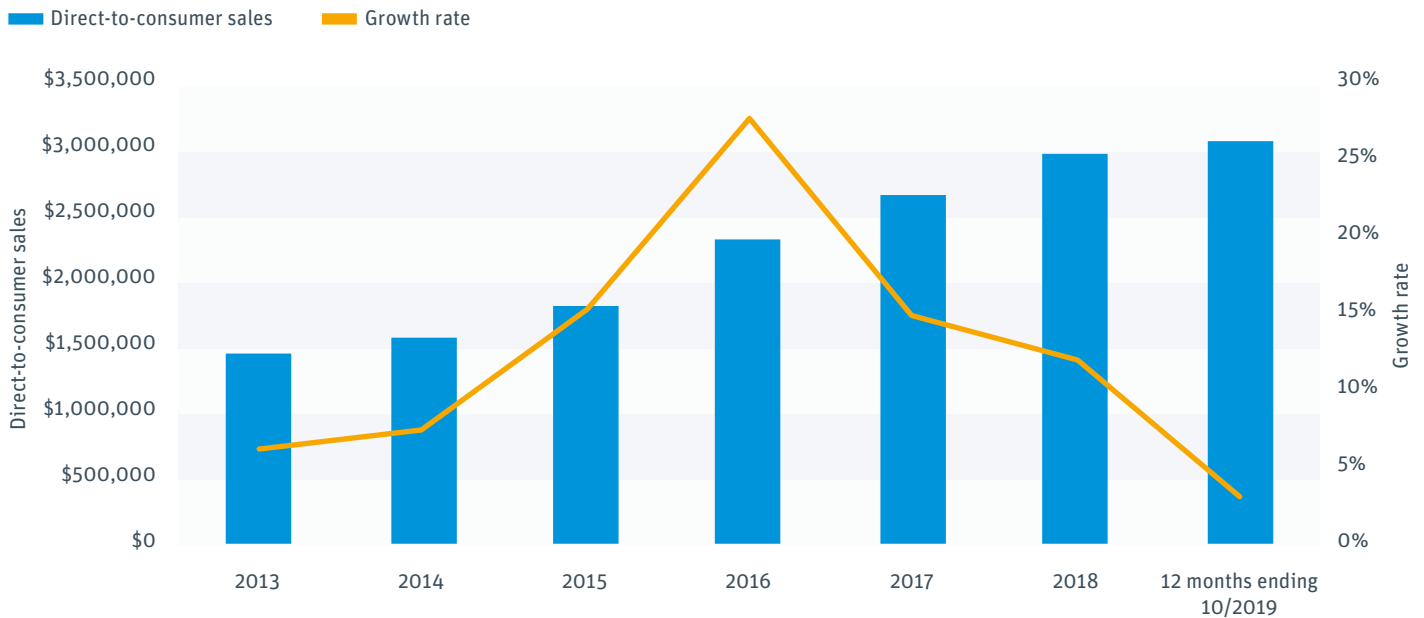
Figure 21 is a product of that database. The trended sales growth rate has slowed slightly over the past decade, which is consistent with the other industry data we see.

Higher gross margins are a clear trend that started in 2011 with the recovery from the Great Recession and went on to mirror the industry's move to DTC tactics. Pretax profit hovers around 8 percent for this sample, though the nine-month period ending

September 2019 had slightly lower profitability than average. As noted in figure 2 in the "Introduction" section of this report, there is widespread variability in sample sales growth and, by extension, profitability today.

Sales growth through nine months for the benchmarked group is 7.2 percent and is showing resilience in the face of consumer change, obviously the result of hard work in the DTC channel. Currently, the sales growth noted is at the upper end of our estimate of 4 percent to 8 percent projected sales growth, which we made in early 2019.

This nine-month information is missing the heavy October-November-December selling period. In the SVB State of the Wine Industry Survey, owners expected to end 2019 with sales value growth of 10 percent and case volume growth of 8 percent, above our estimate.

Figure 22: **Total annual direct-to-consumer sales**

Sources: Wines Vines Analytics, ShipCompliant

## Direct to consumer – positive growth but slowing

Luxury wineries sell most of their wine through DTC channels. Prior to 2016, there was significant channel shifting away from wholesale and over to the DTC channel, as SVB survey results showed. Since 2016, the shifting has stabilized, and DTC sales have remained right at 60 percent.

Given that, it's not a surprise to see annual trended data from Wines Vines and ShipCompliant show slowing growth rates since 2016 but still-higher levels of total sales (see figure 22), consistent with the SVB Peer Group Analysis Database (see figure 21).

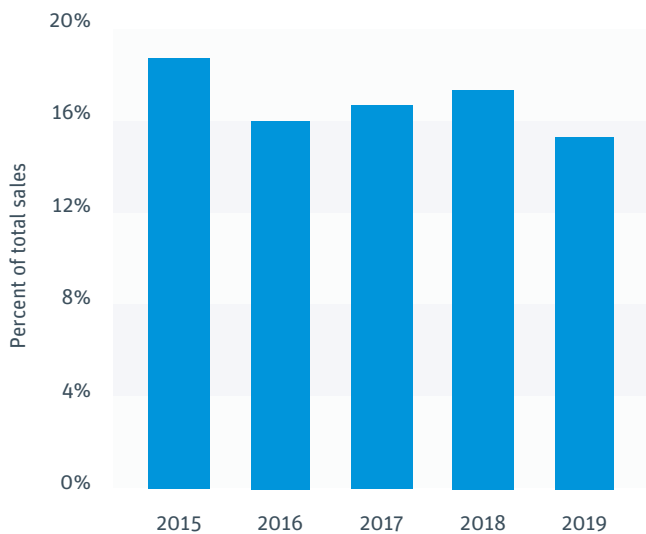
It should be noted that with only seven states still prohibiting direct shipment of wine to consumers, the potential expansion of direct sales from the opening of new states to direct shipping is now more limited than in the past decade. Growth in this segment will come from new subscription models and from wineries growing their sphere of influence and taking their direct sales efforts and winery experience on the road.<sup>19</sup>

That said, one of the more interesting growth opportunities comes via the US Supreme Court's ruling in *Tennessee Wine & Spirits Retailers Association v. Thomas* in 2019.<sup>20</sup> It's a crack in the wall that could help unwind other protectionist barriers against direct shipments of wine from retailers. That ruling may provide other sales options for luxury wineries, particularly for larger retailers with a strong existing experience shipping wine direct.

## Restaurant sales

Retiring baby boomers are slowing both their spending and alcohol consumption as they age. Frugal hedonism<sup>21</sup> has overtaken our younger drinking cohort, and they don't want to pay restaurant markups. They know they can buy a bottle of wine at a store for less. In the restaurant, they are more likely to start with a craft beer or a premium cocktail than a glass or bottle of wine. But consumer shifts being driven by the young consumer don't stop there.

Figure 23: **Sales to restaurants from an average winery**



Source: SVB State of the Wine Industry Survey

In our survey work with wineries, we ask them to tell us the percentage of their sales that flow through each of the major sales paths, such as club, wholesale, direct and restaurant. With that information, we can track relative movement in sales from wine producers to restaurants from year to year.

It's important to note that our data are benchmarks. That means we are providing information that would be meaningful to the "average winery," and on average, wineries are small. So when we show the average winery with 15 percent of its revenue from restaurants, that's not the same thing as saying 15 percent of all wine revenue comes from restaurants (see figure 23).

But for the smaller winery, sales of wine to restaurants has been declining in importance for nearly a decade as distributor representation has become increasingly scarce and DTC progressively more important. Because the larger wineries have distribution, they are more successful than the smaller ones in selling to restaurants.

Restaurant trends are reinforcing that wine is behind the curve in adapting to the new consumer. According to SipSource depletion data, on-premise sales of wine are declining by 2.3 percent on a trailing 12-month basis through September 2019.

With wine priced below spirits and beer at retail outlets, the huge markups in restaurants for alcohol distort the price and value delivered to a restaurant consumer. A premium producer's wine is priced so far above cocktails today that they lose pours to spirits. Larger wineries have pushed through their more affordably priced wines to narrow the price gaps. Any growth opportunity for family wineries in restaurants is in independent restaurants, but even there the problems of markups still exist.

Family wine producers used to consider by-the-glass programs a viable method to get their wine in front of a consumer for trial. The problem I've always had with that theory is that your brand isn't on the glass. I've always believed that in a social setting with no visual, a restaurant consumer consuming by the glass will never remember what they are drinking.

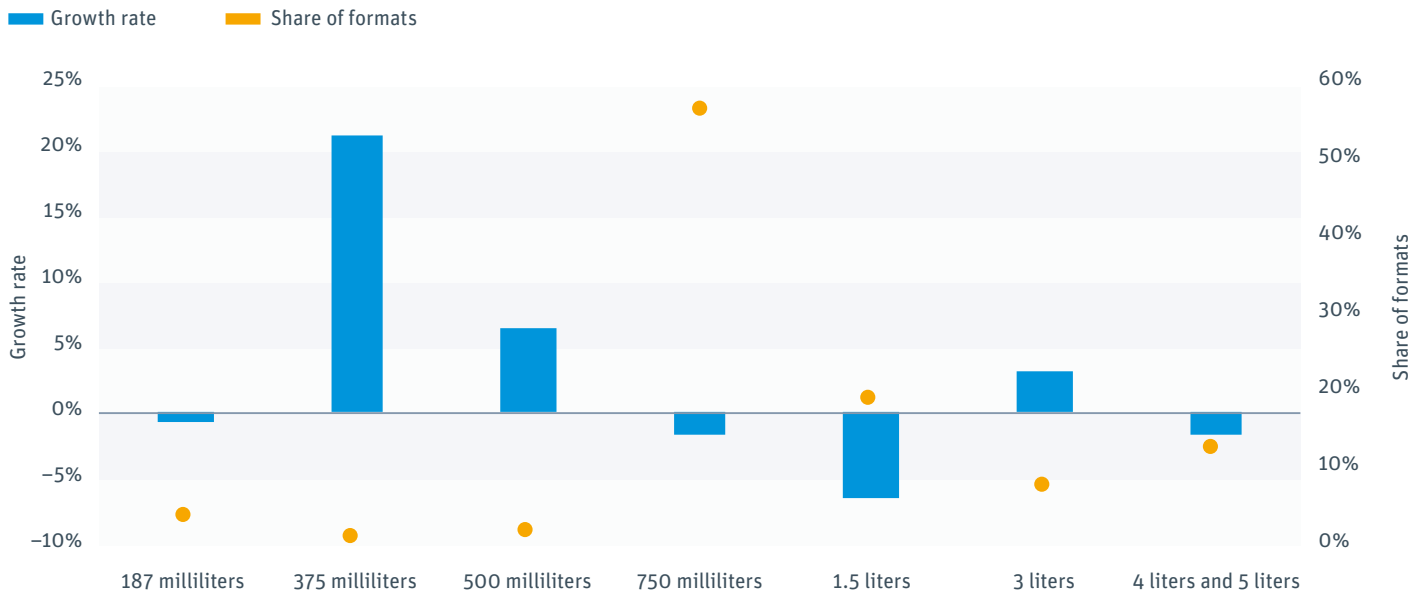
Today, when the consumer is presented with a \$20 premium wine or a \$12 premium cocktail, they will take the cocktail. Combating that price squeeze, wine producers have tried to make lower-priced restaurant wines for by-the-glass programs or have considered those programs loss leaders. Neither is a perfect solution. In the one case, you are getting a lower-quality wine to a new consumer to introduce your wine. That's not the right impression. In the latter case, you lose margin. That's clearly not a good approach either but might be a better solution than discounting by the bottle when there is excess supply.

## Formats, varietals and packaging

One of the issues the wine industry has to unlock is the value equation. Value isn't just price, though price is a component. And wine compared to other alcoholic beverages is expensive.

With frugal millennials squeezing pennies together and the median boomer a year away from normal retirement, price does matter. But taking your top-level pricing down is a risk. Once it's down, it's going to be very difficult to raise it back up. There is an interesting thing happening in packaging that might be one solution for your winery.

Figure 24: Growth rate and share of formats



Source: SipSource, September 2019

Over the past year, the growth rate of the 750-milliliter bottle format has dropped (see figure 24), which is as you would suspect with total wine volume turning negative. But two formats are seeing growth. While they are small components on a share basis, both the 375-milliliter and 500-milliliter formats are growing, as is the 3-liter category, which is capturing premium bag-in-a-box. Each of those has a story with a more frugal consumer.

The 3-liter story is the old super-size boomer model of including more product at a lower price per unit and saving on packaging. That's how 2-liter soda came to be.<sup>22</sup> The value play there is to reduce packaging costs. With the other smaller formats, packaging costs are actually higher, but the overall price of the product is lower. There is a lesson to be learned in that.

As boomers retire, they will join millennials as frugal consumers and change their consumption and spending. But as any wine lover will tell you, it's hard to drink good wine and go backward to lesser-quality wine.

A 750-milliliter bottle is a lot to drink at one sitting for a 60-plus-year-old person, and research shows that there will be 128 percent more mature consumers who, through divorce or death of a spouse, will be living in a single-person household by the year 2030.<sup>23</sup> For many of those people in the next 20 years, a 500-milliliter bottle will be a solution that fits their lifestyle.

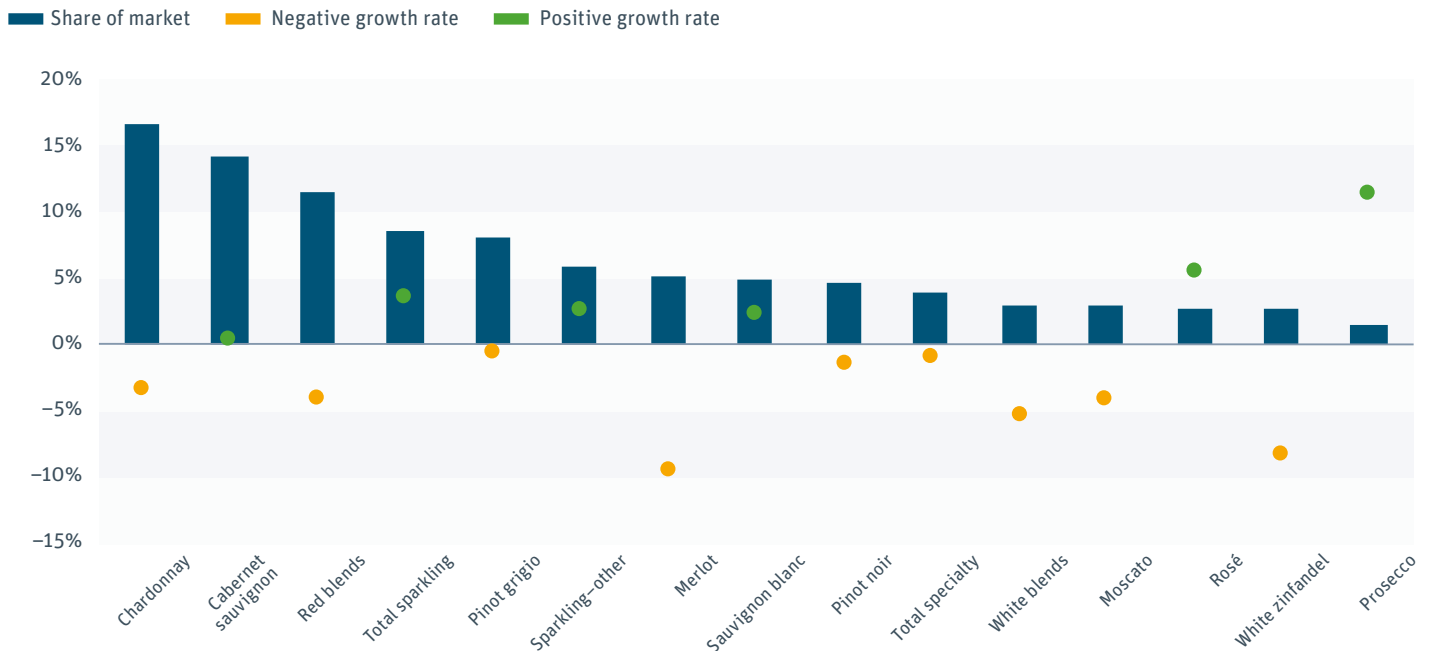
Restaurants, too, with their markups, are creating leverage on the problem of the price of wine compared to other substitutes. Spirits and mixed cocktails are the beneficiaries when by-the-glass now comes in at \$15 and above for a decent glass of wine.

If enough producers make a 500-milliliter offering, it's not a reach to expect to see smaller formats fill a need between by-the-glass offerings and 750-milliliter offerings in restaurants. The format will also play to the single diner and the dining couple who want both a white and red wine with dinner.

The 375-milliliter format has a lot going for it with younger consumers who are consuming less alcohol. Importantly, though, if you are making a \$45 bottle of wine as your lowest-price offering of red wine, you are out of the reach of a young consumer aspiring to premium wine, especially when two bottles are what a new pair of Allbirds will cost.<sup>24</sup>

A young consumer will more likely take a risk on your \$45 750-milliliter bottle if it's sold for \$22.50 in a 375-milliliter offering. That approach will work in the wine club, grocery stores and restaurants, though I'd advise against putting smaller formats in a tasting room as they will likely cannibalize 750-milliliter over-the-counter hand sales.

Figure 25: Varietal growth rate and share of market



Source: SipSource, September 2019

Canned wine continues to get an oversized level of press, with 80 percent growth but just one half of 1 percent share. Cans are taking off in other parts of the alcohol beverage industry as single-serve options. And a growing number of wineries are having success with cans, which have an appeal to the younger consumer. The economics of smaller sizes are the same for cans as for 375- and 500-milliliter formats.<sup>25</sup> You are providing a way for the consumer to spend less on the unit purchase. The wine industry needs to have more single-serve options for the consumer.

If you think the negative health messaging on wine has been tough on sales, consider sugared soda, which was long ago tied to obesity and diabetes,<sup>26</sup> leading to the removal of every vending machine from every school in America. How are they marketing?

Enter Coke Mini,<sup>27</sup> which has given the company a new shot in the arm and is showing double-digit growth. How? They reduced the size of the can to 7.5 ounces and now sell on the health claim of “lower sugar.” There are many lessons for wine producers to consider with Coke’s success through that strategy.

Movements in varietal share and growth rate are reflecting consumer changes (see figure 25). While chardonnay is still the

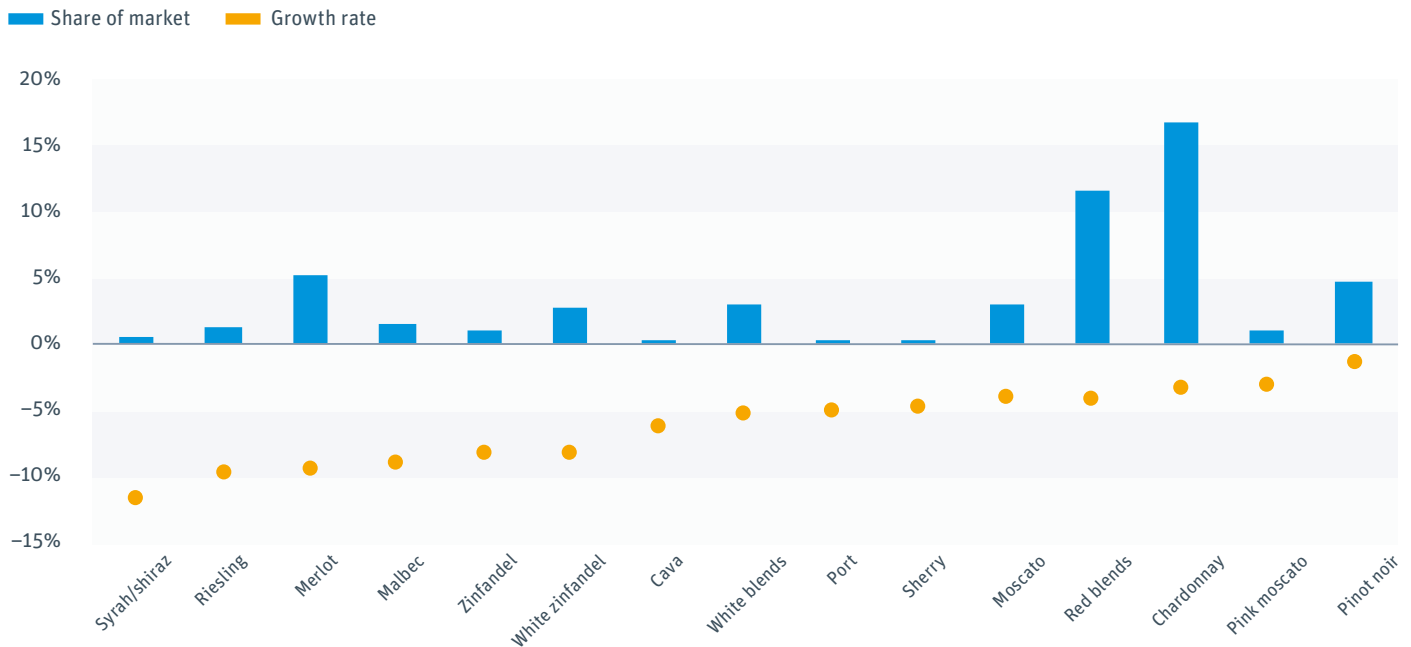
most popular varietal, its growth rate of negative 3.4 percent on a trailing 12-month basis isn’t helpful in reducing an oversupply, particularly in Monterey County and Washington.

Red blends, an entry-level category and growth segment for more than 10 years, are trending down today. That’s a concern, given that the pattern for consumers has been to enter the product from the sweet side — moscato a decade ago and recently Roscato and Stella Rosa, for instance — then graduate to drier wines. Red blends have been a natural bridge to drier varietals because the category crosses semisweet and dry versions.

The fact that the red blend segment is starting to decline, along with the majority of varietal wines, is an indication that the young consumers are moving through their sweet wine discovery phase but not sticking with wine as the boomers did. They aren’t trading up.

There is good varietal growth in the sparkling category, along with sauvignon blanc, rosé and prosecco. Cabernet, which was king, is probably more of a prince now when it comes to growth, but it’s still in the green. Apart from cabernet, the other varietals are providing interesting clues to what’s working at present.

Figure 26: Varietals in decline and share of market



Source: SipSource, September 2019

All of the sparkling wines share a few characteristics that are attractive to entry-level consumers. It is a celebratory category, and fun is important to the young consumer.<sup>28</sup> Sparkling wines are lower in alcohol than most still wines, which is a plus for consumers trying to be mindful of health and wellness trends. The sparkling category has large selections of “serious” wine, but there are entry-level brands providing a bridge from sweet wines. And sparkling wine is consumed in a smaller flute. There are more servings per bottle as a result, which lowers the cost per serving.

The highest-growth varietal is prosecco at 11.5 percent, but rosé (5.5 percent) and sauvignon blanc (2.4 percent) also share common characteristics. They are premium wines that are consistent in flavor profiles and widely available, and they can be found below \$20 retail, which is again appealing to younger consumers.

While there are only a few favored varietal children growing in popularity these days, there are many varietal orphans looking for adoption (see figure 26). Of greatest concern is the continuing

failure of merlot and the addition of negative growth in pinot noir and chardonnay to add to the negative growth story.

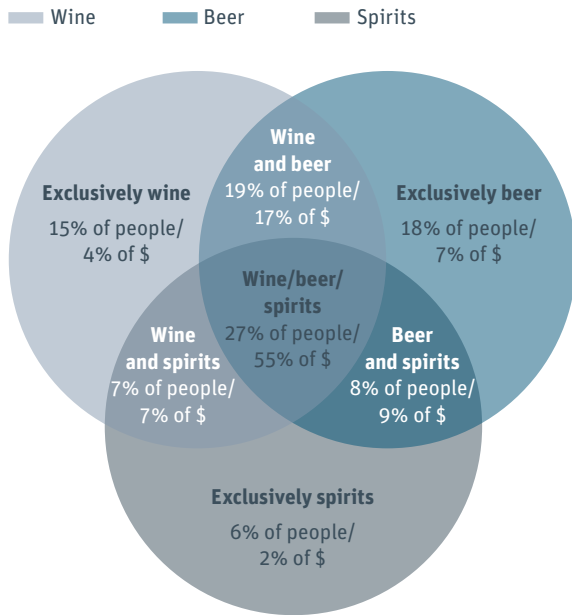
While merlot isn’t likely to return to positive growth in 2020, pinot noir and chardonnay may get there as larger wineries find values in bulk and grape contracts for those two varietals and drive promotional dollars through private and négociant labels.

## Substitutes – spirits, cannabis and imports

Given that wine is declining in volume sales, the question is not only why is it happening, but also where are the wine consumers going? Part of the answer is that they are going without.

Substantial information available suggests that health-conscious consumers are moving away from alcohol due to health concerns. Health in that context isn’t just about the traditional negative impacts from alcohol. It is more encompassing, including issues such as calories and weight gain. That consumer change is driving fashionable trends such as Dry January,<sup>29</sup> Mindful Moderation<sup>30</sup> and the Sober Curious Movement.<sup>31</sup>

**Figure 27: Competition is beer and spirits**  
*Only 15% of drinkers drink wine alone*



Wine category includes still and sparkling wines. Beer category includes flavored malt beverages and ciders.  
 Source: Nielsen Homescan Panel, total US 52 weeks ending June 29, 2019

Another part of the answer to where the missing wine consumers have gone is provided in figure 27. Today, spirits are a strong substitute for wine because alcohol beverage consumers drink across categories.

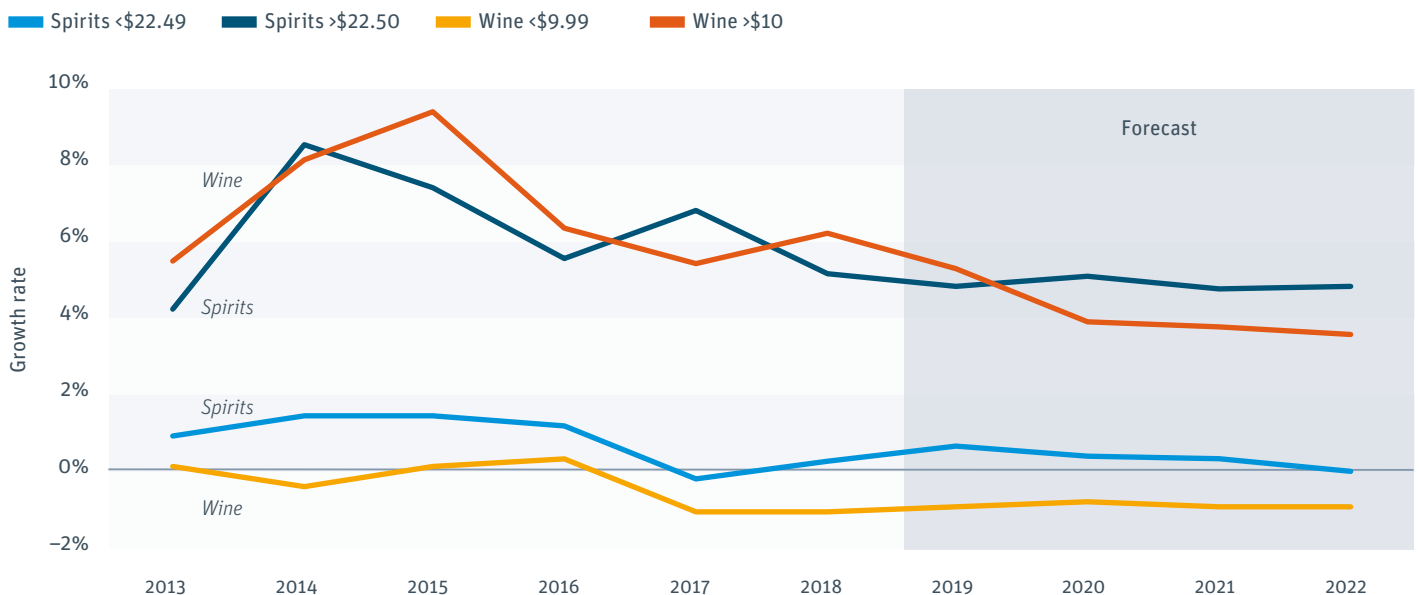
Just 15 percent of consumers today say they are exclusively wine drinkers, and those who do drink only wine are supplying just 4 percent of total alcohol sales. That group skews older, buys generic and drinks modest amounts frequently. But those consumers who drink across categories represent 61 percent of households and 88 percent of alcohol beverage spending.

### Spirits

Seeing the success of the premium wine and craft beer industries, decades ago the spirits industry refocused on improving quality. Today, in some states where it's allowed, there are craft spirits tasting rooms focusing on experiences and driving club sales just like family wineries. But spirits have another distinct advantage over wine: price.

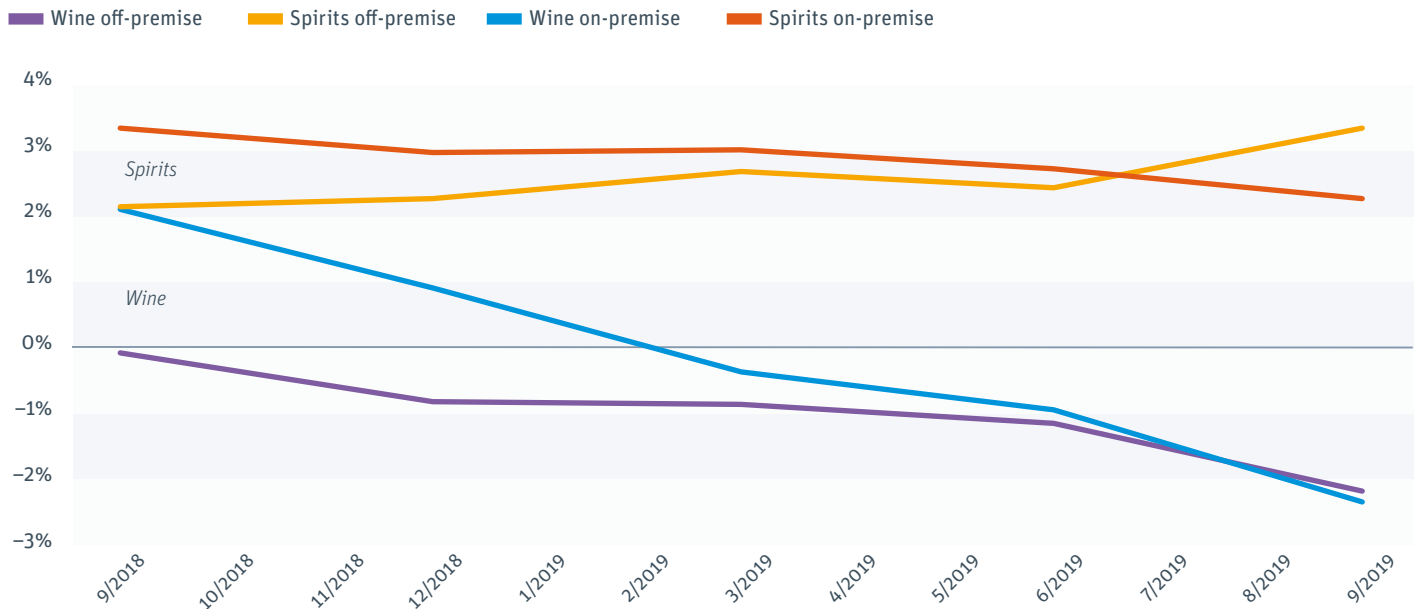
According to Nielsen, it costs \$1.02 for a 12-ounce serving of beer, \$0.88 for a 1.45-ounce serving of spirits and \$1.51 for a 5-ounce pour of wine. That lower price per serving is a clear part of the success story of spirits today.

**Figure 28: Trended and forecasted growth rates in spirits and wine**



Source: IWSR Drinks Market Analysis, 2019. Units are converted to 9L case volumes.



Figure 29: **Trailing 12-month trend of wine and spirits on- and off-premise**

Source: SipSource, 2019. Units are converted to 9L case volumes.

Both wine and spirits producers have improved on quality in the past 20 years. For young consumers, spirits are simpler than wine, so it is easier to gain expertise. Still at the front end of their homeownership years, millennials find spirits more suitable for smaller homes and rentals compared to creating spaces to store wine. A cocktail bar takes up less room and doesn't require the expense of running a wine cooler 24 hours a day. With their pricing advantages, it's easy to see why spirits are winning out over wine with young people.

Market analysis from International Wine and Spirits Research (IWSR) shows the on-premise volume growth rate declines over time in both spirits and wine (figure 28). That is the impact of successful efforts by the anti-alcohol lobby in characterizing alcohol as unhealthy.

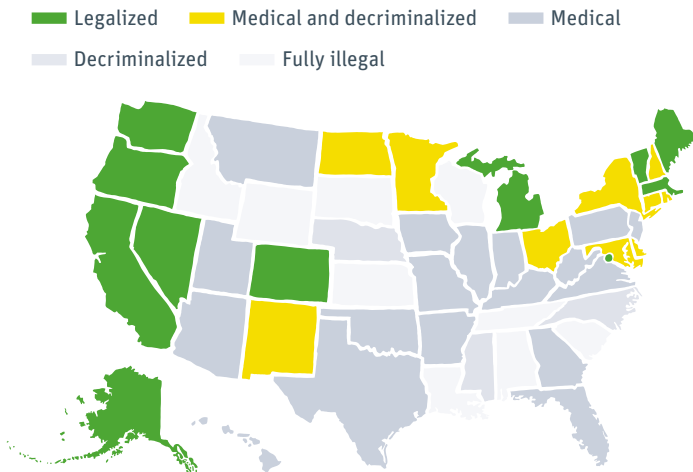
Young consumers are drinking less. Consistent with other syndicated information, lower-priced wine in this analysis is in a secular declining mode, while lower-priced premium spirits are in a low-growth trend. In the IWSR analysis, premium wine and premium spirits growth rates have trended together, but wine fell behind spirits starting in 2019. IWSR's forecast is for spirits to continue to grow and take share from wine.

When we look at a different data set, trended wholesaler depletion volume data from SipSource show a similar result for on- and off-premise depletions for wine (see figure 29). What's interesting from this data is that both spirits and wine volumes are declining on-premise, but the decline in wine is much more rapid compared to spirits, which are still in growth mode while wine crossed into negative growth on-premise in early 2019. Off-premise spirits from this view are accelerating in growth, while wine once again is decelerating on a volume basis.

## Cannabis

Following the 2012 passage in Colorado of Amendment 64 and in Washington of Initiative 502, which legalized the recreational use of marijuana for the first time in the US, a question about substitution started to arise in alcohol beverage circles. Is cannabis a strong substitute<sup>32</sup> for Guinness, Grey Goose and Gigondas?

I'm not so sure that's the right question, but it's certainly the fear in the wine business. Anecdotal evidence<sup>33</sup> has led many people to conclude that alcohol beverage sales were down in Colorado and the Pacific Northwest immediately after the legalization of recreational marijuana. But one analyst who reviewed tax data

Figure 30: **Marijuana legalization status**

Source: DISA Global Solutions, <https://disa.com/map-of-marijuana-legality-by-state>

for wine and cannabis concluded that at least for Colorado, there was no material change in alcohol consumption post-legalization.

For those who fear it's a substitute, what if it is actually a complement<sup>34</sup> and cannabis encourages wine sales in the same way that higher popcorn sales stimulate added butter sales?<sup>35</sup> We really are lacking solid data either way.

I don't think anyone doubts cannabis is a growth industry — it easily qualifies if we ignore all of the illegal sales of marijuana that were already taking place. We can just pretend we're starting from the day it was made legal in a state and say that's all growth.

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*If there is substitution, it will likely be felt in the younger consumer demographic.*

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But the Cannabis Consumers Coalition conducted a well-run consumer study and determined that 64 percent of current marijuana buyers have been users for 10 years or more.<sup>36</sup> So yes, it's already been around, which means that there's a difference between legal growth and real growth. Looking at real growth makes it harder to argue that legalization today is having a major impact on current wine sales.

Research hasn't provided a clear answer regarding the central question of substitution. In 2018, *Forbes* printed an article<sup>37</sup> that covered collaborative research<sup>38</sup> between the University of Connecticut, Georgia State University and Universidad del Pacifico, Lima concluding that alcohol sales dropped 15 percent in states when new medical marijuana laws were approved and that marijuana was a strong substitute for alcohol. (I covered that in more depth in my blog.<sup>39</sup>)

On the other hand, research released in Sweden in 2017 covering observations from 1989 to 2016 among more than 140,000 adolescents concluded that marijuana was neither a substitute nor a complement for alcohol.<sup>40</sup>

There are some practical facts to consider in arriving at a conclusion: Most reports suggest that regular cannabis users represent in the low teens of the adult population. Placing a pin on it, let's say about 13 percent of adults are regular consumers of cannabis.<sup>41</sup> Somewhat regular alcohol consumers represent around 60 percent of the adult population.<sup>42</sup>

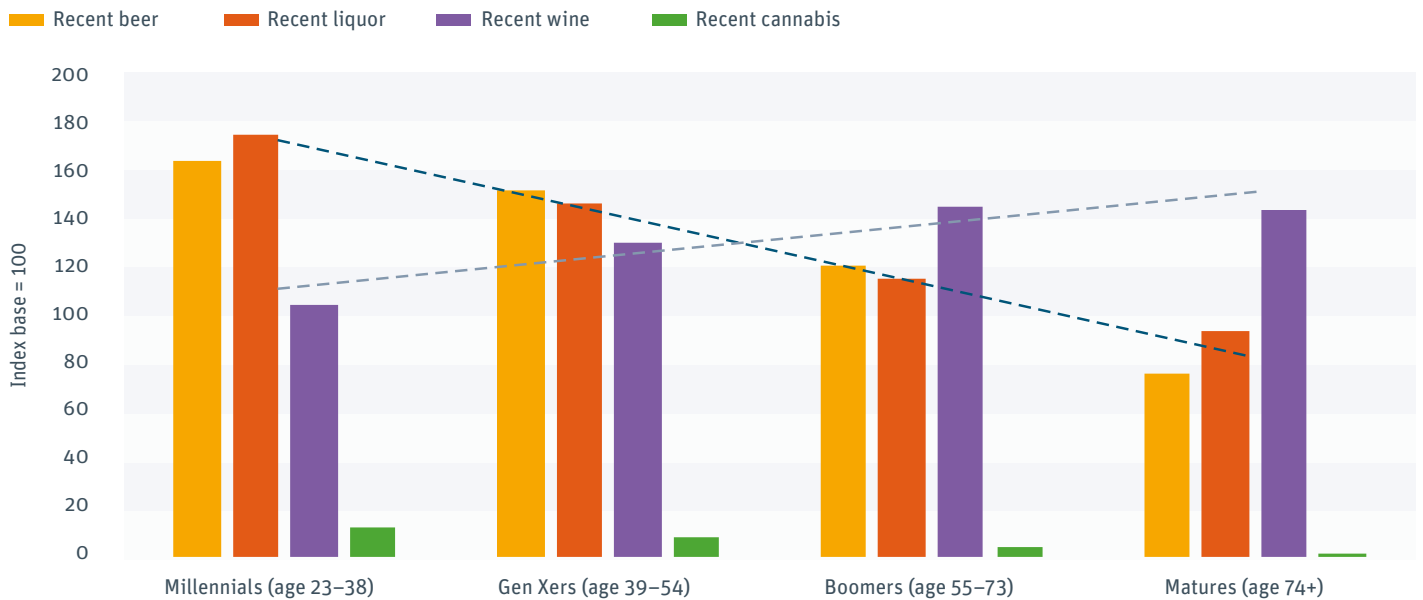
Given the disparity in consumer populations, it would be difficult for the 13 percent to strongly influence the other 60 percent, even if all of the 13 percent reduced the number of occasions in which they drink by a substantial amount. But what if the cannabis users skewed young? Could that impact younger consumers' preference for wine?

That is in fact the case from the best research I've reviewed. The typical description of a regular cannabis user today is a 26-year-old male who has no college education and makes less than \$75,000 per year. So it is possible that if there is substitution, it will likely be felt in the younger consumer demographic.

Figure 31 represents information pulled together from several research reports and sources. It shows the difference in preference between beer, liquor, wine and cannabis in the adult population in the US. When we adjust for the difference in the size of the consumer base, you can see how a young consumer skews more to beer and liquor and less toward wine today. And while millennials are the largest consumers of cannabis of all cohorts, as a cohort they still prefer wine far more than weed.

Figure 31: **Current consumption of alcohol and cannabis by cohort**

Adjusted for current consumer base of each



Sources: Scarborough Research, SVB Analysis

*Cannabis isn't helping wine consumption, and for the young consumer, legalization is probably hindering consumer purchases of lower-priced wine.*

As consumers age, their preference for liquor, beer and cannabis drops, and their preference for wine has historically grown. But that's no guarantee that young consumers today will become fans of wine tomorrow.

As more states legalize recreational marijuana, the legal and economic relationship between alcohol and marijuana will become better understood — and with marketing and socialization, cannabis may become a larger issue for the wine industry.

In 2018, one of the world's largest alcohol producers, Constellation Brands, invested \$3.8 billion in Canadian cannabis producer Canopy Growth.<sup>43</sup> Later in 2018, Francis Ford Coppola partnered with a Humboldt County, California, marijuana farmer to produce a product line under his brand.<sup>44</sup> And beyond that, companies from Coca-Cola to Coors are looking at the market as an opportunity to start the next big revolution in beverage sales.<sup>45</sup> With this kind of investment and promotion, what we see today in consumption patterns could easily change.

My conclusion thus far is that marijuana and fine wine have largely different social uses and aren't substitutes or complements, which mirrors the Swedish research finding. That's not to say a premium wine consumer would never inhale. It's saying that if they do consume marijuana, it would be at a different time and for a different purpose.

Inexpensive wine or beer might have a similar social purpose as marijuana on the lower end of the price scale. I can envision some substitution effect in lower price points for beer and spirits, since the average cannabis user today is young, and younger people prefer spirits and beer instead of wine.

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*I worry more about CBD-infused beverages being defined in the narrative as healthy and wine being defined as unhealthy.*

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For today, we can say with certainty that cannabis isn't helping wine consumption, and for the young consumer, legalization is probably hindering consumer purchases of lower-priced wine.

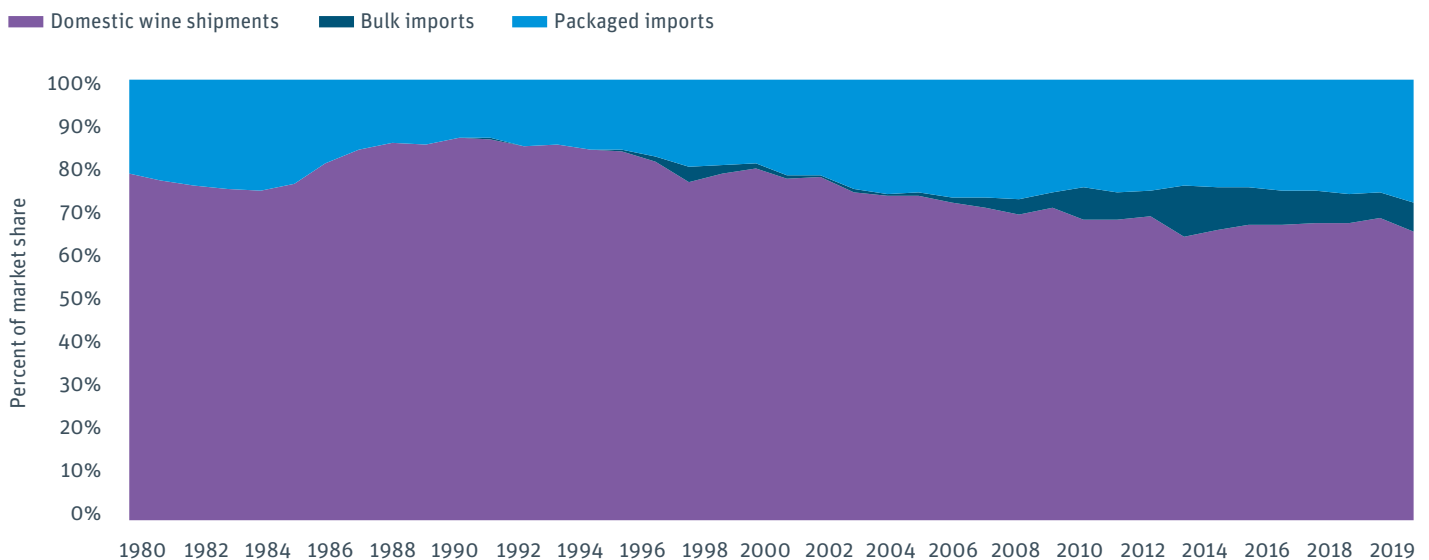
My current fear isn't THC, though that might change. With the health and wellness pendulum swinging away from alcohol and seemingly toward cannabis, I worry more about CBD-infused<sup>46</sup> beverages being defined in the narrative as healthy and wine being defined as unhealthy. In that context, CBD-infused beverages could become a real threat as a substitute for wine.

Could wineries join in and produce CBD-infused products themselves? Although the TTB and the FDA do not yet permit the use of CBD in alcoholic beverages, several European markets are selling CBD-infused spirits, and as mentioned, beer companies are ahead of the curve with direct investments. It seems safe to say that at some point we will see CBD-infused beer and CBD-infused hard seltzers in the US. Wine will be a laggard when it does join in, though once CBD becomes legal for US permit holders, I would expect to see a lot of small wineries playing with concepts. It's just a question of time, but if I had to hazard a guess, it will be more than five years before we see a wine and CBD beverage.

## Imports

Most US fine wine producers ignored the growth trends of imports over the past 25 years but did so more particularly in the 1990s, when wine “just sold itself.” Today, the winery owner is far more aware that foreign competition is a current and looming risk. The market share of domestic wine shipments has continued to drop, beginning in earnest in the early 1990s. Bulk imports have been used by large producers in domestic brands, and since the early 2000s, those bulk purchases have also grown foreign wine's share of the total market (see figure 32).

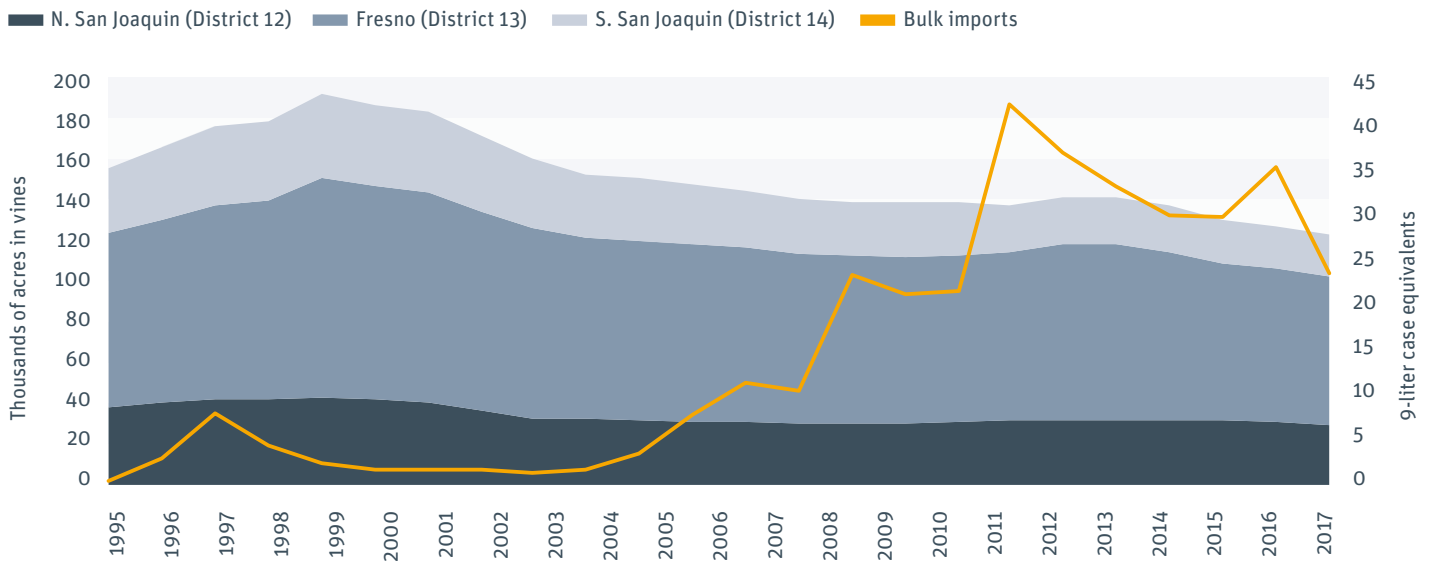
Figure 32: **Decrease in US market share versus imports**



Estimated data for 2019

Source: Gomberg-Fredrikson

Figure 33: **Vine acres removed in California's San Joaquin Valley versus growth in foreign bulk imports**



Sources: Grape Acreage Report by USDA National Agricultural Statistics Service, Gomberg-Frederikson

It's hard to blame winery owners for being silent about the activities of the international wine interloper historically. When you have the best worldwide market in which to sell wine and you can sell all you make, increase your prices and still grow your volume, why worry?

Growers in the Central Valley of California were the first to feel squeezed out by foreign wine suppliers. While overplanting played a role in the removal of more than 100,000 gross acres from production after 1999, a significant component of the removals up to the present day came about because cheaper juice could be brought in from other countries as bulk wine.

The US generic consumer didn't care if the chardonnay was Australian, Chilean or American. That allowed large wine producers to cut back on buying local fruit, causing the removal of tens of thousands of acres in the process.<sup>47</sup> That relationship can be seen in figure 33.

While premiumization took hold as generics fell out of favor, it seemed there was always enough consumer demand to satisfy both the growing shipments of imports and the production of premium domestic wine. But those days are past. The future holds different conditions for domestic family wineries than the past two decades did.

As domestic wineries see US growth opportunities taper, they will notice more well-made and competitively priced imported wines hitting domestic shores, eroding their market share. An individual winery's growth will be at the expense of share from somewhere else. As that realization grows, the fight will be for younger value-conscious consumers who come to the table with sharper pencils, are always looking for the best deal and are wide open to world wine.

*As domestic wineries see US growth opportunities taper, they will notice more well-made and competitively priced imported wines hitting domestic shores, eroding their market share.*

*If domestic wine starts losing value in the consumer's mind because of the comparatively high price, the big wine companies have foreign supply to bring into the equation.*

Today, the larger producers are ahead of the changes in the marketplace. Given the high prices being paid for arable vineyard property in established appellations, they are hedging their bets by buying premium vineyards and at the same time finding ways to partner with foreign producers to fill quality gaps in their own portfolios.

If domestic wine starts losing value in the consumer's mind because of the comparatively high price, the big wine companies have foreign supply to bring into the equation, which will put added pressure on domestic producers.

Bottled wine imports continue to take a sizable chunk out of the domestic business. Import sales are led by Italian pinot grigio

and prosecco, New Zealand sauvignon blanc and French rosé. New Zealand saw the largest change in both dollar sales and volume last year (see figure 34).

Australian<sup>48</sup> and Chilean<sup>49</sup> exporters recognize that their reputation as low-quality producers hasn't helped their brand in the world and are working at improving their image and quality. The Australian government's \$50 million Export and Regional Wine Support Package has helped Australian producers make some minor progress, but with the lowest average bottle price, both countries have a way to go to meet their goal.

Argentina, with a good reputation for quality, is struggling with its export business due to the country's severe financial problems.<sup>50</sup> Chile and Spain are below other countries in terms of import performance, with reversals in total sales and volumes and declining average bottle prices.

## Other substitutes

Total beer volumes have been in decline for decades, but that's largely been in domestic brands and mass-produced beer. Imports are doing well, as is craft beer. According to information released from the Brewers Association, the craft brew industry produced 25.9 million barrels in 2018, which represents 4 percent volume growth. In value terms, the industry grew 7 percent on \$27.6 billion in total 2018 sales. But like the wine industry, the craft beer industry suffers from a scale problem.

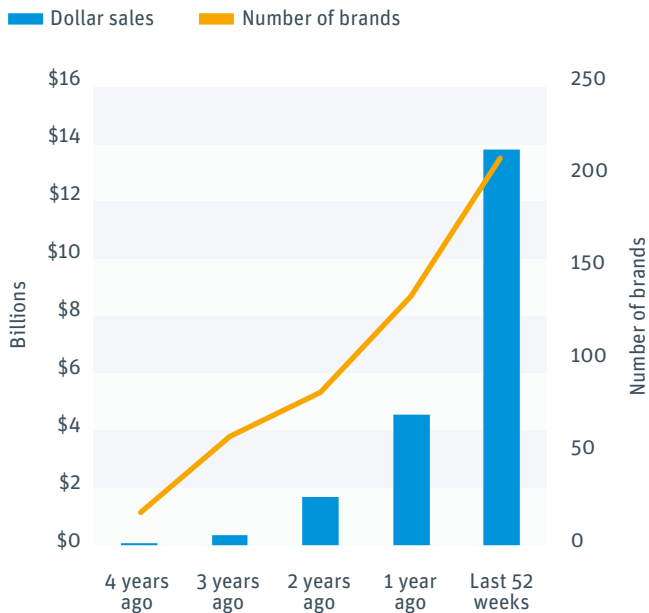
Figure 34: **Imported wine into the US**

52 weeks ending 10/2019

Country	Sales	Value change	Percent change	9-liter-case equivalents	9-liter-case equivalent change	9-liter-case equivalent percent change	Average bottle price
Italy	\$1,204,976,807	\$22,256,699	1.9%	10,510,079	-15,684	-0.15%	\$9.55
Australia	\$721,361,295	-\$9,107,633	-1.2%	11,842,598	-228,371	-1.89%	\$5.08
New Zealand	\$498,197,327	\$38,644,431	8.4%	3,604,148	289,498	8.73%	\$11.52
France	\$463,023,601	\$11,362,437	2.5%	2,927,042	-9,244	-0.32%	\$13.18
Argentina	\$330,188,526	-\$21,423,462	-6.1%	3,610,539	-299,925	-7.67%	\$7.62
Chile	\$255,665,255	-\$5,429,998	-2.1%	3,872,530	-10,019	-0.26%	\$5.50
Spain	\$160,006,333	-\$8,507,161	-5.0%	2,040,902	-60,593	-2.88%	\$6.53

Source: Nielsen Beverage Group

Figure 35: Annual growth in hard seltzers



Source: Nielsen Beverage Group, November 2019

Larger beer makers continue to buy up regional craft beer makers when the latter hit a production ceiling. The larger companies then drive higher volumes but move away from the tenets that made the craft beer interesting to consumers. The end result is that craft beer has been in a declining growth mode for many years, although it still has positive growth.

There is a theory among beverage analysts that people drink only so much liquid, and the game is really about share of gullet, or share of stomach, or share of throat, depending on who's talking. From that perspective, craft beer is a substitute for wine, and so are kombucha, coffee, bottled water and chocolate milk.

Among the non-wine producers, there is quite a bit of innovation. Coke comes in a blueberry acai flavor now. Red Bull has a coconut flavor. 19 Crimes has expanded into an IPA beer. Ready-to-drink cocktails are showing almost 50 percent growth. Wine isn't really innovating like the other beverage producers, but canned wine, though a small segment still at 0.5 percent of the category, is growing by 80 percent a year. But the largest disruptor today comes in the form of soda water and industrial ethanol.

Alcohol beverage companies, beer companies and even Coca-Cola<sup>51</sup> have jumped on the hard seltzer category. Barely an idea in 2015,<sup>52</sup> spiked hard seltzers leveraged the growth in LaCroix sparkling water and the popularity of vodka and soda in bars. Today, they are exploding in growth (see figure 35). The appeal is mainly to millennials, who see the beverage as clean or pure; lower in alcohol, carbs and calories; transparent with ingredients; refreshing and healthier than other alcohol beverage alternatives. In some ways, it's a bit like the introduction of light beer in 1973, which was targeted to appeal to consumers concerned about their weight.<sup>53</sup>

Are hard seltzers a wine substitute, or could they be a gateway in the same way wine coolers were a gateway for the boomers' move into wine? If you believe the "share of gullet" theory, then they are a substitute. The early research that has been done suggests that at least 40 percent of the growth in hard seltzers is coming at the expense of wine. That said, it's more of a substitute for beer today and is being regulated as beer — that's the first good news the major beer suppliers have had in some time.

Will spiked seltzers inevitably bring more young consumers to wine? Once large beverage companies adopt the formula and make a wine cooler called a "hard seltzer wine cooler," that could happen. In the interim, there are a lot of lessons to take away from the consumer attributes that are driving growth, and those can be applied to wine.



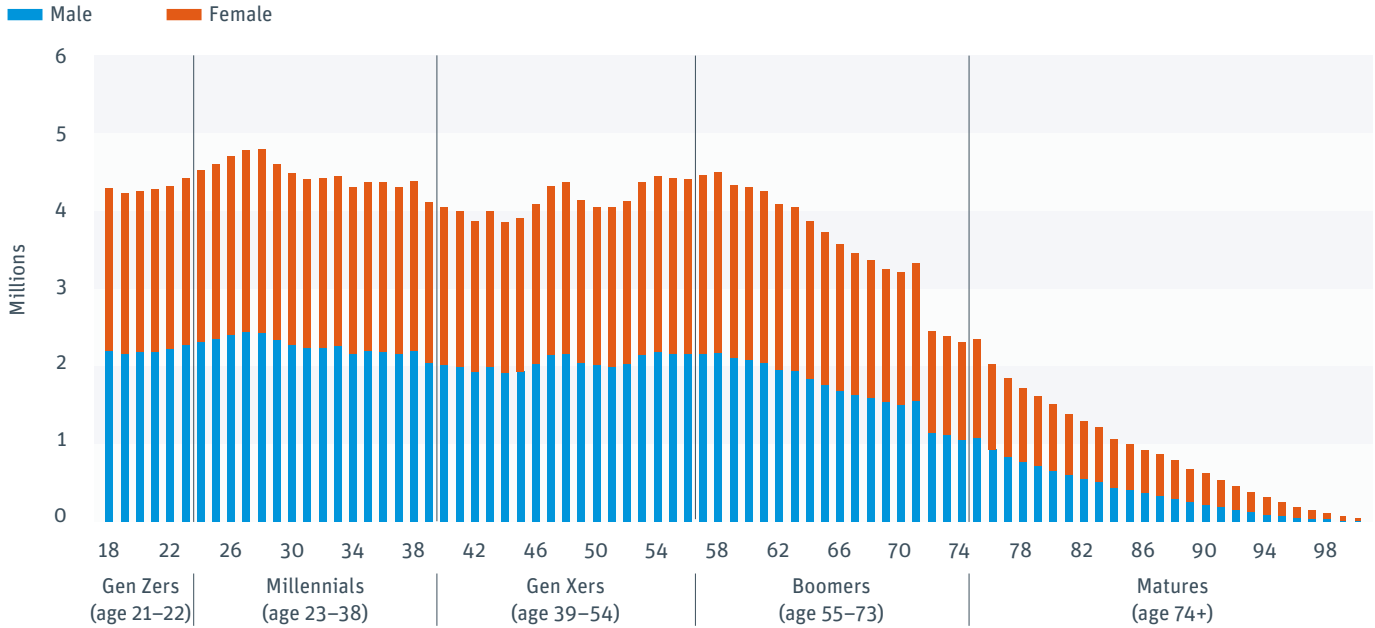
# 7

## Demographics and marketing

The US wine business is hitting a ceiling in its ability to grow because of a few fundamental challenges the industry hasn't fully embraced or addressed. Those are hard words to write, but they are supported by our own extensive work in the industry and by syndicated volume data, which have been down-trending for several years and are now negative. We can't correct what we don't identify or acknowledge.



Figure 36: **US population by age**



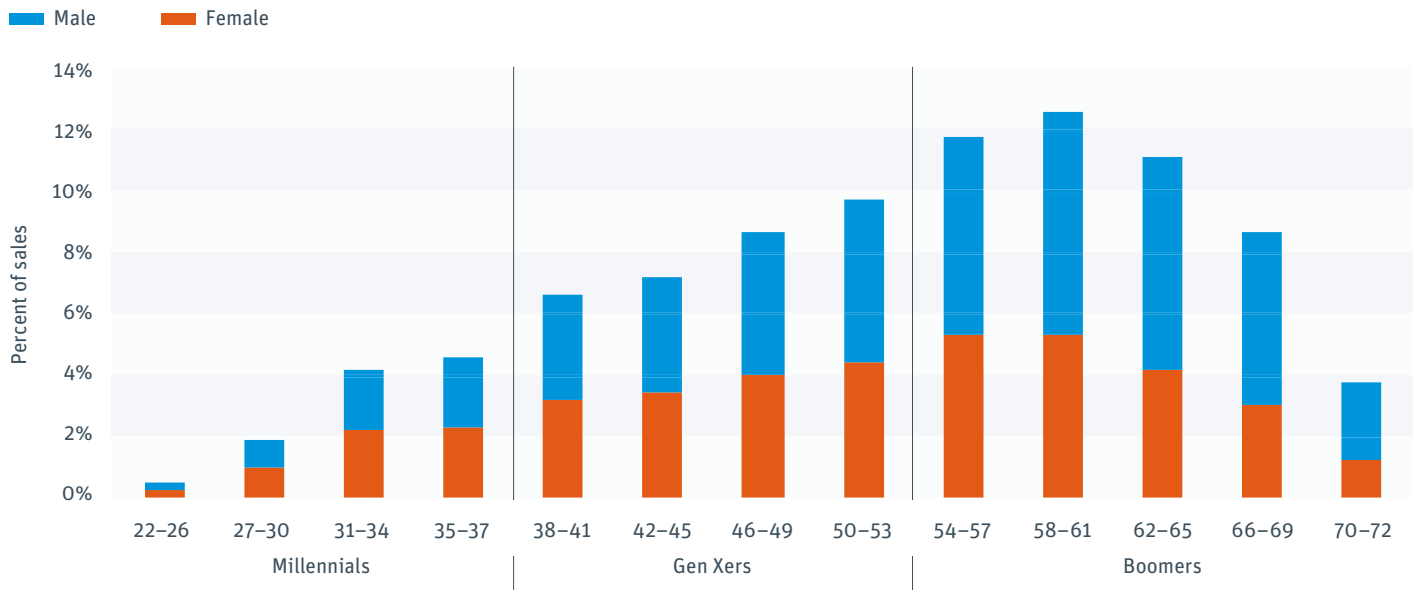
Source: US Census Bureau Population Estimates, 2018

After more than 25 years of robust growth, we are now weighted down by dated strategies of what has “always worked before,” locking us into ruts in our day-to-day business tactics. We are doing a poor job in recognizing and reacting to changing consumer values and in diagnosing or accepting the factors creating the consumer change, and as a result, we aren’t developing effective strategies to discover new avenues for growth.

The change we see in sales is due to shifts across all of the four major cohorts as each moves through periods of wealth accumulation, as their palates and preferences evolve, as their population size changes over time and as their view of alcohol in the context of health and age impacts their personal consumption patterns.

*We are doing a poor job in recognizing and reacting to changing consumer values and in diagnosing or accepting the factors creating the consumer change, and as a result, we aren’t developing effective strategies to discover new avenues for growth.*

Figure 37: Premium wine buying by age group



Source: Customer Vineyard, 2018

Each cohort is playing a role in the consumption shift in wine today:

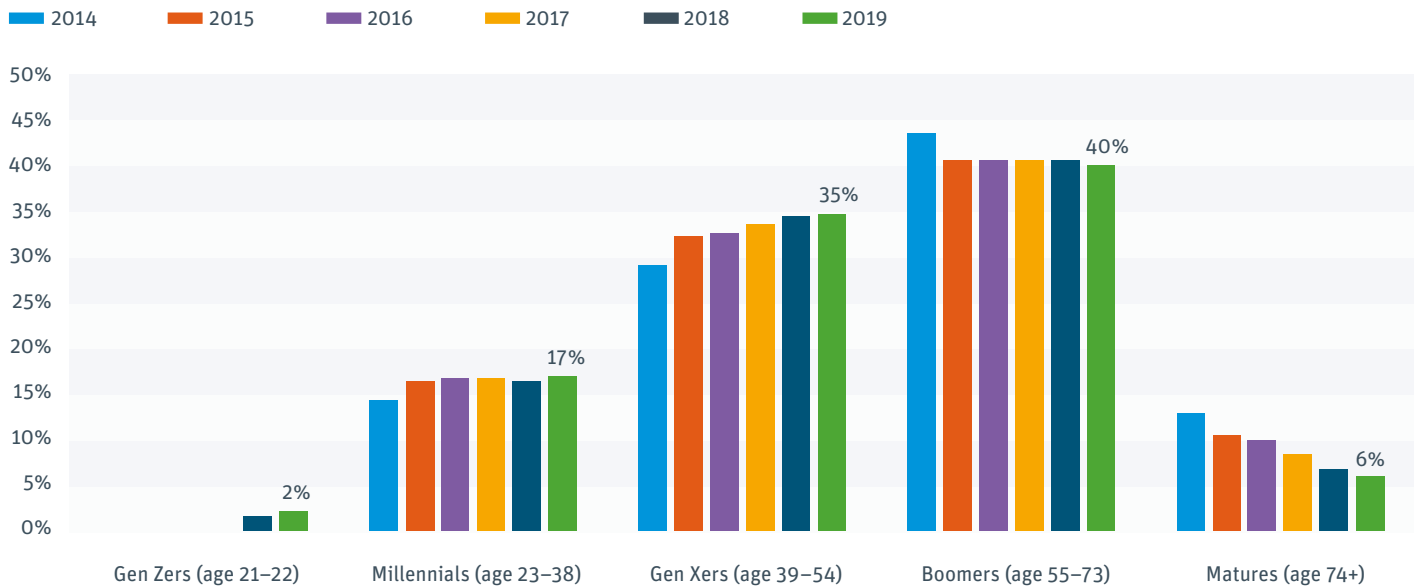
- We are living with the sunset of the mature cohort, who are still meaningful consumers of wine, but their numbers are in decline due to mortality.
- Baby boomers, with 70 percent of the disposable income and more than 50 percent of wealth in the US, are still the dominant consumer of wine today. They are exhibiting changing spending patterns due to age, health and retirement concerns.<sup>54</sup> The median boomer will reach the normal retirement age of 66 in 2021. The good news is that they will likely continue to work past normal retirement and continue to buy wine.
- Gen Xers, who have now lived through the two longest economic expansions in US history, are in their prime spending years and are holding up their end of wine buying as the largest current growth cohort, but their smaller numbers limit their ability to influence change.
- The millennial cohort, which should be a large growth opportunity for the US wine industry, is not presently engaging in the wine category as once imagined.

*In my view, the issue of greatest concern for the wine business today is the lack of participation in the premium wine category by the large millennial generation.*

### Cohort consumption

In my view, the issue of greatest concern for the wine business today is the lack of participation in the premium wine category by the large millennial generation. In just 10 more years, the last boomer will pass age 66 and be eligible for full Social Security benefits.<sup>55</sup> What will the average consumer look like with the boomer in full retirement?

Figure 38: Wine consumption by cohort



Source: SVB State of the Wine Industry Survey

*Today, the millennial's retail silence, particularly for discretionary spending in premium wine, is deafening.*

While millennials hold slightly higher consumption shares in the \$8 to \$14 bottle price points today and are interested in wine by all accounts, they haven't made any noticeable movement to be premium wine consumers for almost five years, holding firm and consuming around 17 percent of the premium market based on Silicon Valley Bank research (see figure 38), 20 percent based on Nielsen data and only 11 percent based on research done on hundreds of thousands of premium club member records by Customer Vineyard (see figure 37).

While the wine industry makes slow inroads to attracting the young consumer, the luxury market has gone all-in, adapting product offerings, digital communication and engagement strategies and evolving distribution channels. According to Bain's Annual Luxury Goods report,<sup>56</sup> Generations Y and Z accounted for 47 percent of luxury consumers in 2018 and for 33 percent of all

luxury purchases. However, they contributed virtually all of the luxury market's growth. The comparison with the wine business is stark. Between 11 and 20 percent of millennials consume wine. However, about double that number, 33 percent, consume luxury goods, and they aren't providing any growth to the wine category.

Perhaps it was wishful thinking, but industry analysts have mistakenly overestimated the impact of the millennial on the US wine business for some time.<sup>57</sup> Believing that millennials were consuming wine already might have created a false sense that nothing needed to be done. But the millennials' real progress in capturing premium wine share from boomers has been a delayed promise because of several factors, including their early preference for craft beer and spirits, questions surrounding the health of alcohol consumption and their delay in establishing careers, families and wealth compared with prior generations.

None of that means we have to live with these results. There is time to adapt. With the median age of the millennial consumer only 32, the industry still has time to find its footing. But for today, the millennial's retail silence, particularly for discretionary spending in premium wine, is deafening.

Millennials are delaying most of the life events that would otherwise create positive economic impact. They are taking longer to graduate from college, they delay marriage or never expect to marry,<sup>58</sup> they postpone having children<sup>59</sup> and they have taken longer to start their careers. The homeownership rate of millennials is about 8 percent lower than the homeownership rate of Gen Xers and baby boomers at the same age.<sup>60</sup> A telling statistic is that more adults aged 30 or younger live with their parents than at any time since the Great Depression.<sup>61</sup>

Some of the patterns we're noticing, such as millennials delaying marriage, have more to do with societal changes, but the 2008 financial crisis<sup>62</sup> is at least as much of a factor in stunting the generation's spending.<sup>63</sup>

## The millennial “Indulgence Gap”

With the economy in disarray in 2007, the US Federal Reserve rapidly started to lower interest rates, and when rates got close to zero and the economy still needed more stimulus, the Fed began a quantitative easing program,<sup>64</sup> the purpose of which was to calm the banking system, improve the employment situation and stabilize prices. In the process, they reflat both the stock market and home prices.

Roughly six years after their prior peak, the S&P 500 and the median price for US homes returned to earlier levels. Since then, median home prices have increased by 20 percent, and the S&P 500 has risen by 80 percent and continues to hit record closes as of this writing.

Who participated in the financial recovery? Largely it was older Americans — Gen Xers and baby boomers, who had both jobs and assets. The younger millennials were frozen in place, without assets and looking for work, unable to take advantage of the asset reflation during the period. To make matters worse for them, they were also loaded down with student debt. These are the consumers we're depending on for growth.

The uneven financial recovery that had millennials stuck in time, and older generations moving ahead, has created a tear in the evenness and flow of consumer spending we've termed the “Indulgence Gap.”

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*The uneven financial recovery that had millennials stuck in time, and older generations moving ahead, has created a tear in the evenness and flow of consumer spending we've termed the “Indulgence Gap.”*

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The delay by the younger consumer getting into life will have to take its time to normalize. The millennials are already taking their place as good consumers of luxury items, and hopefully wine will follow, but first they will make progress in their careers and, for a time, spend money on needs instead of discretionary purchases.

Economists differ on their forecasts for the length of the economic lag caused by the Great Recession, but a cursory review of the subject shows that the guesses range from three to eight more years, depending on any intervening recessions.

## The missing millennial

Premiumization, at least for now, still spans across all of the alcohol beverage categories, whether we're talking about craft beer, craft spirits or premium wine. The millennial prefers craft beer and spirits over wine, though, and most reports cite the growth of craft beer and spirits as coming primarily from the millennial cohort.

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*The question must be asked:  
Has the US wine business  
already lost the young  
consumer?*

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## *The conditions that fueled the boomer's adoption of wine in 1994 aren't present with the millennial consumer.*

In contrast to craft beer and spirits, most of the growth in the wine business today is from Gen Xers and boomers. The millennial is drinking wine in the \$8 to \$14 range but is responsible for very little of the current growth in wine. The question must be asked: Has the US wine business already lost the young consumer?

While all indications point to the stagnation in the young consumer's move to wine today, we have to note that the median age of millennials is only 32 years old, with the oldest 39 years

Figure 39: **Historic US table wine consumption by retail price (750-milliliter bottle) and percentage of total volume**

	1991	1995	1998	1999	2000	2001
<b>Cases sold (retail price)</b>	<b>Millions of cases</b>					
Ultra-premium (over \$14)	2.4	3	5.5	10.1	14.4	14.8
Super-premium (\$7 to \$14)	7.1	10.1	21.4	24.5	24.5	26.4
Popular premium (\$3 to \$7)	28.1	34.5	48.1	49.5	52.6	51.3
Jug wine (below \$3)	69.2	69.4	67.8	65.7	55	52.6
Total	106.8	117	142.8	149.8	146.5	145.1
Average price	\$3.44	\$3.88	\$4.60	\$5.21	\$5.88	\$5.96
<b>Total volume</b>	<b>Percent total volume</b>					
Ultra-premium (over \$14)	2%	3%	4%	7%	10%	10%
Super-premium (\$7 to \$14)	7%	9%	15%	16%	17%	18%
Popular premium (\$3 to \$7)	26%	30%	34%	33%	36%	36%
Jug wine (below \$3)	65%	59%	47%	44%	37%	36%

Sources: Gomberg-Fredrikson 2003, in Heien and Martin, "California's Wine Industry Faces New Era"

of age. As history shows, it wasn't until boomers reached the median age of 35 that their wine preference really emerged. That said, the conditions that fueled the boomer's adoption of wine in 1994 aren't present with the millennial consumer.

The boomer came into the growing premium wine business when US wine pricing was much lower, even on an inflation-adjusted basis, and the boomer consumer was in a better place financially. They could afford wine. Beer was falling out of favor, with the large producers paying inadequate attention to better-quality options, making wine more attractive to boomers in relative terms. Maybe as important was the positive health message advanced in the 1990s regarding the benefits of moderate wine and alcohol consumption.

That's not the case today. In fact, almost the exact opposite is true of the entry-level opportunity for young consumers.

- They are being influenced by purchased science that is at odds with the prior findings of better overall health outcomes with moderate wine consumption.
- They are less affluent than boomers at the same point in life.
- Wine is more expensive today. Figure 39 shows the ultra-premium wine segment starting at only \$14 per bottle during the 1990s. High-end bottles cost more today. Wine is now more expensive than beer and nearly twice as expensive as spirits. According to Nielsen, the current price per serving is \$1.02 for beer (12 ounces), \$0.88 for spirits (1.45 ounces) and \$1.51 for wine (5 ounces).
- The quality of spirits is much better compared to the era when boomers chose wine as their beverage of choice.
- There are growing distractions for the young consumer, such as health messaging, cannabis, energy drinks, spiked seltzers and health-directed beverages like kombucha.

## Marketing wine to millennials

There are emerging data from two separate sources that millennials are spending the most per bottle when they do buy wine. While that doesn't mean they are spending the most per purchase — they are buying fewer bottles per purchase — they do appear to be buying expensive bottles for gifts and special occasions. That's a promising start because, if proven, it shows that young consumers are interested in wine. When the right marketing and quality/price are delivered, they should be buyers. But attracting the millennial to the wine category has to start with changing our marketing message.

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*Millennials are spending the most per bottle when they do buy wine.*

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Today, we are still selling “long, warm days and cool nights.” We are talking about the wine, the pH and Brix at harvest, the harvest date or the special soils. Often, we talk about the owners and their background, their accomplishments and successes, if not about the family's history. We sell hospitality and gracious living, with a nod to the lifestyles of the rich and famous in many cases. That worked for the boomers, but that message at best is wasted on millennials and at worst is turning them off.

Millennials don't trust the rich, are skeptical about inauthentic and opaque marketing and don't care about your family's name on the bottle. They are more interested in what's in the bottle — the ingredients and additives — and how you make the world better.

The key to future success in marketing to millennials is to recognize the things that are important to them versus what's important to the boomers and to leverage those values in marketing wine (see figure 40). That's not meant to imply that we need to change our core brand or a traditional label, but we have to evolve.

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*Attracting the millennial to the wine category has to start with changing our marketing message.*

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Social responsibility is important to millennial consumers.<sup>65</sup> That's a factor embedded in their purchase decisions. They are driving change in boardrooms, insisting that companies consider how they impact both the earth and society as a whole. They didn't attend my Econ 101 course, where I learned that the goal of a company is to maximize shareholder profits.

Many in the wine business use sustainable farming practices and take great care in their winemaking by recycling water, avoiding the use of glyphosate, building and retrofitting with LEED Certification in mind and being good stewards of their land. Some use biodynamic and organic<sup>66</sup> farming techniques, but little of that shows up in marketing a bottle of wine today, and none of it appears in terminology and graphics the young consumer expects.

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*We sell hospitality, which worked for the boomers, but that message at best is wasted on millennials and at worst is turning them off.*

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Figure 40: **Generational differences**

Value	Boomers	Millennials
<b>Work life</b>	Hard work	Meaningful work and life balance
<b>Two-income families</b>	Allowed for luxuries	Needed for rent and homeownership
<b>Defining success</b>	Material things and awards	Fulfilling friendships and relationships
<b>Winning</b>	Compete to win THE trophy	Everyone wins a trophy
<b>Technology</b>	To improve efficiency	To communicate, connect and be entertained
<b>Support group</b>	Family	Friends
<b>Marriage</b>	Marry early; divorce early	Not required but secretly desired
<b>Children</b>	Important; two or more	Conflicted; at least one child if the timing works
<b>Choice in food</b>	Don't eat if it's bad for you	Only eat if it's good for you
<b>Faith</b>	Pick one flavor	Optional but accepting; prefer spirituality to religion
<b>Government</b>	Not to be trusted	Not to be trusted
<b>Business</b>	Capitalism is the path to individual wealth	Business success comes with social responsibility
<b>Social justice</b>	Responsibility of government, church and law	My responsibility
<b>Diversity</b>	Civil rights movement drove change	Social and ethnic diversity drives change
<b>Finances</b>	Debt is good	Savings are good
<b>Landfills and waste</b>	Disposable culture	Reuse and repurpose culture
<b>Spending</b>	Conspicuously	On important things
<b>Pleasure</b>	Work before play	Play at work
<b>Fun</b>	Work	Yes, please
<b>Retirement</b>	Not if I don't have to	I'll never be able to, but the sooner the better
<b>Experiences</b>	Bucket lists	Unique, adventurous and socially connected

Figure 41: **Sample nutrition label**

<b>Nutrition Facts</b>	
Serving Size: 12 fl oz (355ml)	
Amount Per Serving	
<b>Calories</b>	<b>129</b>
Calories from Alcohol 120	
% Daily Value*	
<b>Total Fat</b> 0mg	<b>0%</b>
<b>Sodium</b> 28mg	<b>1.8%</b>
<b>Total Carb</b> 5.6g	<b>2.2%</b>
Sugars 5g	
<b>Protein</b>	<b>&lt;1g</b>
*Percent Daily Values are based on a 2000 calorie diet.	
<b>Ingredients:</b> Purified Water, Alcohol from Cold-Brewed Sugar, Crystalline Fructose, Natural Fruit Flavor, Sodium Citrate, Citric Acid.	

*We lack the transparency our consumers are demanding when we refuse to put calories on the label.*

Eating healthy is a critical value of young consumers, and there is ample evidence that aging boomers are taking their cues from young people, adopting their own health-conscious diets and consumption patterns, too.

Look at snack foods today, and you will see they often come in 100-calorie packages. Why is that? Because young consumers are conscious about their health, and weight is a factor in living a healthy life.

What is the largest-selling brand of spirits today? Tito's Vodka. What is the lowest-calorie mixed drink at a bar? Vodka and soda. How many calories are in a vodka soda? Sixty. How many calories are in a glass of wine? You don't really know, do you?

Even most of us in the industry don't know how many calories are in a 5-ounce glass of wine. We lack the transparency our consumers are demanding when we refuse to put calories on the label, and that is a huge marketing miss.

If we really want to reach the millennial, we need to look at how other beverages are marketed successfully, including soda, energy drinks, hard seltzers and spirits. Then we need to repurpose those ideas for our own benefit.

Look at the back of the can of one of the top brands of hard seltzer (see figure 41). Notice the low number of calories per serving. The content description has few ingredients and nothing the consumer can't pronounce. Pay attention to the use of the term "natural" and how industrial alcohol is described as "Alcohol from Cold-Brewed Sugar." All seltzers contain lower alcohol than wine, which has an appeal to both younger and older consumers. All of those are messages regarding health for the young consumer, and they are working.

Look at almost any packaged good today, and you will see small circles on the label that reflect health attributes: non-GMO, natural, no added sugars, low-sodium, vegan, low-fat, pesticide-free, no additives, glyphosate-free, no artificial colors, no artificial flavors, no synthetic ingredients and many more (see figure 42).

Many manufacturers put third-party brands on labels, such as certified organic, certified naturally grown and certified sustainable. While the wine industry can't make health claims and include an icon that says "healthy" due to TTB label regulations,<sup>67</sup> we can inform the public of the health attributes in our products,<sup>68</sup> and we should be doing that if we want to market to a health-conscious population.

Figure 42: **Health attribution labels**



What ingredients are in a bottle of wine? Grapes, sometimes with added native yeast and minuscule amounts of added sulfites. Wine couldn't be any more natural, especially compared to other alcoholic beverages. But we aren't close to being transparent with what's inside our bottles. Not letting the consumer know just how few additives are in wine and how naturally it's made is a lost differentiator and a mistake.



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*Across all generations, consumers' preferences and their price sensitivity to wine are evolving, and that should be changing the way wine is both marketed and sold.*

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### Sales and marketing for family wineries

Across all generations, consumers' preferences and their price sensitivity to wine are evolving, and that should be changing the way wine is both marketed and sold.

Wineries that have great wholesale partners are doing well, particularly in the price segments above \$9. For smaller family wine producers, the current product-to-market strategy remains a sharp focus in the tasting room and club models, with an ongoing struggle to cobble together wholesale representation.

The current DTC model is a reaction to losing out on three-tier representation as the wholesale tier consolidated starting in the late 1990s. The enhanced tactics and strategies that have evolved in the tasting room and wine club over the past decade have allowed the family wine business to survive and thrive, but those strategies have always been limiting.

The basic philosophy under which the tasting room and club models are executed reflects a point of view we shared more than a decade ago: We aren't selling chemicals in a bottle. We are selling value, and for a luxury good like wine, that is defined as perceived quality plus experience, divided by price, where "experience" is a placeholder for things like the shopping experience, the consuming experience, an experience enhanced by a venue or sound, the way your box of wine looks when you receive it from UPS, your online experience, every interaction with a person at the winery, the way owning or consuming the product makes you feel about yourself and much more.

$$\text{Value} = \frac{\text{Perceived Quality} + \text{Experience}}{\text{Price}}$$

The problem is that the whole evolution of the concept of "experience" within the equation was immediately stunted when the wine industry defined it as being synonymous with the tasting room experience and nothing else. All of the focus on value and brand creation has since fallen on the tasting room and wine club, to the exclusion of other strategic options.

While great strides continue to be made to elevate the club and tasting room channel with metrics and training — and that should continue — consider this critical question:

In an increasingly digital world, what industry would insist that its consumers first physically come to its place of business to buy its wares?

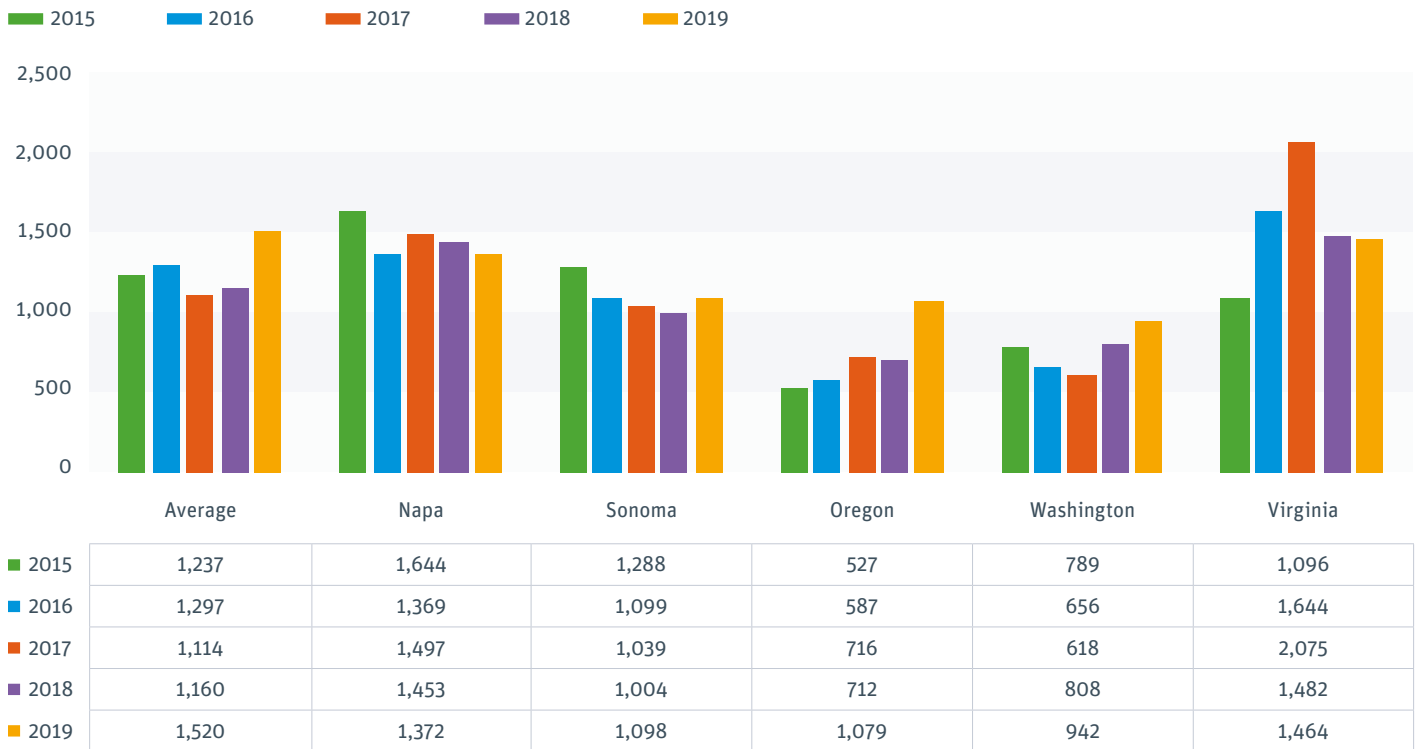
That is what wineries insist on today with the current tasting room and club models. How many cars would Detroit sell if they demanded that people come to Michigan to pick up their car? Today, the rate of growth in the important tasting room and club channel is also showing fatigue.

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*In an increasingly digital world, what industry would insist that its consumers first physically come to its place of business to buy its wares?*

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Figure 43: Average monthly visitors to tasting rooms by region



Source: SVB Direct to Consumer Survey

## Cracks in the tasting room model

DTC sales make up 60 percent of the average family winery's revenue today, and almost all of that growth is dependent on a consumer first visiting the winery's tasting room. After many years of focusing on the club, we are running into instances where owners are unable to grow their active club. Their facilities can only attract and host a fixed number of visitors. When their club cancellations equal their tasting room's conversion-to-club, the model is mature.

Of equal concern, tasting room visits in Napa and Sonoma have trended lower over the past five years, though Sonoma had a reprieve in 2019 (see figure 43). The downward trend is due to several factors, but it's not fewer tourists — tourism is up, but tasting room visits are down in those regions. That seems like a paradox.

There are many reasons average visitation trends are dropping in mature regions, but at the core is a changed consumer. The visit to wine country is no longer about the wine. The older consumers come to wine country, stay at a luxury hotel and visit one or

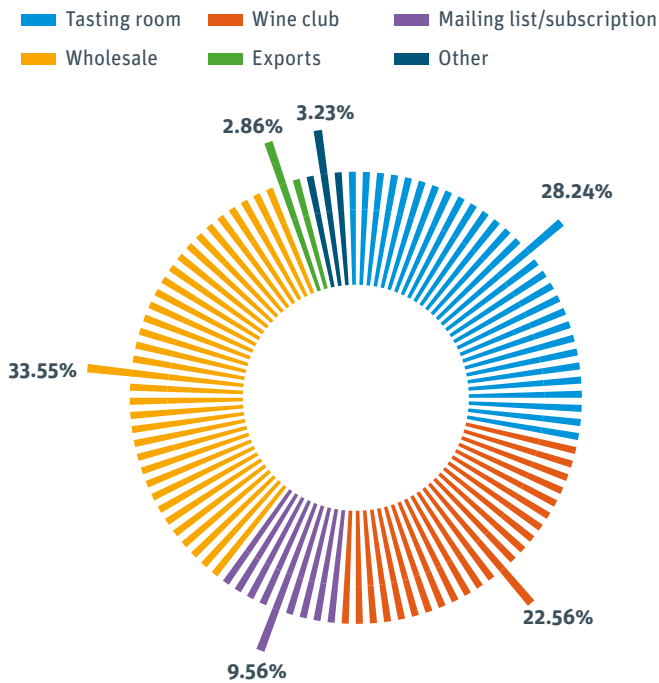
two of their favorite wineries instead of the five they visited as young consumers. Younger consumers come to wine country, share an Airbnb with others to save on cost and visit one or two wineries that offer the lowest tasting room fees and/or the best experience — which is a different experience from that which the older consumers seek.

Tasting room visitation in the Pacific Northwest, and notably in Oregon, is still growing well. The average sale in the tasting room is improving across the regions we survey, which explains much of the overall growth in sales in all regions. But shifts in consumer behavior will be a growing concern, even in Oregon.

The average winery today receives about 28 percent of its DTC revenue from tasting room sales, 23 percent from the wine club and 10 percent from mailing lists or subscriptions (see figure 44). This means that of a winery's direct sales today, 61 percent has to come from a consumer who first walks into the tasting room.

Consider the plight of the wine-loving consumer in Minneapolis. For that person to be part of your winery's revenue stream, they will have to first know you exist somehow, then get to your

Figure 44: **Sales channel mix for the average winery in 2019**



Source: SVB State of the Wine Industry Survey

facility by some means of transportation, pay for wine over the tasting bar and hopefully join your wine club while there.

Enlightened wineries that understand the interwoven local hospitality network that's presented to small wineries make sure they get their share of wine country visitors who wander into wine country without a plan. They work with concierges, livery companies and tourism and visitor bureaus.

But what about those consumers who are coming to wine country with a plan and already know the wineries they want to visit and things they want to do? How will you get on their agendas and get them into your tasting room before they leave Minneapolis?

## Today's wine tourist

Today, the consumer is redefining what a visit to wine country is all about. Twenty years ago, the purpose of a wine country trip was to taste and purchase wine. A consumer might make four to five winery stops and at each visit purchase a case. That's not what's taking place today.

*Today, the consumer is redefining what a visit to wine country is all about.*

The wine tourist today is going to wine country and staying in hotels or Airbnb lodging, then making one or two stops per day at a winery. The wineries are treating their guests to seated presentations that last much longer than they did 20 years ago, so there's not as much time to visit as many wineries. Increased tasting fees are also dissuading casual consumers. It's understandable why the average tasting room sale is up in all regions. Tourists know *exactly* where they want to visit before they leave home, and they are predisposed to buy when they walk in the tasting room.

If your full focus is on a tasting room and club strategy and you put balloons on the driveway to capture a random consumer's attention as they drive by, or if you are working with hotels to have them send consumers to you, paying limousine drivers to deliver a diminishing supply of tasting room visitors to your winery or even spending all of your time and energy focusing on tasting room metrics, you are not paying attention to the obvious signs of change.

While each of those tactics has an important place in the still-critical sales channel, your winery needs to find new growth and new consumers, and they aren't going to come from the present tasting room approach.

We have to continue to evolve the tasting room and club models, but the growth opportunity for tomorrow isn't going to come by doing what you're already doing. The growth isn't in delivering better hospitality, hosting seated tastings, planning club events or refining your hospitality training.

The growth opportunity for the small winery going forward is by:

- Getting exposure to consumers who live elsewhere and don't know you
- Finding ways to sell to them — digitally and in person, *where they live*
- Building your brand regionally by evolving the concept of experience away from the winery

## Direct to consumer: Where we need to go next

When I try to describe where we have to go next as a family-run industry — taking the experience on the road, getting in front of a consumer who is a perfect fit for your wine but lives 1,000 miles away, using evolved digital strategies for selling and marketing and applying big data to the equation — I get a common question: Who’s doing that now? Everyone wants the blueprint for success.

The reality is that nobody has the formula for selling wine to a consumer who has never tasted or heard of your brand. New customer acquisition away from the tasting room is still largely untested and an unknown, so the solutions will evolve with new and reformed service providers and consultants and with wineries that experiment and fail quickly, using different techniques (print, digital, phone, etc.) to connect with remote consumers.

We have to take the experience on the road, and we need ideas. One idea might be to start by picking a region — not all 50 states — in which to build your brand. Narrow the focus. Personally invest your time in that remote market. Perhaps hold a charity wine auction to raise money for something important to a town. Consider entertainment and educational events that build your database of people who’ve tasted your wine and already have an opinion.

Take the winery to the customer:

- Consider how a live online video stream at the winery might bring interest and wine country beauty to a remote consumer, even allowing them to attend a winery event from their home.
- Engage the distant consumer with links to a Spotify playlist being played at the winery.
- Stream virtual winemaker tastings.
- Consider cross-marketing with other luxury companies in regions remote from the winery. Those companies might want to use wine to liven their own promotional events and platform.<sup>69</sup>

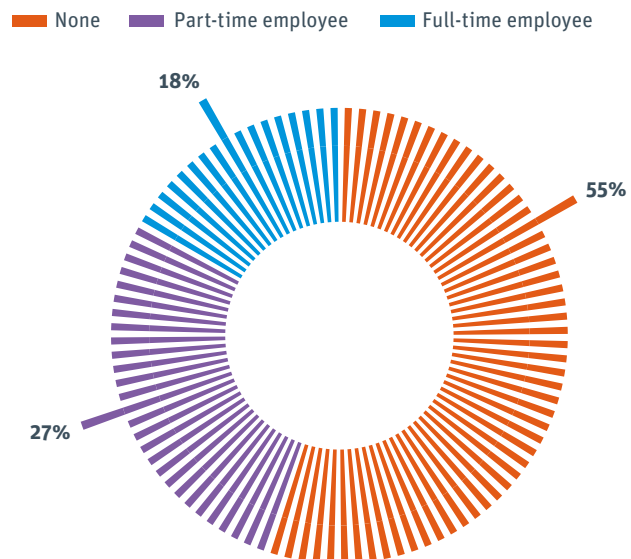
In the SVB State of the Wine Industry Survey this year, we asked how many wineries had an individual assigned to maintain their database of customers and analyze consumer data. Today, 18 percent of wineries say they have a full-time position covering that role compared to just 8 percent last year. It’s impressive to

*Your winery needs to find new growth and new consumers, and they aren’t going to come from the present tasting room approach.*

see a 10 percent shift. Another 27 percent have someone doing the job part-time compared to 25 percent last year (see figure 45).

More than half of wineries don’t have that role covered, but 2020 is a good year to start. In addition to providing current consumer insights about your customers, that person will be able to use the big data tools<sup>70</sup> that are being evolved for the wine business. The tools will help target new consumers who are outside your current model and allow you to keep the ones you have longer.

Figure 45: **Consumer data analytics person**



Source: SVB State of the Wine Industry Survey



# 8

## Land and M&A

Despite the heavy and unrelenting upward trend in North Coast vineyard values since 1994, we believe we are at a place in the cycle where both grape prices and land values should pause their climb in both California and Washington. Oregon, which is still a growth region, will likely see increasing vineyard values for at least another year, though at a slower increase compared to the previous decade.

We don't believe there is a vineyard pricing bubble, so we aren't predicting a correction of any magnitude. We instead expect a softening of prices for all but the most sought-after pieces and a pause in what has been an extended growth period in vineyard prices for several decades.

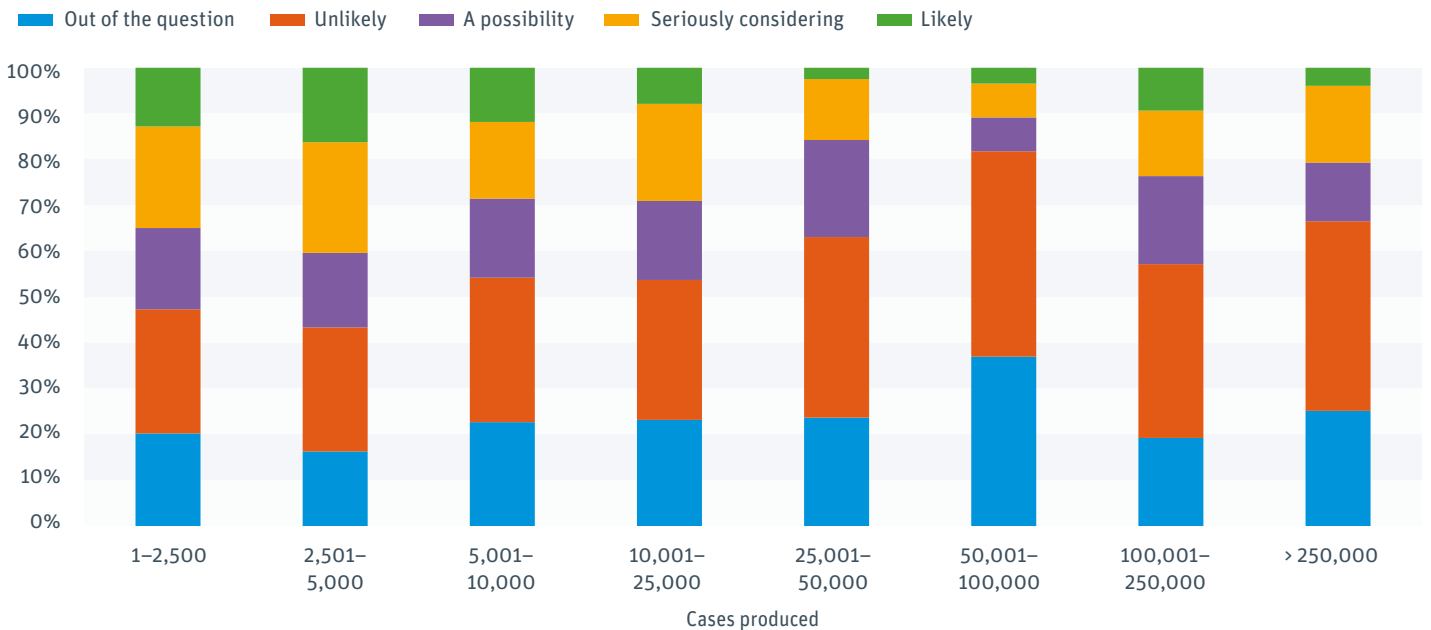
With the industry recognizing the slowdown in sales growth and moderated growth potential, 2019 was a slower year for the M&A market. Major players came into the year largely content and digesting their acquisitions from the prior several years, though the huge and still-pending sale of more than 30 brands by Constellation to Gallo was an outlier.

We predict the M&A market will continue at a reduced volume of transactions compared to 2018 and prior. There should be more sellers who discover they have waited just a little too long to begin the marketing process, and sales prices will fall somewhat from recent prices, if for no other reason than because there are fewer buyers.

*We predict the M&A market will continue at a reduced volume of transactions compared to 2018 and prior. There should be more sellers who discover they have waited just a little too long to begin the marketing process.*

Figure 46 is from the SVB State of the Wine Industry Survey, and you can see that the wineries considering sale today fall in the harder-to-sell smaller case-production models. Another slide of the same data shows that the more likely sellers also trend toward wineries that are less stable financially.

Figure 46: **Likelihood of selling winery in the next five years**



Source: SVB State of the Wine Industry Survey

Vineyard transactions are likely to continue for the present. Some financial investors have taken chips off the table already. We were seeing some vineyard sales from larger investors early in 2019, but there are still some companies experienced in the industry looking for properly priced vineyard acquisitions.

Of course, there will be the buyers who have cash and will bottom-feed, strong brands that will always attract buyers and the iconic historic properties that come up once in a lifetime and will attract very high prices. We expect some vulture funds to emerge over the next 24 to 36 months that will expect to buy land at distressed prices. That's not a formula that's worked in the past. Will it work this time?

Figure 47: **Selected closed M&A transactions in 2019**

Closing date	Target	Acquirer	Assets acquired	Location
January	BRAND Winery & Estate	Private investors (Bean/O'Sullivan)	Brand, facility and vineyards	Pritchard Hill, California
January	Renwood Winery Facility	Rombauer Vineyards	Facility and vineyards	Shenandoah Valley, California
January	Jaeger Oak Knoll Vineyard (~85 acres)	TIAA-CREF	Vineyard	Oak Knoll, California
February	Merry Edwards	Louis Roederer	Brand, facility and vineyards	Russian River Valley, California
March	Laetitia Vineyard & Winery	Vintage Wine Estates	Brand, facility and vineyards	Arroyo Grande, California
March	TEXTBOOK Brand	Distinguished Vineyards & Wine Partners	Brand	Napa, California
April	Grace Family Vineyards	Private investor (Kathryn Green)	Brand, facility and vineyards	Napa, California
April	Conner Lee Vineyard	Josh Lawrence and Tom Merkle	Vineyard	Othello, Washington
April (announced)	Constellation Value Wine Portfolio	E. & J. Gallo Winery	30 brands and 6 facilities	California, Washington, New York
May	Iron Corral Vineyard (~420 acres)	Hess Collection	Vineyard	Pope Valley, California
June	Starmont Winery	Orsi Family Vineyards (leased to Duckhorn Wine Company)	Facility	Carneros, California
June	Wildwood Vineyard (~50 acres)	Lawrence Family (Heitz Cellar)	Vineyard	Rutherford, California
June	Shirtail Creek Vineyard (~320 acres)	TIAA-CREF	Vineyard	Monterey, California
July	Greenwood Vineyard (~45 acres)	Ste. Michelle Wine Estates	Vineyard	Calistoga, California
July	Panorama Vineyard (~300 acres)	Jackson Family Wines (previously leased)	Vineyard	Arroyo Seco, California
July	Santa Lucia Highlands Vineyard (~450 acres)	AgIS Capital	Vineyard	Santa Lucia Highlands, California
August	Chalk Hill Vineyard	Foley Family Wines	Vineyard	Sonoma, California

Source: Zepponi & Company



# 9

## Cumulative negative health messaging

### **Neo-prohibition, the original**

Starting in the early 1980s, a group of loosely related private and public advocacy organizations, special interest groups and governmental agencies organically aligned with the goal of reducing or eliminating the harmful effects of alcohol consumption in the US.



Like the Prohibition movement in the early 20th century, neo-prohibition included diverse groups such as religious organizations that saw drinking alcohol as sinful; activist organizations whose primary goal in this case was eliminating deaths from drunk driving;<sup>71</sup> health organizations funded by special interests and armed with studies about the negative impact of consuming alcohol on productivity and health; and the US government, which was enacting policy.

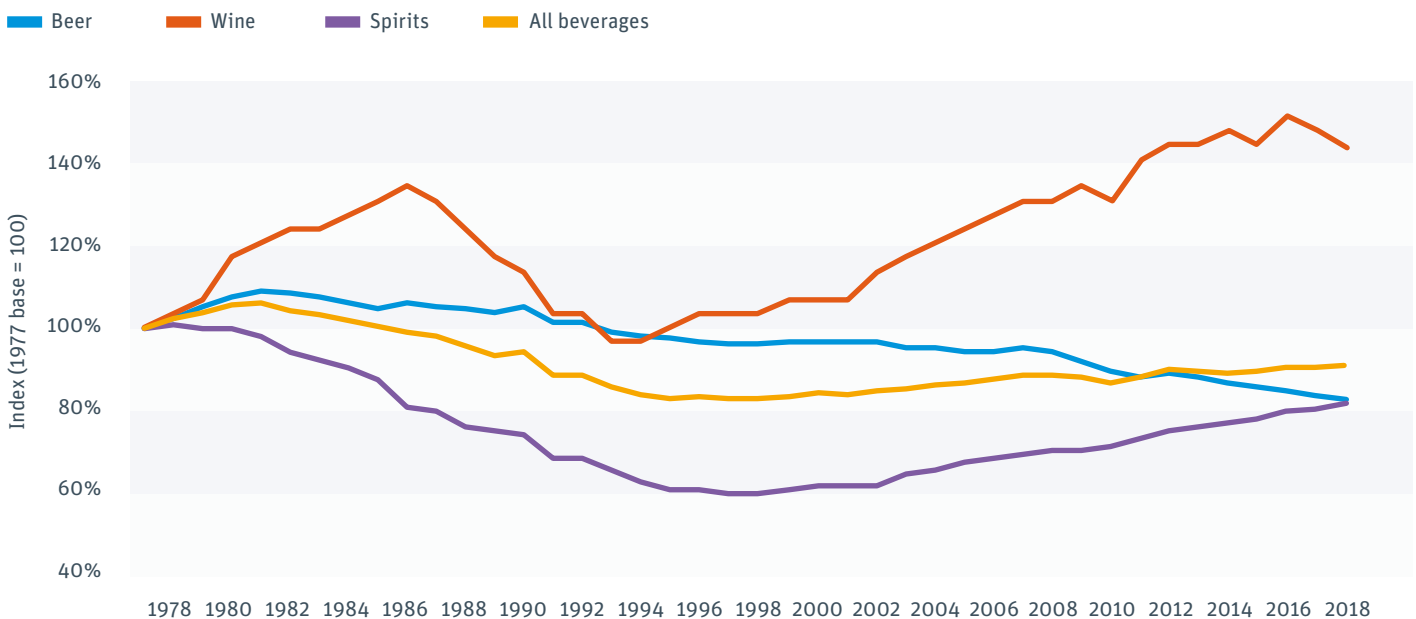
Beginning in 1982, Congress developed a series of grant programs to encourage states to enact stronger impaired-driving laws and lower per se blood alcohol limits. By the mid-1980s, cultural engineering of the messaging was enhanced when some of the neo-prohibitionist organizations effectively characterized wine and other alcoholic beverages as another gateway drug, linking alcohol to unrelated drug addictions and the related costs plaguing society.

The growing clamor culminated with the Anti-Drug Abuse Act of 1988,<sup>72</sup> which included government health warnings about alcohol and the addition of a government warning on alcohol beverage labels.

*The growing clamor culminated with the Anti-Drug Abuse Act of 1988, which included government health warnings about alcohol and the addition of a government warning on alcohol beverage labels.*

On March 3, 1988, President Clinton, through the National Highway Traffic Safety Administration (NHTSA), introduced an administrative order requiring all states to adopt a 0.08 maximum per se standard for drunk driving.<sup>73</sup>

Figure 48: **Percentage change in per capita ethanol consumption in US**



Estimated data for 2018

Source: National Institute on Alcohol Abuse and Alcoholism, Surveillance Report #110

The neo-prohibition message was confronted on November 17, 1991, when 20 million viewers in the US heard the CBS *60 Minutes* broadcast on the French Paradox,<sup>74</sup> immediately causing a spike in red wine consumption. That was followed in the mid-1990s with widespread public acceptance of the Mediterranean diet<sup>75</sup> and later punctuated with the publicized work of Dr. Arthur L. Klatsky,<sup>76</sup> a Kaiser Permanente cardiologist who separated the discussion of moderate and heavy consumption and showed the health benefits of moderate alcohol consumption over both heavy consumption and, surprisingly, non-consumption.

With the positive medical reports, per capita wine consumption soared starting in 1994, when baby boomers hit their consuming stride, which coincided with their prime retail spending years. Spirits consumption showed some modest positive change shortly thereafter due to both Dr. Klatsky's findings and the premiumization trend (see figure 48).

The cumulative weight of the studies that proved moderate wine consumption had positive health benefits redirected the conversation away from health as part of the rationale for anti-alcohol messaging. Once the blood alcohol level was lowered nationwide and the drunk driving component of the movement won a victory, the debate settled into the background for a decade as the wine industry basked in the glow of increasing sales.

### Neo-prohibition, the sequel

The debate over the health impact of alcohol never fully went away. Since the French Paradox story was carried on *60 Minutes*, numerous health organizations have expended considerable time and money to produce alternative research that calls into question or counters the original research findings.<sup>77</sup>

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*Moderate levels of alcohol consumption do not increase risk for heart failure/myocardial infarction or stroke, and in fact provide protective effects.*

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With the studies coming to different conclusions and causing confusion, and with a refresh of the government's Dietary Guidelines for Americans under discussion, in December 2003 the National Institute on Alcohol Abuse and Alcoholism (NIAAA) funded a study to review the empirical work done and "assess the strength of the evidence related to health risks and potential benefits of moderate alcohol consumption."<sup>78</sup>

The conclusion of the report was that "moderate levels of alcohol consumption do not increase risk for heart failure/myocardial infarction or stroke, and in fact provide protective effects." Nonetheless, additional government- and nongovernment-funded anti-alcohol studies have continued and have gained significant traction in the past decade. Europe is ahead of the US in directing consumer sentiment away from alcohol consumption.

In 2018, the UK's Chief Medical Officer, Sally Davies, told a British television interviewer, "There is no safe level of drinking." Even more surprising was the statement by the French health minister, Agnès Buzyn, who said that wine is bad for you.<sup>79</sup> The cumulative weight of the world messaging and anti-alcohol studies has been effective<sup>80</sup> and has once again emboldened US regulators to promote additional restrictive regulations on alcohol consumption.

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In February 2017, the National Transportation Safety Board (NTSB) recommended that all 50 states establish a per se blood alcohol concentration limit of 0.05 or lower. In January 2018, the National Academies of Sciences, Engineering and Medicine<sup>81</sup> produced a study that supported their call to lower the alcohol-

impaired driving limit from 0.08 to 0.05 nationally. Despite overwhelming evidence that counters the study's findings,<sup>82</sup> in March of 2018, Utah acted on the recommendation, and on January 1, 2019, Utah became the first state in the US to enforce a 0.05 per se DUI law.<sup>83</sup> Several other states, including Oregon and Texas, are considering bills in committee, and California, Michigan and New York have each introduced bills to lower their DUI limit to 0.05 percent.<sup>84</sup>

Quietly, in January 2018, the US Department of Health and Human Services (HHS) deleted the dietary guidelines that said moderate drinking could lower the risk of heart disease,<sup>85</sup> ignoring the prior findings by the NIAAA.

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*In January 2018, the US Department of Health and Human Services (HHS) deleted the dietary guidelines that said moderate drinking could lower the risk of heart disease, ignoring the prior findings by the NIAAA.*

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*We have returned to the neo-prohibition era in this debate.*

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We have returned to the neo-prohibition era in this debate. Alcohol consumption is being equated to opioid addiction again.<sup>86</sup> The government is rolling back dietary guidelines and issuing new directives from the US Preventive Services Task Force that recommend all primary care physicians routinely ask about, and counsel patients on, unhealthy levels of alcohol consumption.<sup>87</sup>

The youngest consumers are health-focused, which explains the explosive growth in health beverages in the US.<sup>88</sup> Compared to the boomers, who ate "if it wasn't bad for you," the current generation wants to consume things that "are good for you."<sup>89</sup> With today's messaging, young consumers are consuming less alcohol than prior generations.<sup>90</sup>

Clearly, we need coordinated industry leadership to bring balance to the conversation.

# 10 | Endnotes

1. Instead of winners and losers, I'd like to see leaders and followers. I've seen the industry consistently solve problems when their backs were against the wall. There is every reason to believe that will happen again.
2. Yes, I realize that sounds self-serving to get you to think about the expertise of your banking relationship in that mix of advisors, but it's unintended. This is a time when the professionals you surround yourself with will become increasingly important. It's not like I said, "You need to bank with me." There are other good bankers. Still, SVB might be your best option if you need a bank that can increase your odds of success. OK, that was intended, and now I feel a little self-serving, but I'll get over it.
3. The Winery Owners' Confidence Index is created using the SVB State of the Wine Industry Survey that's run in October of each year. Winery owners are asked whether a given subject is a positive, negative or neutral factor impacting their business. For example, if an owner viewed the economy as a positive factor in their current business success, they would answer "positive." If the economy was hurting the business success, the answer would be "negative." The raw positive answers are netted against the negative responses to create the index.
4. Note: The survey is given to wineries instead of growers. Grower surveys would return a different view. For a winery, a lack of grape supply along with higher prices would have a negative impact on operations. An abundance of grapes and lower prices, which are current realities, are positive impacts.
5. I'm never wrong. It's the alternative facts that mess up my always-accurate predictions.
6. Silicon Valley Bank's Peer Group Analysis (PGA) Database is a proprietary information set that includes both client and nonclient financial statements and extends back into the early 1990s. We are able to use this for diagnosing industry and regional trends, as well as providing anonymized comparisons to our winery client base.
7. Aaron Romano, "[Roederer Buys Sonoma's Merry Edwards Winery](#)," *Wine Spectator*, February 22, 2019.
8. The planting boom in the 1990s included a heavy dose of merlot and syrah planted in every imaginable terroir. While merlot had shown early promise as a soft entry point for the new consumer of red wine, the frenzy and variety of styles and quality created consumer confusion. Neither varietal has been an easy sell since.
9. [Dot-com bubble](#).
10. [Charles Shaw wine](#).
11. Cannabis isn't a viable crop for grape growers to plant either. California and Oregon are already producing several times more cannabis than currently needed, and it's illegal to send excess across state lines.
12. Following a vineyard secured by bank debt will almost certainly require the written agreement of your lender and in many cases will require the approval of the county in which you operate as well. Pulling vines without bringing your lender into the discussion is likely a violation of your loan agreement and could have serious consequences.
13. WSWA, [Wine & Spirits Wholesalers of America](#).
14. Distributors participating at this time include Breakthru, Lipman, Republic National, Southern Glazer's, Young's Market and several others, which represent more than half of wine sold both on- and off-premise in the US.
15. In the US, Costco has licenses to sell wine in 448 stores. It is the largest wine retailer in the US, with more than \$2 billion in sales.
16. "[E. & J. Gallo Winery Announces Deal With Constellation Brands](#)," April 3, 2019.
17. The sale of the Constellation brands to Gallo is under review by the Federal Trade Commission. Originally expected to close before calendar-year-end 2019, the transaction is being renegotiated, according to company statements, with a greater portion of consideration coming in the form of contingent consideration based on brand performance. This purgatory isn't an easy thing for distributors to handle. That's reflected in Constellation's wine sales volumes, which are off for the year 12.3 percent by volume through July, according to Gomberg-Fredrikson information. The company also announced that it has taken a \$300 million charge to account for the change in deal terms.
18. Adam Brandolph, "[Events With Alcohol Help Libraries Raise Funds for Extras](#)," *TribLIVE*, September 17, 2014.
19. As covered in the SVB DTC survey and videocast, wineries have a backward model that requires customers to come to the winery to buy wine and join the club. How would car sales be impacted if Detroit required consumers to come to Michigan to pick up their car? I encourage wineries to look outside the existing tasting room model and go to regions where there are pockets of club members, essentially taking an experience on the road and gaining club members in the process.

20. Anthony Zelli, "[Supreme Court Rejects State Residency Requirements for Alcohol Retail Licenses](#)," *National Law Review*, July 11, 2019.
21. "Frugal hedonism" is a term I coined to describe a young consumer trend. Younger consumers understand artisanship and quality. They like nice things just like the generations before them. But instead of consuming as much as they desire using credit cards, as did their boomer parents, younger consumers prefer to live in smaller homes, reduce their rent expense, stay away from consumer credit, drive less expensive cars that have appealing style or just use ride-sharing and save their discretionary income for simple luxuries they truly enjoy. They will splurge at times, but they are tight-fisted with their wallets given their damaged financial capacities.
22. [Two-liter bottle](#).
23. "Single-Person Households to Record 128 Percent Growth by 2030," *Business Wire*, April 1, 2019.
24. [Allbirds](#).
25. For all of you who say you will never put your wine in a can, how many said you would never drink wine with screw tops? Personally I'm not a fan of cans, but I'm a boomer and like what I like. I'm not the consumer you need to impress and sell.
26. Rachael Rettner, "[A Daily Can of Soda May Raise Diabetes Risk](#)," *Live Science*, April 24, 2013.
27. Paul La Monica, "[Small Cans Lead to Big Sales for Coca-Cola](#)," *CNN Business*, October 21, 2019.
28. Fun is important to me too, but by all accounts, millennials are having more fun than me. I'm thinking I need to switch parties and be a millennial.
29. [Dry January](#).
30. Jamie Ducharme, "['Mindful Drinking' Is the Latest Health Craze](#)," *Time*, January 4, 2018.
31. Leah Groth, "[The Sober Curious Movement: Everything You Need to Know](#)," *USA Today*, September 10, 2019.
32. [Economic substitutes](#).
33. Anecdotal evidence in this context means that I heard a bunch of wine sellers talking about legalization ruining their sales quotas in one wine shop after pot was legalized.
34. [Complementary goods](#).
35. That's another good example of a complementary good. Cannabis consumption has been found to stimulate popcorn demand, Italian ice-cream bar sales and Diet Dr Pepper consumption.
36. Larisa Bolivar, [Cannabis Consumers Coalition 2017 Report on Demographics and Consumption Habits](#), May 2017.
37. Thomas Pellechia, "[Alcohol Sales Dropped 15% in States With Medical Marijuana Laws](#)," *Forbes*, January 22, 2018.
38. Michele Baggio, Alberto Chong and Sungoh Kwon, "[Helping Settle the Marijuana and Alcohol Debate](#)," University of Connecticut, Georgia State University and Universidad del Pacifico, Lima.
39. Rob McMillan, "[Weed Is Impacting Wine Sales](#)," *SVB on Wine*, January 28, 2018.
40. Isabella Gripe, Anna-Karin Danielsson and Mats Ramstedt, "[Are Changes in Drinking Related to Changes in Cannabis Use Among Swedish Adolescents?](#)" *Journal of Addiction*, Volume 113, Issue 9, September 2018.
41. Christopher Ingraham, "[How Many Americans Regularly Use Pot? The Number Is, Errr, Higher Than You Think](#)," *Sacramento Bee*, April 20, 2017.
42. [Alcohol Facts and Statistics](#), National Institute on Alcohol Abuse and Alcoholism, August 2018.
43. Michael Sheetz, "[Corona Beer Maker Constellation Ups Bet on Cannabis With \\$4 Billion Investment in Canopy Growth](#)," *CNBC*, August 15, 2018.
44. Bill Swindel, "[Film Director Francis Ford Coppola Jumps Into Cannabis Industry](#)," *Press Democrat*, November 1, 2018.
45. Will Yakowicz, "[Forget Kombucha and Coconut Water. Cannabis Is the Next Beverage Trend](#)," *Inc.*, June 11, 2018.
46. [THC versus CBD](#).
47. "[Central Valley Growers Pulling Grapevines](#)," *California Agriculture*, Volume 57, Number 3, June 1, 2003.
48. "[Growing the USA Market Is the Focus Following 20 Per Cent Growth in Australian Wine Exports in 2017-18](#)," *Wine Australia*, June 2018.
49. Gabriel Stone, "[Chile Adapts Strategy to Global Change](#)," *The Drinks Business*, September 10, 2015.
50. Mohamed El-Erian, "[Argentina's Economic Crisis Is the Result of Avoidable Mistakes](#)," *The Guardian*, September 10, 2019.
51. Scottie Andrew and Brian Ries, "[Coca-Cola Will Sell an Alcoholic Beverage in Japan After a Successful Test Run](#)," *CNN Business*, July 23, 2019.
52. Shannon Palus, "[Why You Can't Escape Spiked Seltzer This Summer](#)," *Slate*, August 9, 2019.
53. In its original concept, light beer was called diet beer.
54. Forty-two percent of boomers have no retirement savings as of 2018. Baby boomers began reaching age 65 in 2011 – 26 million so far – and another 50 million will turn 65 over the next 10 years. Twenty-six percent expect to work past age 70.
55. I performed a search to determine if Las Vegas posted odds on the chances of receiving full Social Security benefits. Las Vegas will allow you to bet on almost anything. Since they aren't making book on that one bet, I can only presume bookies don't see Social Security as a good bet.
56. Claudia D'Arpizio et al., "[The Future of Luxury: A Look Into Tomorrow to Understand Today](#)," Bain & Company, January 10, 2019.
57. Amy Reiter, "[Millennials Are Drinking a Whole Lot of Wine](#)," *Food Network Dish*, March 1, 2016.
58. Wendy Wang and Kim Parker, "[Record Share of Americans Have Never Married](#)," Pew Research Center, November 24, 2014.
59. Quoctrung Bui and Claire Cain Miller, "[The Age That Women Have Babies: How a Gap Divides America](#)," *The New York Times*, August 4, 2018.
60. Jung Hyun Choi, Jun Zhu and Laurie Goodman, "[The State of Millennial Homeownership](#)," *Urban Wire*, Urban Institute, July 11, 2018.
61. Drew DeSilver, "[In the U.S. and Abroad, More Young Adults Are Living With Their Parents](#)," Pew Research Center, May 24, 2016.

62. [The 2008 financial crisis](#).
63. Christopher Kurz, Geng Li and Daniel J. Vine, "[Are Millennials Different?](#)" Finance and Economics Discussion Series 2018-080, Board of Governors of the Federal Reserve System, November 2018.
64. [Quantitative easing](#).
65. Charles Taylor, "[What Makes a CSR Message Resonate With Millennials and Generation-Z?](#)" *Forbes*, April 30, 2019.
66. Unlike other products, the use of the term "organic" has mixed consumer responses when it comes to wine. But the natural wine movement is an outflow of the concept. Finding the right tone with the terms "organic" and "natural" isn't black and white but invites exploration. My suggestion is to use your wine club to get answers. Tell them you're thinking of a change and ask them what they think. They will appreciate that you consider their advice useful, and that engagement by itself is positive.
67. I checked with a respected beverage attorney before adding these comments about health attributes and was told it was within the bounds and legal for permit holders to do so. That said, we can't include a health icon that says "healthy" on a bottle. That seems obvious. But if you want to go down this path and talk about your wine's attributes, please get your own legal advice on this complex topic and keep me out of hot water! Please see [www.TTB.gov/rulings](http://www.TTB.gov/rulings) for added information.
68. If you choose to go down this path by including this information on your bottle, don't add everything in this list. Keep the message focused on the attributes you believe are the most important differentiator in your brand. Please see [www.TTB.gov/rulings](http://www.TTB.gov/rulings) for added information.
69. [Think Restoration Hardware Wine Vault and Barista Bar](#). But almost any company at the high end regionally wants to have wine poured at events. Partner with a caterer and bring the company and their clients to wine country.
70. [Emetry and Customer Vineyard](#) are two companies finding ways to apply big data resources to aggressively drive revenue to the winery versus passively waiting for customers to walk in the door.
71. [Mothers Against Drunk Driving \(MADD\)](#) and [Students Against Destructive Decisions \(SADD\)](#).
72. [The Alcoholic Beverage Labeling Act \(ABLA\) of the Anti-Drug Abuse Act of 1988, H.R. 5210](#), is a US federal law requiring that (among other provisions) the labels of alcoholic beverages carry a government warning.
73. President Clinton introduces a call for a [nationwide 0.08 maximum standard for drunk driving](#).
74. Morley Safer, "[The French Paradox](#)" (video), *60 Minutes*, November 17, 1991.
75. [Mediterranean diet](#).
76. Arthur L. Klatsky, M.D., "[Moderate Drinking and Reduced Risk of Heart Disease](#)," *Alcohol Research and Health*, Volume 23, Number 1, 1999.
77. J. Ferrières, "[The French Paradox: Lessons for Other Countries](#)," *Heart* (Journal of the British Cardiovascular Society), Volume 90, Issue 1, 2004.
78. [State of the Science Report on the Effects of Moderate Drinking](#), National Institute on Alcohol Abuse and Alcoholism, December 19, 2003.
79. James McAuley, "[Wine Is Bad for You, France's Health Minister Warns. It's Not Going Down Well](#)," *Miami Herald*, March 6, 2018.
80. Michael Greger, M.D., "[What About the French Paradox?](#)" NutritionFacts.org, May 22, 2018.
81. [National academies \(NASEM\) release recommendations to lower the BAC level to 0.05 nationally](#), January 17, 2018.
82. Jackson Shedelbower, "[Once the Facts Are Known, It's Clear .05 Blood-Alcohol Limit Won't Save Lives](#)," *USA Today/Times Record News*, November 20, 2018. Etienne Blais and Pierre Maurice, "[Toward Improved Evaluations of Laws Against Drink-Driving](#)," *The Lancet*, December 12, 2018.
83. Bill Chappell, "[Utah Cuts DUI Alcohol Limit to Lowest Level in US; Law Also Affects Gun Owners](#)," NPR, March 24, 2017.
84. Carter Williams, "[3 More States Debate Lowering DUI Threshold to .05 Percent](#)," KSL.com, May 2, 2019.
85. Justin Scheck and Tripp Mickle, "[With Moderate Drinking Under Fire, Alcohol Companies Go on Offensive](#)," *The Wall Street Journal*, November 29, 2018.
86. Kelly Wynne, "[Alcohol Is Killing More People Per Year Than the Opioid Crisis, and Most Deaths Are Young Women](#)," *Newsweek*, November 17, 2018.
87. "[Screening and Behavioral Counseling Interventions to Reduce Unhealthy Alcohol Use in Adolescents and Adults](#)," U.S. Preventive Services Task Force Recommendation Statement, November 13, 2018.
88. Emma Liem, "[Consumers Are Demanding More From Their Beverage Experiences](#)," *Food Dive*, January 22, 2018.
89. Imagine consumers wanting to consume food and beverages that are good for you! According to multiple studies, moderate alcohol consumption is good for you, but that's not part of a balanced message being delivered.
90. Joel Achenbach, "[Teenagers and College-Age People Drink Less While This Group Pours Another Round](#)," *The Washington Post*, April 16, 2018.

**For more information on this report and to learn more about how SVB can help you move bold ideas forward for your company, please contact Rob McMillan at 707.967.1367 or email him at [rmcmillan@svb.com](mailto:rmcmillan@svb.com).**

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