State of the Wine Industry Report 2019

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Contents

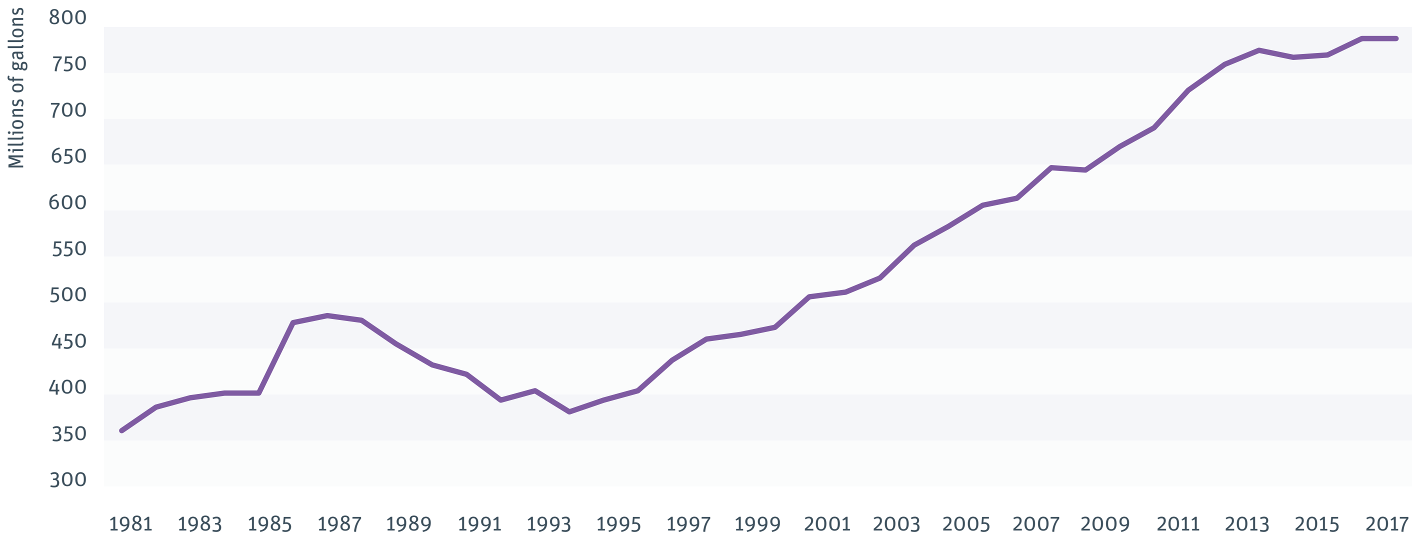
Cover image courtesy of Bob McClenahan Photography

1 Introduction

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 were up as well. Strong consumer confidence and a healthy 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.

Figure 1: **US wine consumption**

Volume



Sources: California Wine Institute, Gomberg-Frederickson, BW 166

Beginning in 1994, the US wine business experienced a long trend of increasing consumption and consistently higher price points. The growth and premiumization of wine were driven by the longest economic expansion on record, coincident with the baby-boom generation entering their peak retail spending years. That expansion was then magnified by a series of key findings linking improved health to wine consumption.[1]

Twenty-five years later, the US is the largest wine-consuming country in the world,[2] giving US producers an amazing home-court advantage. That said, while the total dollar sales of wine in the US is still growing, the rate of growth is flattening (see figure 1). This is at a time when the US is in its second longest economic expansion in history, and business analysts see the US economy operating at such an optimal state that it has reached the rare "Goldilocks" moment.[3]

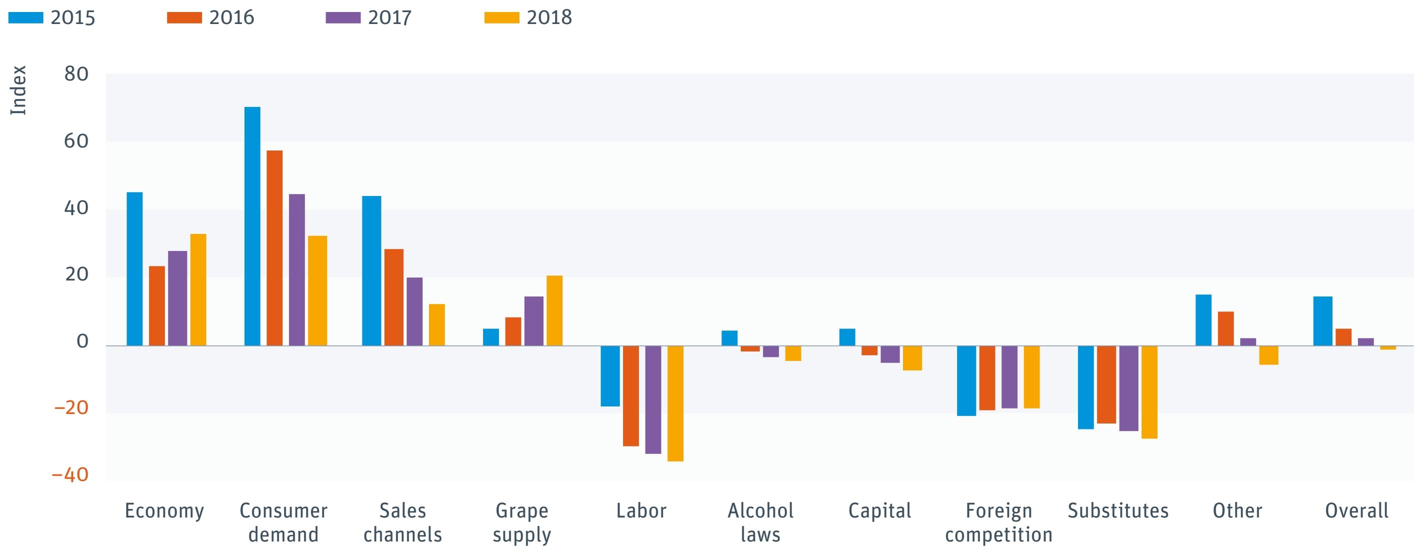
Just like the early 1990s when the boomers made their retail presence obvious, driving record wine sales, the huge millennial generation, all over 21 years of age now, is moving into their careers and higher-spending years. They will surpass the baby boomers as the nation's largest demographic by pure numbers in 2019.[4]

The US is the largest wine-consuming country in the world, giving US producers an amazing home-court advantage

2 Executive summary

Winery owners can feel the industry changes that are quietly running beneath the surface. The economy and consumer demand are the largest positive contributors to winery owners' confidence, with labor, foreign competition and substitutes their biggest fears (see figure 2).

Figure 2: **Annual change in winery owner confidence**



Source: 2018 SVB Annual Winery Conditions Survey

The grape supply and the economy are viewed as a greater part of their success, but consumer demand and labor elicit increasingly negative responses. In 2018, the Winery Owners' Confidence Index[5] dropped into negative territory for the first time since the index was created four years ago. With a good economy and sufficient consumer growth, you would think owners would have a cheerier outlook.

Most of the same circumstances that drove double-digit sales growth in the 1990s are in evidence today, so we could reasonably expect them to drive another round of industry growth. But instead of an uptrend in the business metrics, consolidated annual volume growth of wine consumption is close to becoming negative for the first time since the early 1990s, and that syncs with the owners' feelings. What is different this time?

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.
2. Millennials aren't yet embracing wine consumption as many had predicted. Damaged financial capacity is a major contributor, but cannabis legalization is another factor explaining their slow adoption of wine.
3. The cumulative impact of negative health messaging — absent offsetting promotion of the health benefits of moderate wine consumption — is negatively influencing consumption, particularly for the millennial consumer.
4. Wine imports and substitutes (such as craft beer and spirits) are an increasing threat for mindshare among emerging wine consumers.
5. Distributor consolidation and a lag in innovating alternative direct-to-consumer (DTC) strategies beyond the tasting room and club models are limiting DTC growth for family wineries.
6. Large retail brand owners are expanding private/white label offerings to control the supply chain, drive down costs and offer lower consumer prices. This strategy plays to the emerging frugal consumer and captures wine sales that would otherwise be filled by traditional wine companies.

7. Vineyard labor availability is limited, and the price for labor is increasing.

Other issues facing the industry include the slight oversupply of grapes in California and the inability of wineries to take price increases against higher input costs. With price increases difficult against the backdrop of slowing sales growth, the trend and mantra of premiumization we've become used to is coming to an end.

The trend and mantra of premiumization we've become used to is coming to an end

With continuing distributor consolidation, the dominant competitive issue for the family winery remains — finding a sustainable path to sell to the consumer. That too is becoming more challenging with declining tasting room visitation in some regions.

Seven tailwinds

1. With a good 2018 US economy, Gen X 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 in 2018.

2. Though the median millennial is 30 years old today, the population peaks in size at age 24, meaning there are growing numbers of young consumers advancing into their 30s, the age their alcohol beverage mix normally starts to include more wine.

3. The fine-wine-producing regions of Oregon and Washington remain on a strong double-digit growth path.

4. Producers with long-established brands and those with good distributor relationships continue to perform above their peers.

5. The number and diversity of retail concepts and locations selling wine continue to grow to record numbers.

6. The harvest of 2018 was of high quality in virtually all growing regions in the US, with the exception of Virginia,[6] where hurricanes made for a disastrous season, and, to a lesser extent, New York,[7] which also had heavy rain to contend with.

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 a good 2018 in the books, 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 consumers finding more discretionary income, labor and migration issues becoming disentangled, and the emergence of digital platforms and strategies to unravel the many problems and opportunities in the DTC sales channel.

Hope is always good, but hope is never a good strategy.

Despite the positive year in 2018 and 25 years of great growth for the US wine business, I believe 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. To continue its growth in the years ahead, the US wine industry needs new direction and a changed focus.

We believe this report will inform your team's thinking about the particular place you occupy in 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 years ahead.

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3 2018 predictions in review

We have been researching the wine business since 1991 and making predictions for far more than a decade. Some years, we properly characterize a market change. In other years, our findings might be off in terms of timing or even wrong,[8] but we always review the forecasts made the prior year just to keep score.

Our lead statement last year was the following:

The US wine industry is at the tail end of its largest growth period in history. Today, consumers are leaving the lower price segments in favor of better-quality offerings, but after more than 20 years of straight-line growth trends, total volume growth is leveling out.

That was an accurate statement and one I'll reiterate and expand on this year.

What we got right

- We predicted sales growth of 4 to 8 percent for the premium wine segment, which was an improvement from the 2016 full-year actual growth rate of 2.7 percent.
  - Silicon Valley Bank's Peer Group Analysis (PGA) Benchmark Database[9] shows a nine-month year-to-date sales growth rate of 5.2 percent, and according to our Annual Winery Conditions Survey, the premium wine segment expects a good last quarter. We should finish up near the high end of the range.
- For the industry as a whole, we said sales would rise by 2 to 4 percent, while volumes would increase up to 1 percent.
  - Nielsen Beverage reported retail store sales for the 52 weeks through November 3, 2018, were up 1.4 percent and volumes down 0.5 percent. We'll give ourselves a pass by noting that BW 166 and Wines Vines Analytics show 4 percent growth for the year when including DTC and on-premise sales.[10]
- We expected acquisitions to cool somewhat from the torrid pace of the past three years, as many of the major buyers digested their purchases. We expected to see foreign purchases of US wineries and significant transactions for vineyard properties over the year.
  - Each of these proved out.
- We said increasing imports would continue in the lower premium price points.
  - Nielsen reported sales growth in imports of 1.5 percent.
- We predicted overall supply would be balanced, with chardonnay in particularly strong demand. Cabernet would be balanced with flat to down pressure at the high end of the market.
  - The market played cat and mouse with purchasing, indicating balance through the year. The record harvest in California in 2018 changed the bulk wine dynamics at year-end, and we finished up 2018 with an oversupply problem.
- We expected Oregon and Washington vineyards to continue to see high interest from larger wine companies that would pay higher prices for acquisitions.
  - Several Pacific Northwest wineries and vineyards changed hands.
- We said the California Central Valley would be closer to being in balance in 2018 after 2017 acreage removals, but some additional removals would be needed in the southern San Joaquin Valley to produce sustainable pricing opportunities.
  - This seems to be true, but a large 2018 harvest may put that to the test.
- We thought retiring baby boomers and frugal millennials would drive a rotation of consumer preferences. Premiumization would continue, but softening was likely on the luxury end for wineries without strong brands. For established brands, we thought growth opportunities remained positive.
  - This was a good guess, but we will change parts of that forecast for this report.
- We predicted price increases would be difficult to pass through in 2018. We said overall pricing should be flat.
  - Spot on. Price increase on average was zero — some brands found opportunities to raise prices, and others were forced to drop prices.
- We said that routinely increasing both volume and price, as had occurred over the previous 20 years, would prove to be difficult for wineries given the low-growth, low-inflation environment.
  - Both volume and sales dollars are flattening or trending lower.

What we got wrong

- We thought millennials were migrating away from red blends and introductory wines and were starting to have a positive impact on lower-priced still wine categories — both domestic and foreign. We expected the trend to continue.
  - This was the largest surprise of this year's report. Due to many factors, including their limited financial capacity, a preference for premium spirits and craft beers, delayed careers, negative health messaging regarding alcohol, and the legalization of cannabis, the millennial consumer has temporarily stalled in growing their wine consumption. That set up a new look at the cohort in this report and a discussion of needed strategies and tactics.

The millennial consumer has temporarily stalled in growing their wine consumption

- We predicted that when 2017 totals were calculated, California would have crushed about 3.8 million tons of grapes, slightly more than in 2016. Pacific Northwest harvests would set another record in terms of yield in Oregon and would moderate slightly in Washington.
  - Harvest came in 200,000 tons heavier in California at the end of 2017. Hey, it's only a 5 percent miss.
- We said California vineyard prices in premium regions would flatten compared with the strong growth we'd seen for the previous five years.
  - This is one of those predictions that is right in direction and wrong in timing. The scent was in the air last year, but there were still motivated buyers coming from several directions, and prices for vineyards continued with another year of growth.

4 2019 US wine business predictions and observations

- We aren't making any predictions about the national and world economies. Our predictions are made with the expectation that the US economy will remain in a steady state, without a recession.
- We predict sales growth of 4 to 8 percent for the premium wine segment, roughly flat from the 2018 sales growth estimate. For the off-premise retail store channel, sales will grow between 0.5 percent and 2.5 percent, while volume will decline, with a growth rate between negative 0.5 percent and positive 1.5 percent.
- The M&A market will slow noticeably in 2019 as many of the major buyers continue to digest their purchases and execute on new brand strategies. We will still see some foreign purchases of US wineries and significant transactions for vineyard properties over the next 12 months. For wineries, the M&A will be reserved for iconic properties that might come up and sell for the full price, fatigued owners who see the flat business conditions ahead and opt out and vineyard transactions.
- Imports will gain market share at the expense of US producers.

We predict sales growth of 4 to 8 percent for the premium wine segment, and between 0.5 and 2.5 percent growth for off-premise retail sales

Supply

- By all accounts, when 2018 totals are calculated California will have crushed a record volume of grapes. We are forecasting the harvest to come in at 4.4 million tons in California. Once counted, the Pacific Northwest harvests will also set records in terms of yield.
- Overall supply is long in California. Grape and bulk prices will noticeably drop in the California market in 2019. Washington is starting with a slight excess going into the 2018 harvest, and its harvest will end up heavy. Oregon will have a record harvest but will sell it all as the demand for Oregon pinot noir continues to accelerate.
- California vineyard prices in premium regions will flatten compared with the strong growth we've seen for the past several years.
- Oregon vineyards will continue to see high interest from larger wine companies, though vineyard prices may stabilize. Washington land prices may moderate in the face of oversupply conditions for larger producers. Premium producers in Eastern Washington will see modest growth in land prices.

Grape and bulk prices will noticeably drop in the California market in 2019

Demand

- Retiring baby boomers seem to have a long tail and fortunately aren't quick to run to the 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 median boomer hits retirement age in four years.
- Premiumization is nearing its apex as a trend, as indicated by the slowdowns in total sales volume, decline in premium sales growth rates and the difficulty in passing price increases on to consumers.
- Millennials aren't engaging with wine as hoped. They lack financial capacity, currently prefer premium spirits and craft beers, and have been slow getting into careers. Cannabis demand skews to younger males today, and that is also likely playing a role in the cohort's delayed appreciation for wine.

Millennials aren't engaging with wine as hoped. They lack financial capacity, currently prefer premium spirits and craft beers, and have been slow getting into careers

- We have entered a period where the cumulative negative message about alcohol and health is impacting demand from young consumers. They have stalled in growing their wine preference, leaning toward premium spirits and craft beer.
- The Gen X cohort will surpass the baby boomers by around 2022 to become the largest fine wine–consumer demographic in the US. By 2027, millennials will surpass Gen Xers to become the largest fine wine–consuming cohort.

As an industry, we're transitioning to a period of flat to negative volume growth, low sales growth and a modest surplus of grapes, which will put pressure on prices

Price

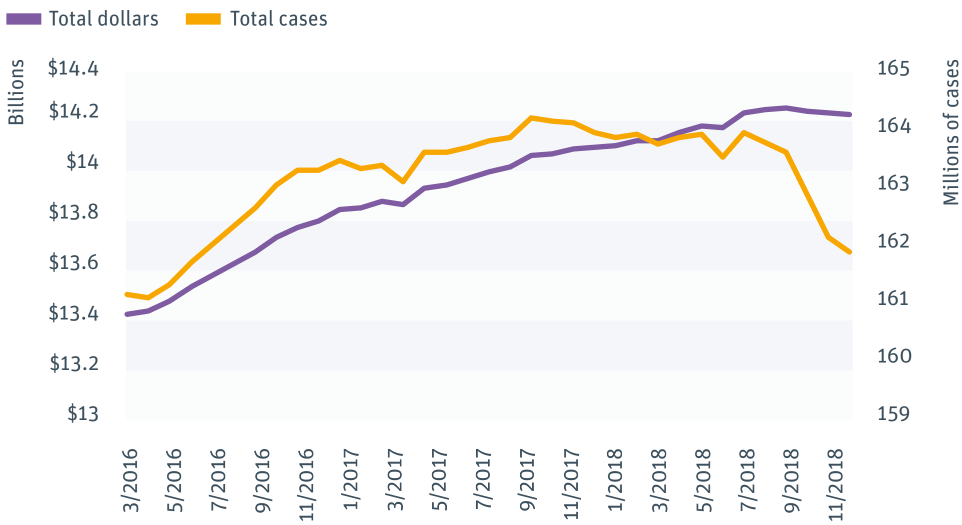
- Price increases will be very difficult to pass through in 2019. Overall pricing should be flat for premium wine as the industry works through sluggish volume growth and a surplus of wine. The added supply will show up in both négociant and value-priced private label products. We should see some limited price reductions in the middle-teens bottle pricing. Wine below $9 will continue to shrink in volume and value.
- Routinely increasing both volume and price, as has occurred over the past 20 years, will prove to be difficult for wineries given the low-growth, low-inflation environment. As an industry, we're transitioning to a period of flat to negative volume growth, low sales growth and a modest surplus of grapes, which will put pressure on prices.

5 Sales growth trends

In the 1990s and early 2000s, we saw a routine trend of growing brand strength in the wine trade, evidenced by snowballing volumes and increasing pricing opportunities for retailers. In the late 1990s, consumer demand was so strong, Silicon Valley Bank often had winery clients selling out of wine by midyear and distributors scouring the corners of the wine business, begging small wineries for their product.[11] That's clearly not the case today.

Figure 3: **Total off-premise sales in dollars and cases**

Moving 52-week average



Source: Nielsen Beverage Group, November 2018

A high-level view of US wine sales reveals that total industry dollar growth has landed in a flattening period, and growth in volume has rolled over this past year, tipping into decline as we can see in the off-premise data shown in figure 3. But is the new volume decline a short-term issue or a secular change? Or should we ignore the trend and push it off as channel shifting to sales that aren't picked up in Nielsen's store network?

Growth in volume has rolled over this past year, tipping into decline

Diagnosis is complex, but trends are clearly pointing to a slowdown in direction and fundamental change. Aggregated data shown here don't always give a complete view of performance. Often the real information lies in segmenting the results. Doing so tells us there remain pockets of opportunity and growth. We see fading segments that were at one time successful and are now in neutral and still other brands, trends and segments that have seen their best days.

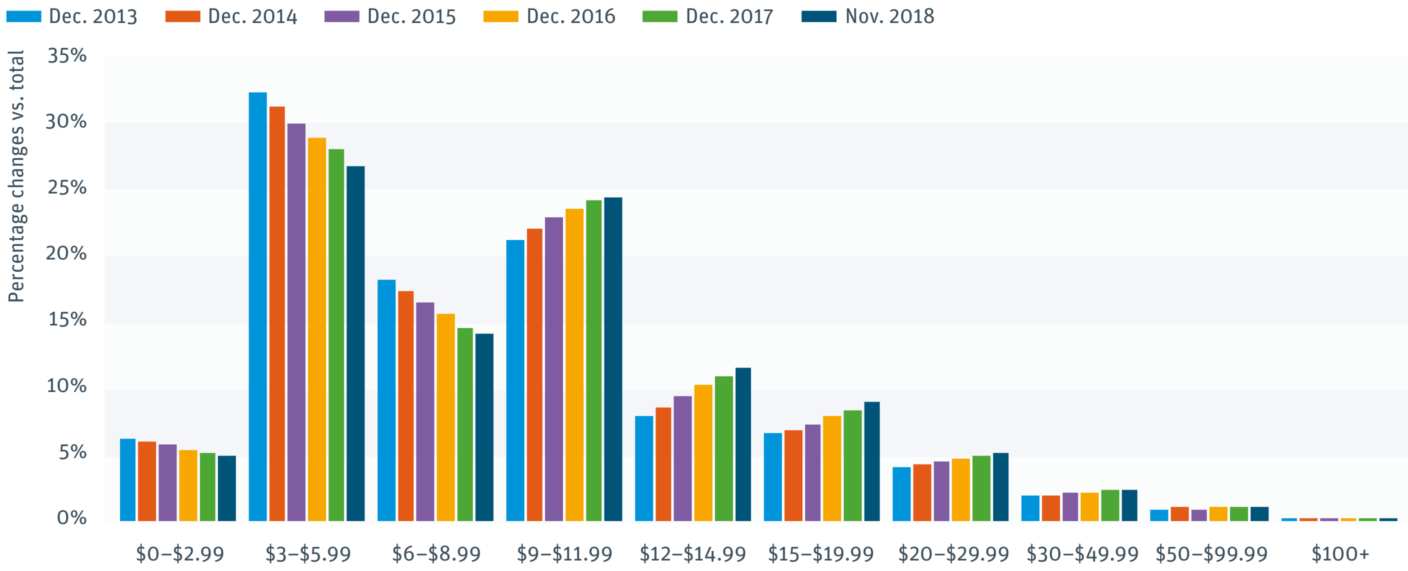
Over the past decade, we've watched generic wines, without a story or connection to a place, fall out of favor with consumers. The dated strategy of "just sell it for less" had a limit, and in recent history, we saw the effect, as lower price segments consistently declined in their rate of growth and higher-priced premium wine advanced[12] (see figure 4). That premiumization has been working well for the industry for some time, but premiumization as we've come to know it is in its final phases as a trend. What does that mean for the wine owner?

Wine selling below $9 retail — in clear retreat

Through November 2018, more than 70 percent of wine sold by volume and 46 percent by dollars was below $9 retail. The large volume segment is in full retreat, losing 9 percent of both volume and dollar sales over the 12 months ending November 2018 (see figure 5).

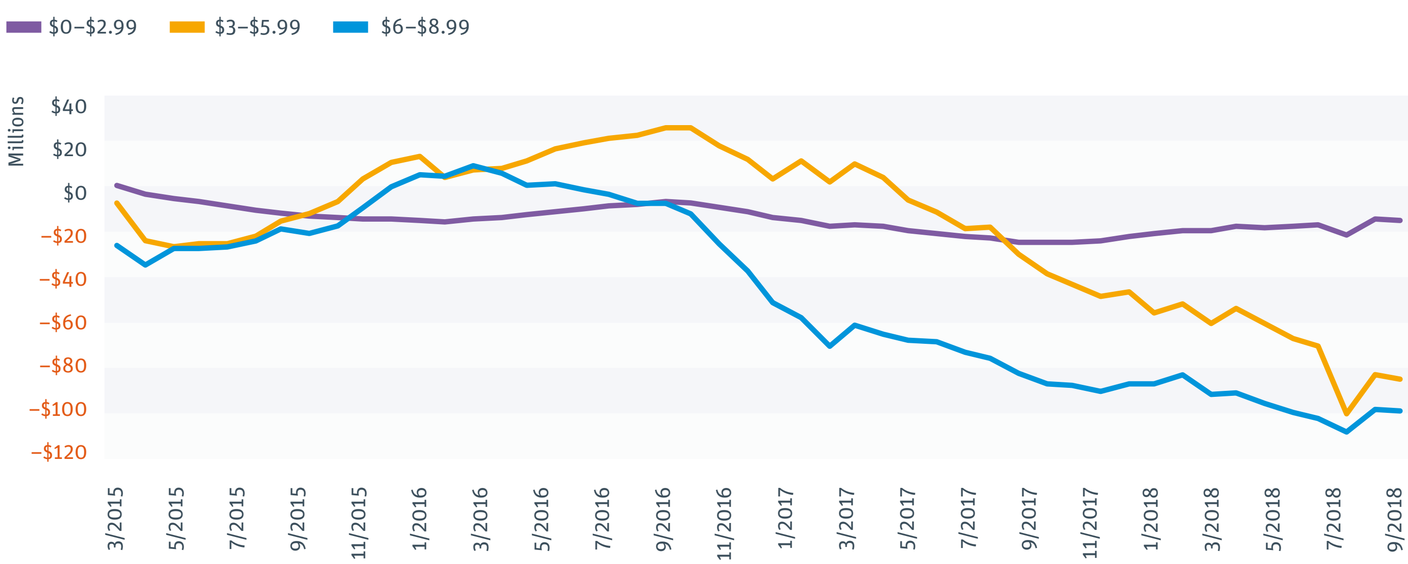
The only countervailing dynamic of the recent trend has been a short-lived improvement in $3 to $6 wines in 2017, but even that minuscule bright spot is not what it seems.

Figure 4: **Retail sales changes in price segments**



Source: Nielsen Beverage Group, 2013–2018

Figure 5: **Rolling 52-week sales growth of wine below $9**



Sources: Nielsen Beverage Group, SVB Analysis

The volume and growth came in $3 to $6 wines because all formats from Nielsen are converted to 750-milliliter bottles, and $14+ box wine is a growth segment. The box wine category has continued to do well, going up 4 percent. The large players — Constellation Brands, The Wine Group, Delicato Family Vineyards, Trinchero Family Estates and E. & J. Gallo Winery — all saw growth, each using its distribution muscle to push larger box and Tetra Pak formats. So even the minor positive news in the below $9 segment was a bit of a mirage. It really reflected thrifty consumers who gravitated to better value juice sold in larger formats.

Bridging the price break — new retail experiences

Straddling the price category divide at $9 are several new retail sales concepts trying to layer in different experiences with service, and their numbers are expanding. Today, you can buy wine and other alcohol at Bed Bath & Beyond, Starbucks, Burger King, movie theaters, tap rooms, barber shops and laundromats. You can also have it delivered from a multitude of digital and same-day retailers.

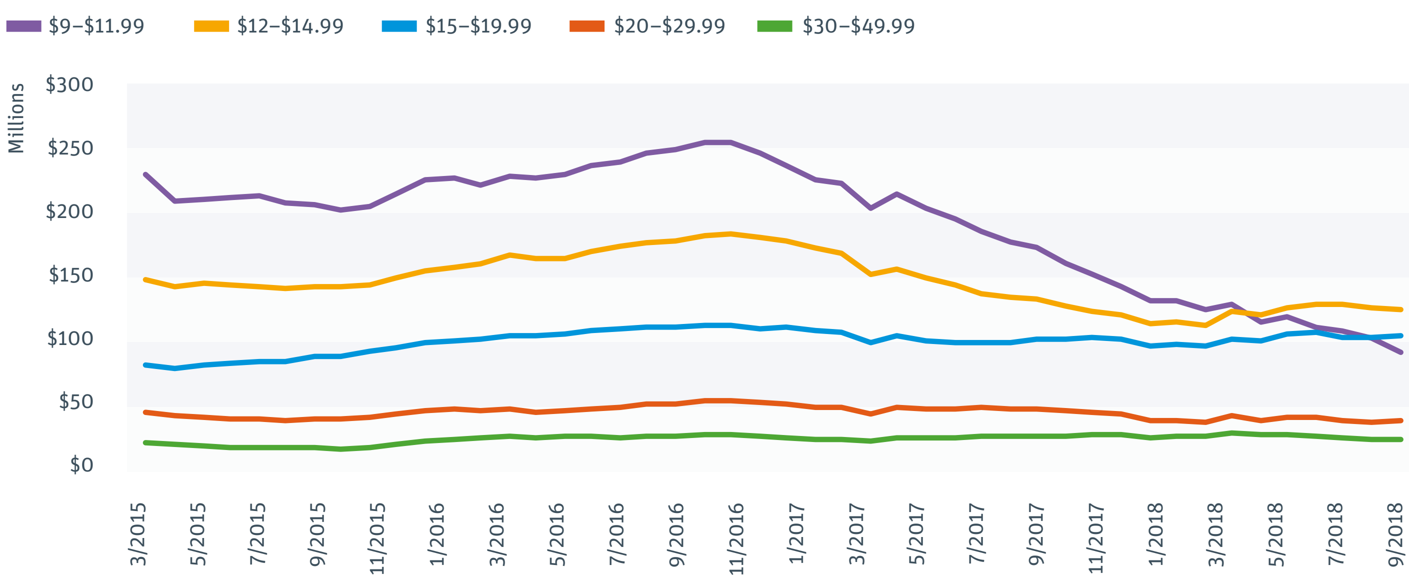
Newer entrants, discounters and private labelers with their own brands are showing good growth in the price points surrounding $10 as well. So are the more traditional US discounters like Kroger, Walmart and Target, which are each competing for private-label share with an increasingly thrifty consumer. All of this volume is being supplied by the wholesaler and skews below $15 universally, so as a consequence isn't a growth opportunity for smaller premium wine producers.

Wine selling above $9 retail — growth, but slowing trends

While there is no real definition of the term "premium wine," we define it as wine above $10 per bottle. That segment is responsible for 54 percent of the dollar sales today but only 29.9 percent of the volume.

The segment of wine sold above $9 is expanding, up 4.1 percent in dollars and 3 percent in case volume through November 2018. But one of many clues that's suggesting premiumization is beginning to break down is shown in figure 6, where declining sales growth in most price segments has become a clear trend.

Figure 6: **Rolling 52-week sales growth of wine above $9**



Sources: Nielsen Beverage Group, SVB Analysis

Syndicated data summary

Since the end of 2015, according to Nielsen data, the sales growth rate of off-premise retail wine has been declining. It's still growing, but its rate of growth is consistently slowing through the year. That's a newsworthy change of market direction.

Some analysts suggest we're just seeing a channel shift away from locations participating in data syndication, and there is some truth to that statement. The Nielsen data exclude some nontraditional channel information like Costco (the largest US wine retailer, with about $2 billion in wine sales), DTC sales, discounters like Aldi and Lidl and the on-premise restaurant trade. The growth rate from those sales isn't factored into the charts.[13]

No matter what, I always have a hard time dismissing obvious trends from healthy data collectors like Nielsen, which collects data on nearly two-thirds of the wine sold off-premise in the US. It can't be ignored, so we need to dig a bit deeper to understand if this is a change in consumer purchase behavior or something else.

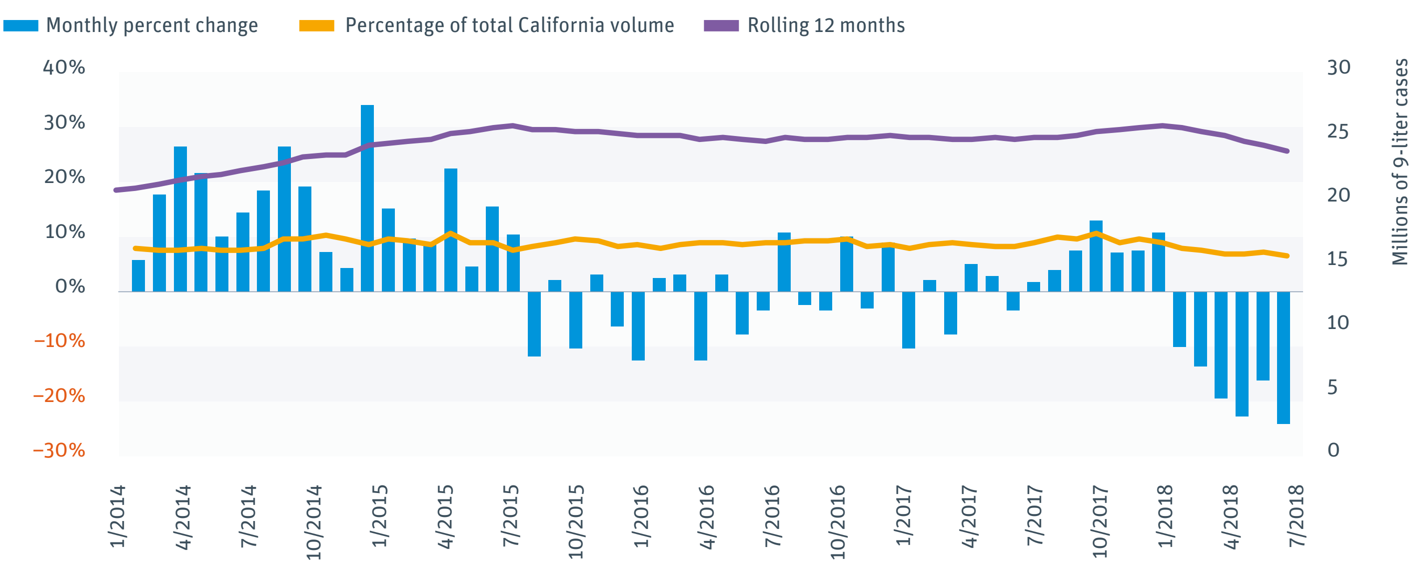
Winery shipments

Gomberg-Fredrikson shipment data from wine warehouses come at sales trends from a different perspective compared to Nielsen, using public tax documents instead of retail sales. While there is crossover, this data set excludes wine shipped from companies such as Constellation Brands, which own their own warehouses. A large portion of DTC shipments are included in the Gomberg-Fredrikson information.

Using the most current information as of August 2018, figure 7 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. 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 shipments data.

Figure 7: **Warehouse shipment trends**



Source: Gomberg-Fredrikson through August 2018

So we would show a decline in shipments in figure 7 if a sizable brand were removed from reporting public warehouses. But we have another view of those larger producers represented in figure 8 that gives us another check.

Figure 8: **Shipments from seven largest California producers**

8 months ending 8/2018

Winery	Millions of gallons	Change year over year	Percent change
E. & J. Gallo Winery	132,006	–5,511	–4.2%
The Wine Group	78,686	2,359	3.0%
Constellation Brands	62,624	–1,055	–1.7%
Trinchero Family Estates	28,994	1,458	5.0%
Treasury Wine Estates	19,800	213	1.1%
Delicato Family Vineyards	18,985	1,384	7.3%
Bronco Wine Company	13,047	–1,178	–9.0%
	354,142	**–2,330**	**–0.7%**

Source: Gomberg-Fredrikson, August 2018

The eight-month performance of the seven largest California wineries, which should typically account for about 68 to 70 percent of total annual US wine sales, showed that there were two million fewer gallons shipped, which is a 0.7 percent decline (see figure 8).

Winery financial performance

Winery financial statements are another source for verifying the wine trends. Silicon Valley Bank has collected financial statements from clients and non-clients as part of our daily routine for decades. We then aggregate the data and provide our clients with consulting and benchmarking data gratis. We also use the information to track larger-scale industry moves of premium wine.

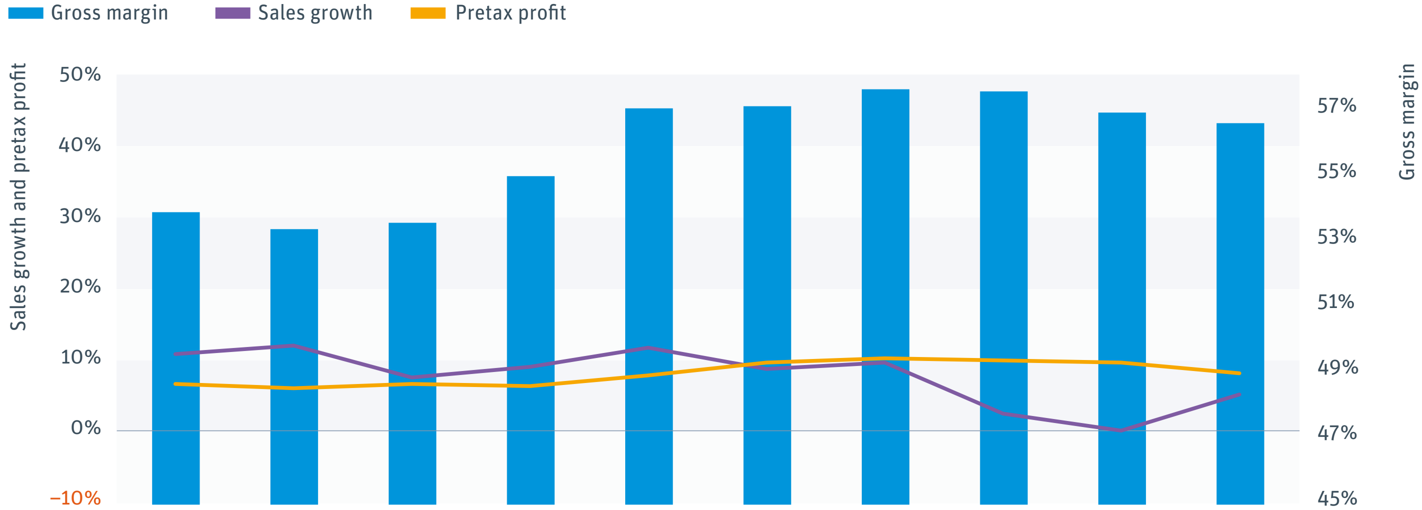
Our database reflects the wine industry overall by numbers and includes hundreds of wineries overwhelmingly from the US West Coast. Average case production in the database is 27,886, with a range of 1,000 to 750,000 cases. The average retail bottle price is about $28. It excludes the largest wineries that are captured in the Gomberg-Fredrikson chart (see figure 8).

Figure 9 is a product of that database, with data starting in 2010 when the financial crisis was in full swing. But redacted for space and just off the left of this chart in 2009, sales growth for the industry was negative 3.8 percent — it has rebounded nicely since then.

The trended sales growth rate has slowed over the past decade while wineries simultaneously evolved their strategies over to DTC models. That should imply higher average sales prices and gross margins that do show up in the information in figure 9. Gross margin has trended higher from about 53 percent to around 57 percent in the time frame displayed. Pretax profit remains between 8 and 12 percent.

On a positive note, sales growth through nine months for the benchmarked group as a whole is 5.2 percent, and while that's a low number in historic terms, it is much better performance compared to the 0.3 percent performance we demonstrated through the same nine-month period in 2017. The improved 2018 performance for the premium wine industry is likely due to more discretionary income for consumers from good economic conditions and the 2018 tax cuts. Higher grape pricing is just now starting to show up in the information in modestly lower gross margins for each of the last two years.

Figure 9: **Premium wineries' financial benchmarks**

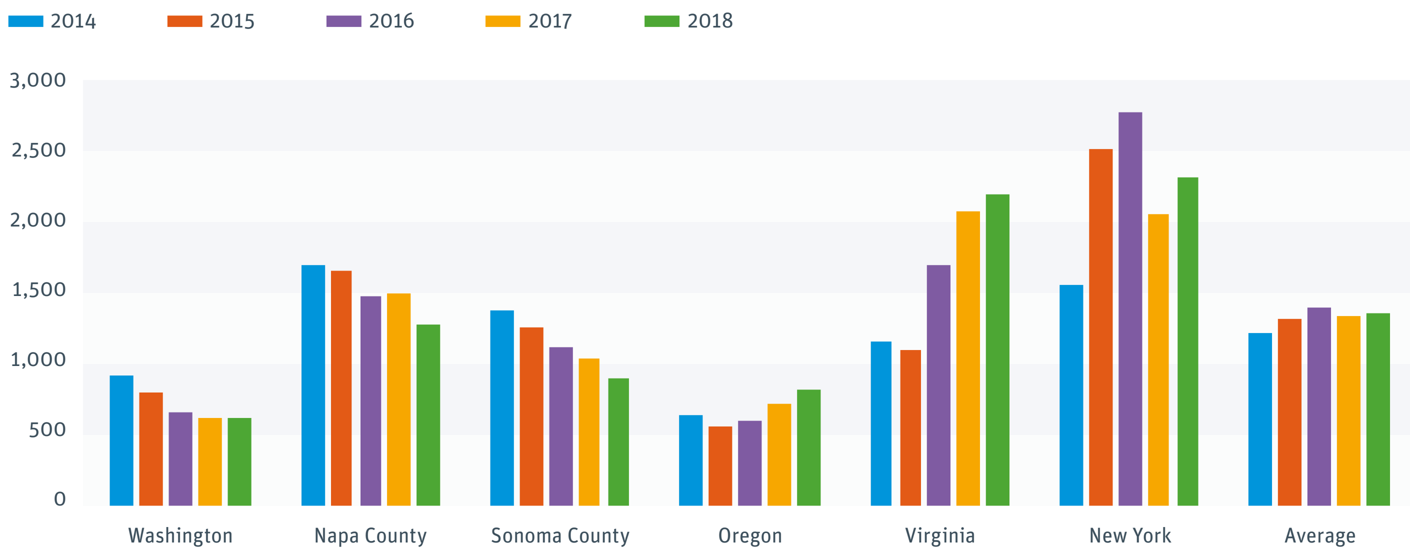


	12/2010	12/2011	12/2012	12/2013	12/2014	12/2015	12/2016	12/2017	9/2017	9/2018
Gross margin	53.7%	53.2%	53.4%	54.8%	56.8%	56.9%	57.4%	57.3%	56.7%	56.4%
Sales growth	10.8%	12.2%	7.7%	9.2%	11.9%	8.8%	9.6%	2.7%	0.3%	5.2%
Pretax profit	6.7%	6.1%	6.9%	6.6%	8.0%	9.6%	10.2%	10.0%	9.7%	8.2%

Source: 2010–2018 SVB Peer Group Analysis

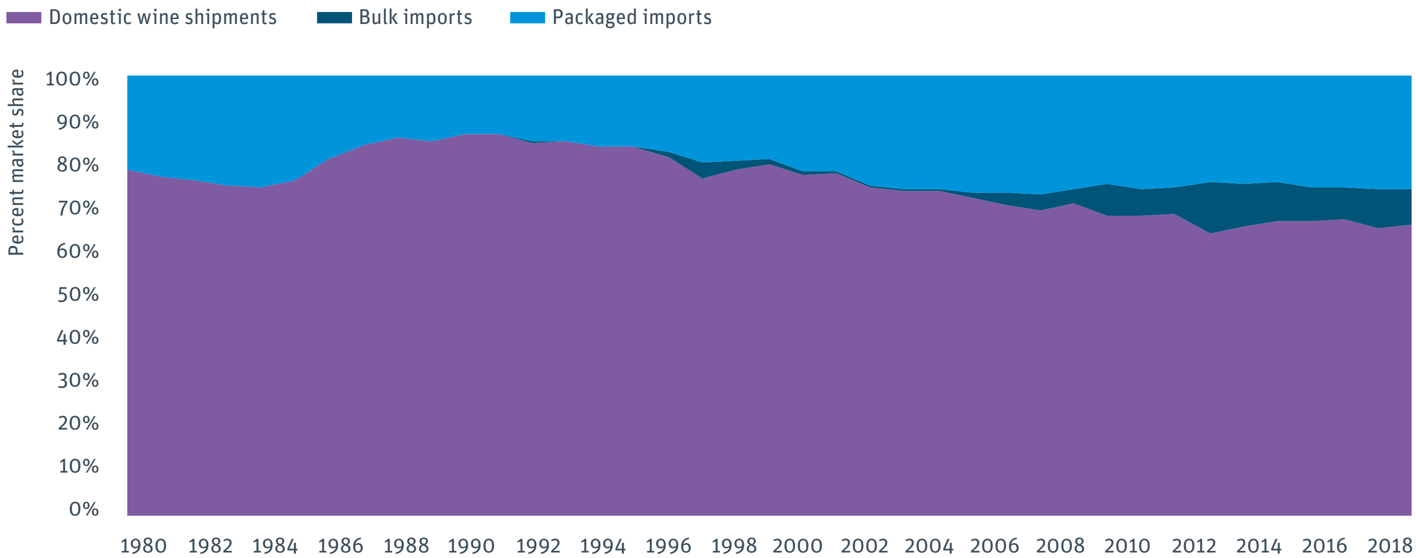
This nine-month information is missing the heavy October-November-December selling period. The 2018 SVB Annual Winery Conditions Survey also had owners reporting higher year-end expectations, so undoubtedly year-end sales will improve somewhat from what is reported here and fall in line with what we predicted in last year's report when we forecasted a growth range between 4 and 8 percent for the premium wine segment.

Figure 10: **Changes in monthly tasting room visitor counts**



Sources: 2014–2018 SVB Direct-to-Consumer/Tasting Room Surveys

Figure 11: **Decrease in US market share vs. imports**



Estimated data for 2018
Source: Gomberg-Fredrikson, November 2018

The tasting room

DTC sales make up 61 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.

Tasting room visitation in the regions of Napa and Sonoma has trended downward for the past five years (see figure 10). That shift is due to several factors, but it's not fewer tourists — tourism is up at the same time tasting room visitation is down in those regions. That seems like a paradox.

There are many reasons average visitation trends are dropping, 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.

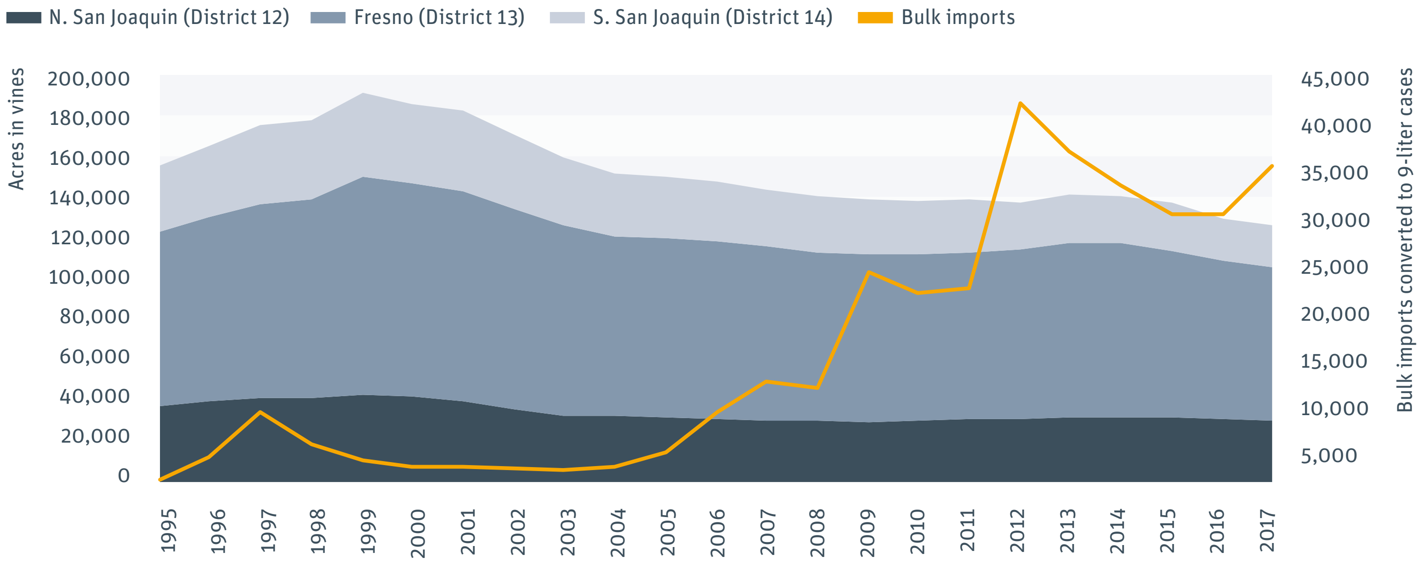
Tasting room visitation in the Pacific Northwest, and notably in Oregon, is growing well. The average sale in the tasting room is improving, which explains much of the overall growth in sales in all regions, but shifts in consumer behavior will be a growing concern, even in Oregon.

For more information on the issues behind declining tasting room visitation, see the State of the Wine Industry 2018 report, pages 31–33, and the section titled "Cracks in the tasting room model" later in this report (on page 47).

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 (see figure 2). The market share of domestic wine shipments has continued to drop, starting in the early 1990s. Bulk imports have been used by large producers of domestic brands, and since the early 2000s, those bulk purchases have also grown foreign wine's share of the total market (see figure 11).

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

Figure 12: **Vine acres removed in California's San Joaquin Valley vs. growth in foreign bulk imports**



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

> *As domestic wineries see US growth opportunities taper, they will notice more of the good-value imported wines hitting domestic shores, eroding their market share*

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, another significant factor has been the availability of cheaper juice that could be brought in as bulk wine from other countries.

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.[14] That relationship can be seen in figure 12.

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 the domestic family wineries today compared with the past two decades.

As domestic wineries see US growth opportunities taper, they will notice more of the good-value 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, always looking for the best deal, and are wide open to world wine.

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 and fill quality gaps in their own portfolios.

Figure 13: **Imported wine into the US over 52 weeks**

Country	Sales	Value change	Percent change	9-liter-case equivalents	9-liter-case equivalent change	9-liter-case equivalent percent change	Average bottle price	Percent change in average bottle price
Italy	$1,174,264,462	$12,696,546	1.1%	10,481,911	−41,624	−0.4%	$9.34	1.47%
Australia	$727,504,683	$23,077,228	3.3%	12,013,617	15,780	0.1%	$5.05	3.04%
New Zealand	$457,322,337	$35,160,210	8.3%	3,303,259	234,051	7.6%	$11.54	0.65%
France	$450,236,731	$37,111,392	9.0%	2,939,393	258,564	9.6%	$12.76	−0.61%
Argentina	$350,131,904	−$30,083,381	−7.9%	3,877,558	−370,279	−8.7%	$7.52	0.87%
Chile	$259,152,332	−$12,357,937	−4.6%	3,864,103	−111,784	−2.8%	$5.59	−1.82%
Spain	$165,728,886	−$4,201,800	−2.5%	2,090,602	−12,592	−0.6%	$6.61	−1.92%

Source: Nielsen Beverage Group, November 2018

France had the biggest increase in volume and the largest change in dollar sales last year

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

Bottled wine imports continue to take a sizable chunk of the domestic business as noted in figure 11. Import sales are led by Italian pinot grigio and prosecco, Australian wine, New Zealand sauvignon blanc and French rosé and sparkling wine. France had the biggest increase in volume and the largest change in dollar sales last year (see figure 13).

Australian[15] and Chilean[16] 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 their producers make some minor progress, seeing higher sales and volumes as well as an average bottle price increase, the highest among the major importers according to Nielsen, albeit off the lowest average price.

Argentina, with a good reputation for quality, is struggling with its export business due to the country's severe financial problems.[17] Chile and Spain bring up the bottom of import performance and are seeing reversals in total sales and volumes and show declining average bottle prices.

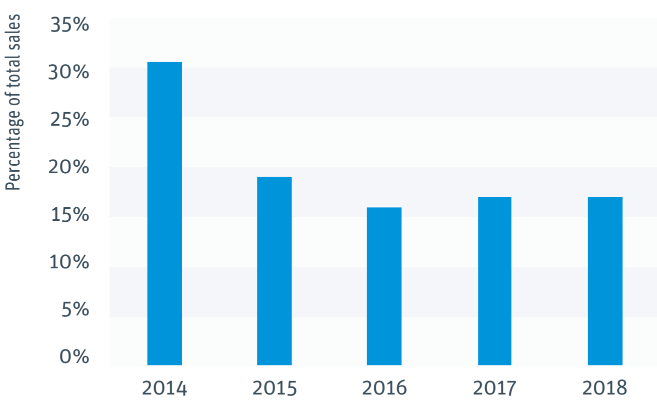
Restaurant sales and consumer shifts

Explaining the sales trend within the on-premise trade is complex. The factors shaping restaurant sales of wine today are a mix of events, starting with wholesalers' movement away from smaller wineries.

It is magnified by a consumer movement away from many of the full-service chain restaurants, the growth in fast casual dining that doesn't feature wine, increasing at-home wine consumption and declines in overall same-store consumer traffic. All of that is against the countervailing backdrop of a better retail economy in 2018, leading to higher average checks. It appears, however, that a better economy alone is not sufficient to fully offset the countervailing headwinds, and restaurants are working with newer concepts that are showing positive signs.

Retiring baby boomers are slowing both their spending and alcohol consumption as they age. Frugal hedonism[18] has overtaken our younger drinking cohort, and they don't want to pay restaurant markups. Young consumers 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 vs. a glass or bottle of wine. But the consumer shifts being driven by the young consumer don't stop there.

Figure 14: **Sales to restaurants from the average winery**



Sources: 2014–2018 SVB Annual Winery Conditions Surveys

Restaurant sales

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 our data are benchmarks. That means we are providing information that in this case would be meaningful to the "average winery," and on average, wineries are small. So when we show the average winery with 17 percent of their revenue from restaurants, that's not the same thing as saying 17 percent of all wine sales comes from restaurants (see figure 14).

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

For 12 months through October 2018, according to Nielsen CGA on-premise information, restaurant sales of wine were higher in both dollars and volume but with a slightly lower growth rate compared to the prior year (see figure 15).

Figure 15: **US on-premise wine sales**

Restaurant and bar/nightclub channels

	2017	2018
Dollars	2.10%	1.10%
Volume	1.50%	0.80%

Source: Nielsen CGA On-Premise Consumer Survey, October 2018

Looking at just restaurant locations, fine dining is down 6.9 percent, while casual dining is up 1.7 percent. The drinking side of the on-premise business is the interesting change — total physical locations are down 1 percent; casual nightclubs have 7.1 percent fewer locations, and neighborhood bars are down 1.6 percent in numbers, while premium bars are up a whopping 19.7 percent.[19]

When we put that together with other information collected, it tells me the trends are following the change in consumer behavior, with boomers rotating out, Gen X now established and millennials rotating in. It says to me that:

- **Expensive and old fashioned is losing ground.** Lost-concept fine dining establishments, dingy nightclubs, my dad's neighborhood pub,[20] family dining chains, and sports bars where TVs are the experience have all become outdated.
- **Casual, quick and cool is gaining ground.** People are increasingly more drawn to polished and fast casual dining, and premium bars.

Why is fine dining getting hit, while premium bars are soaring in growth? Aren't they both marketing a high-end experience? It's all in the definition of what newer consumers value and the specific restaurant's version of experience.

Consumer and concept shifts

In the same way that the fraternal/social organizations in America (Moose, Elks, etc.) vanished with the mature generation aging,[21] dated restaurant and bar concepts that used to satisfy baby boomer tastes are now closing and making room for the millennial consumers.

Having been raised by parents who lived through the Great Depression, baby boomers wanted to feel successful and well-off. They showed it with conspicuous displays of wealth in their high spending years. Going to a French-themed restaurant where people dressed up, where recipes started with a cube of butter and a cup of heavy whipping cream and where the experience was all about the food — that was a boomer's idea of a great night out.

Today, if the food is the experience, it has to start with sustainable, local, fresh, healthy and organic. But the taste has to be great, the price fair and the venue more casual and interesting for young consumers. But alcohol today is finding its way into new retail establishments.

Nontraditional retailers with their own brands are focusing on wine and alcohol to improve or enhance their client experience. Today, you can buy wine and other alcohol to consume on site at Bed Bath & Beyond, Starbucks, Burger King, movie theaters, tap rooms, barber shops and laundromats, as well as through a multitude of digital and same-day retailers. These retailers are expanding and blurring the definition of a bar, wine bar or restaurant. Why go to the bar when you can grab a pint while doing laundry?

Instead of the boomer way, where hospitality at a restaurant meant child seats, new consumers are looking for active social experiences around food and alcohol. Campo di Bocce in California sells Italian food paired with bocce ball. Kaiser Tiger in Chicago offers up a beer garden in the summer and turns it into curling in the winter for their guests. Flight Club, with several locations, is taking pub darts from England and transplanting the experience in a more current concept to the US.

While the wine industry is awakening to discover the changing demographic preferences, the restaurant industry is well into its own evolution of place and engagement.

- The evolving consumer is less formal. You see it in the success of polished casual restaurants (and with business attire trends becoming less formal, for that matter). *It's not about a display of wealth.*
- New consumers value speed. Quality food is expected, but in two-income families where consumers speak in 280-character sound bites and are never unplugged from work, time is a precious commodity. So fast casual has done well thus far, and likewise, home delivery models are taking off to capitalize on the increasing premium being placed on time-saving. *It's not just about the food.*
- New consumers value visual distraction — a show or something that is more than the subject (food/wine). That is why the new consumer will pay for expensive cocktails served with flair, but won't pay for a fancy meal or expensive bottle of wine served in a stuffy restaurant. The right aesthetics within the venue drive enhanced value. *It's not just about the food or drink anymore.*
- New consumers impute value from fresh, healthy, artisan-produced, local and organic ingredients in their food and beverage choices. Today, the wine doesn't speak for itself, as many have insisted in days gone by. The term "quality" has an expanded meaning. *It's not just about the flavor anymore.*

The larger wine companies working through distribution are laser-focused on chain restaurants and creating stories for their brands, as well as giving sellers something to sell beyond the juice in the bottle. Despite visitor declines in restaurants, total sales are improving but with better results through the chains over the independents, even though independents outnumber chains 4:1.[22]

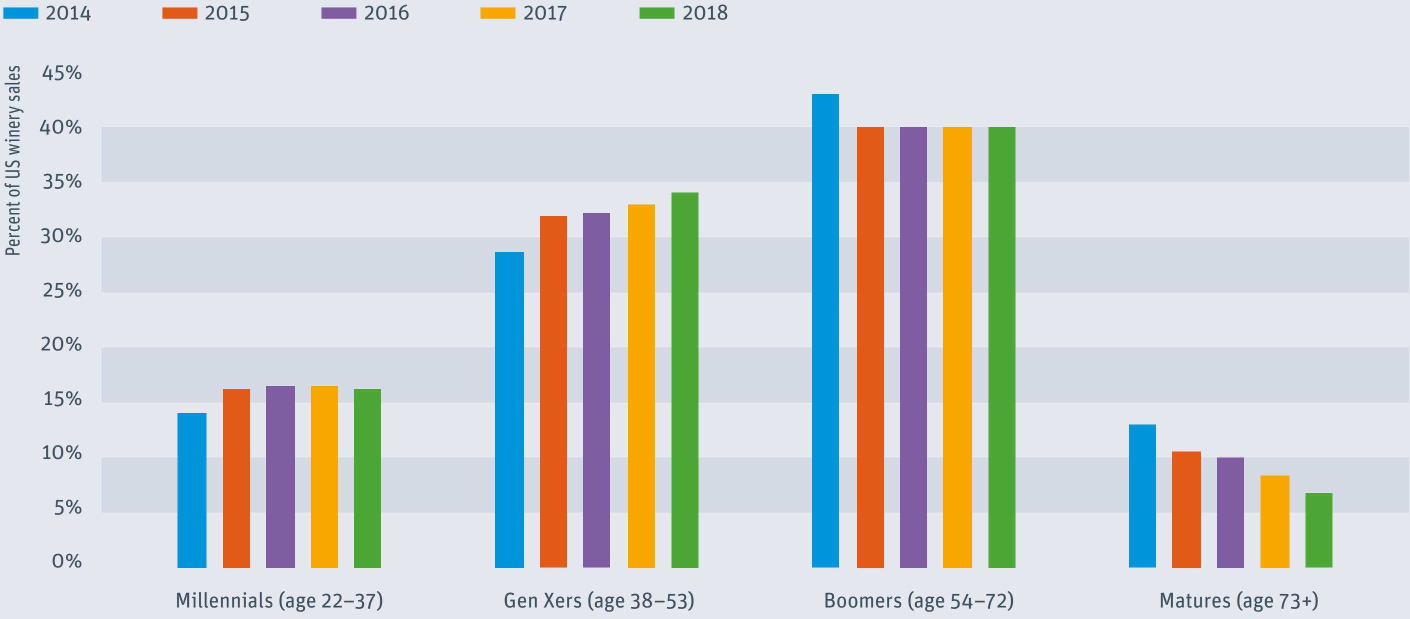
The smaller family wine business is increasingly less effective and disconnected from restaurants.

- Family wineries don't have the same access to the three-tier system that supplies most of the restaurants and chains.
- Family wineries aren't engaging with the new restaurants and bars that are doubling down on experience. Wine is being outpaced by spirits sales and mixologists who are entertaining their patrons, while the wine business is still stuck on producing a product.
- Family wineries are disconnected from the younger consumer who prefers premium cocktails and craft beers over wine, and that's reinforced with the consumer in the current restaurant trends.

The smaller family wine business is increasingly less effective and disconnected from restaurants

Cohorts — their buying preference and current impact

Figure 16: **Average wine consumption by age group**



Sources: 2014–2018 SVB Annual Winery Conditions Surveys

Matures grew up during the Great Depression. Known more as a spirits and beer generation, the matures' wine demand matched their thrifty economic upbringing. The value of alcoholic beverages was highly correlated to alcohol content or the proof per dollar spent. So when an individual from the mature cohort purchased wine, they gravitated to the high-octane fortified wines or low-priced value wines in large formats.[23] Today, matures are the smallest group of wine consumers, representing just 7 percent of the average US winery's sales (see figure 16). The mass-produced wines made for this generation have fallen out of favor gradually and consistently over the past 40 years.

Baby boomers represent the largest native population boom in US history. They first demonstrated their thirst for wine by driving the wine cooler trend[24] in the mid- and late-1980s. Neo-prohibitionism[25] led to short-term declines in wine consumption through the early 1990s. But in 1994, boomers reached a median age of 35 and were established in their careers. With money — and the positive health message of drinking red wine brought to light by the "French Paradox" as further incentive — boomers fueled the largest growth period in wine sales in US history. Today, controlling 70 percent of discretionary income in the US, boomers are still the leading consumers of fine wine and currently represent 41 percent of an average winery's sales.

Gen X is the smallest of the main consuming cohorts today. Largely ignored by the retail press, Gen Xers entered the workforce at a good time economically, and with fewer college graduates competing for careers compared with the generations bracketing them, Gen Xers have had a comparatively easy time building wealth. Today, Gen X is at the peak of their lifetime income and spending. Their presence has been below the radar, but their wine consumption continues to increase, representing 34 percent of an average winery's sales and growing. Indications suggest the majority of current growth in the above $9 wine category is coming from this generation. They are perfectly positioned to surpass the baby boomers as the dominant cohort in fine wine consumption by around 2022.

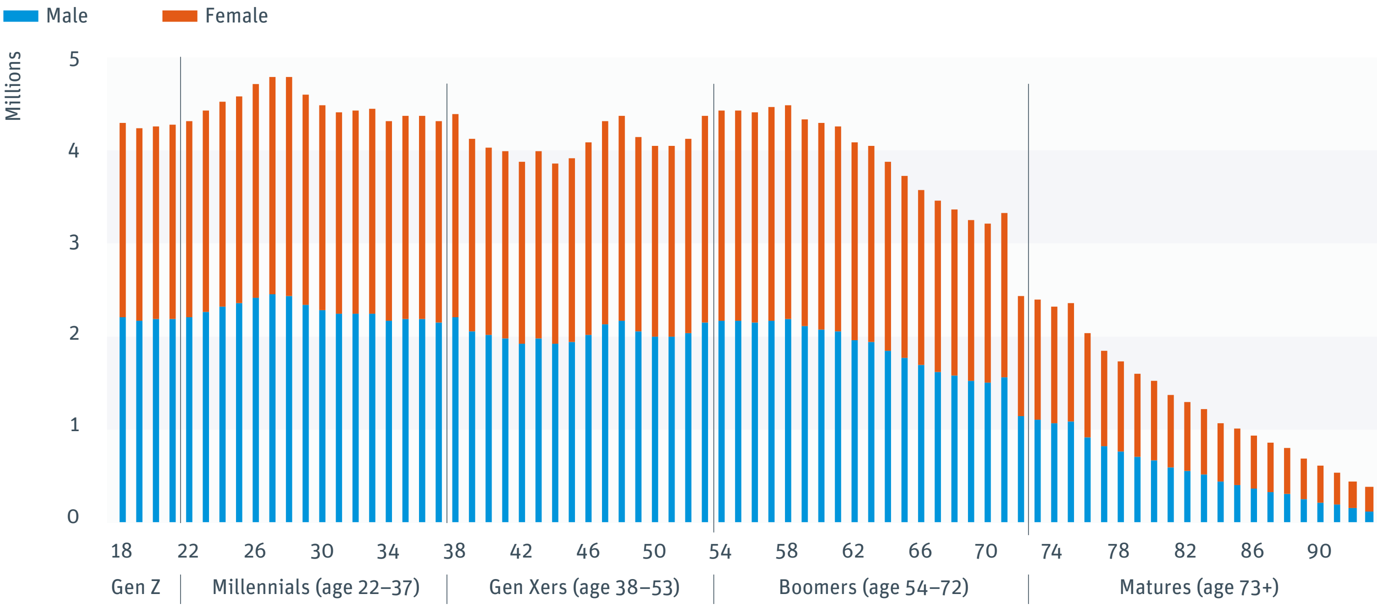
Representing 17 percent of current fine wine consumption is the millennial generation, whose outsized impact has been falsely prognosticated by the wine press[26] for at least a decade. The unfortunate reality is that while millennials have a better appreciation of wine compared with the other cohorts at a similar age, their appreciation has not been reflected in fine wine consumption. The reason? To buy something, a person needs to have both the desire and the financial capacity to make the purchase, and millennials lag prior generations in terms of buying power. We won't see the millennial generation taking over the top spot for wine consumption until 2027. But there is more than financial capacity holding back this consumer's participation in the wine segment. The wine industry isn't organized in messaging anything to this consumer that will resonate. How about: *"The original farm-to-table drink"*?

Image courtesy of Bob McClenahan Photography

6 Demographic preferences and buying behavior

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

Figure 17: **US population by age**



Source: United States Census Bureau Population Estimates 2017

Current demographics provide plenty of clues to understand the sea of change and crosscurrents we are witnessing in wine purchasing behaviors today. We are living with the sunset of the mature cohort who are still meaningful consumers of wine; wealth-laden baby boomers changing their spending patterns due to age, health and retirement concerns;[27] Gen Xers in their prime spending years; and the millennial cohort, which is the next growth opportunity for the US wine industry.

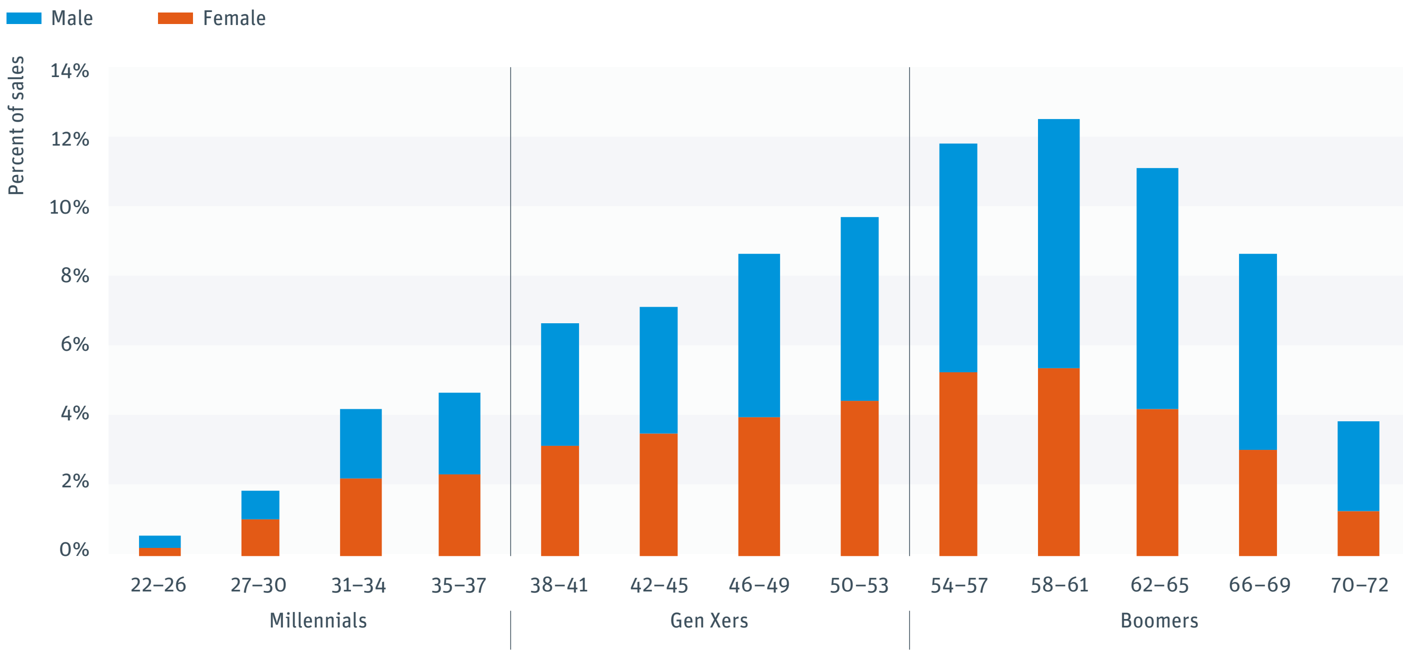
Both the millennial and boomer cohorts have key peaks in population at the ages of 28 and 58 respectively today, putting them at major transition points, with one nearing retirement and ready to scale back their spending and slowing their wine consumption patterns, and the other just getting established in their careers, holding the promise new consumers bring (see figure 17).

The Indulgence Gap

In my view, the issue of greatest concern for the wine business today is the millennial generation's lack of participation in the premium wine category. While millennials hold slightly higher consumption shares in the $8–$11 bottle price points and are interested in wine, they haven't made any noticeable movement to become 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 16).

In my view, the issue of greatest concern for the wine business today is the millennial generation's lack of participation in the premium wine category

Figure 18: **Premium wine buying by age group**



Source: Customer Vineyard, 2018

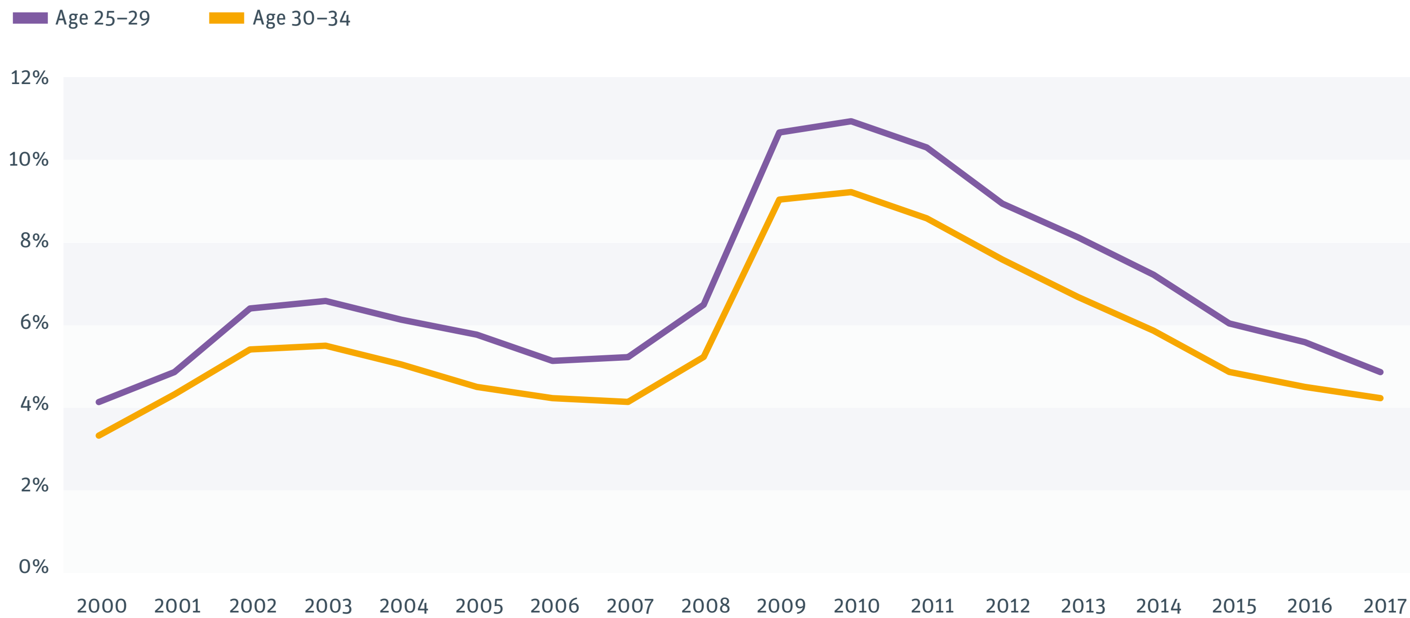
Demographers and industry analysts have mistakenly overestimated the impact of the millennial on the US wine business for some time

A separate data source from Customer Vineyard provides a more granular view of premium wine consumption but is consistent with the findings from Silicon Valley Bank research, showing millennials with even lower participation, between 12 percent and 15 percent, and boomers between 58 and 61 years of age as the largest buyers (see figure 18).

Demographers and industry analysts have mistakenly overestimated the impact of the millennial on the US wine business for some time.[28] The millennials' real progress in capturing premium glass share from boomers has been a delayed promise, however, because of several factors including their early preference for craft beer and spirits, questions surrounding the health benefits of alcohol consumption and a delay in establishing careers and families compared to prior generations.

Not all of that is a dire concern. With the median age at 30, this generation still has time to find their footing. But for today, their retail silence, particularly for discretionary and luxury goods, is deafening.

Figure 19: **Unemployment rate for younger adults**



Source: Bureau of Labor Statistics

Younger consumers financially stunted — reluctant buyers

Millennials are delaying most of the life events that would otherwise create positive economic impact. They are taking longer to graduate from college, delay or never expect to marry,[29] postpone having children[30] and 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.[31] A telling statistic is that more adults aged 30 or younger live with their parents compared to any time since the Great Depression.[32]

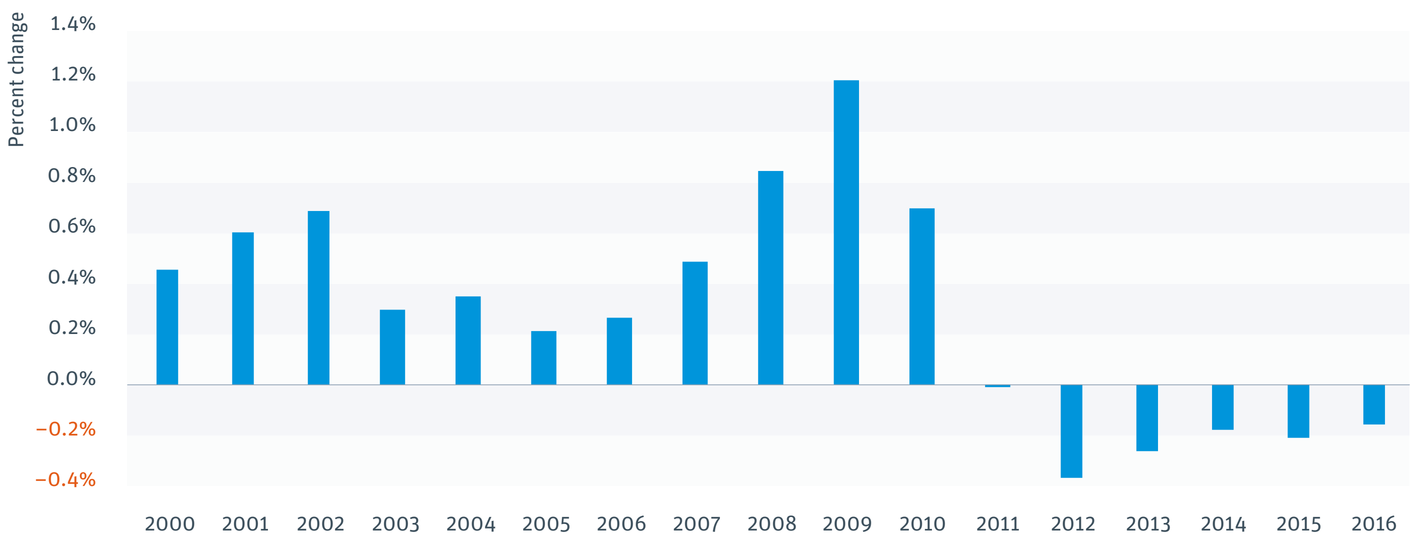
Some of the patterns we're noticing, such as millennials delaying marriage, have more to do with societal changes, but the 2008 financial crisis[33] is at least as much a factor in stunting the millennial generation's spending.[34]

In 2007, there were 18.25 million students attending college, with that year's graduating class starting to look for work. As the economy weakened through the summer, the graduates found themselves shut out of the job market (see figure 19).

Seventy percent of the college graduates had student loans, and with their debt scheduled to begin to amortize upon graduation, they had to make the difficult decision to either take a job unsuited to their degree (bartender, barista, server, etc.) or go back to school to defer the start of their loan payments and add to their debt load (see figure 20).

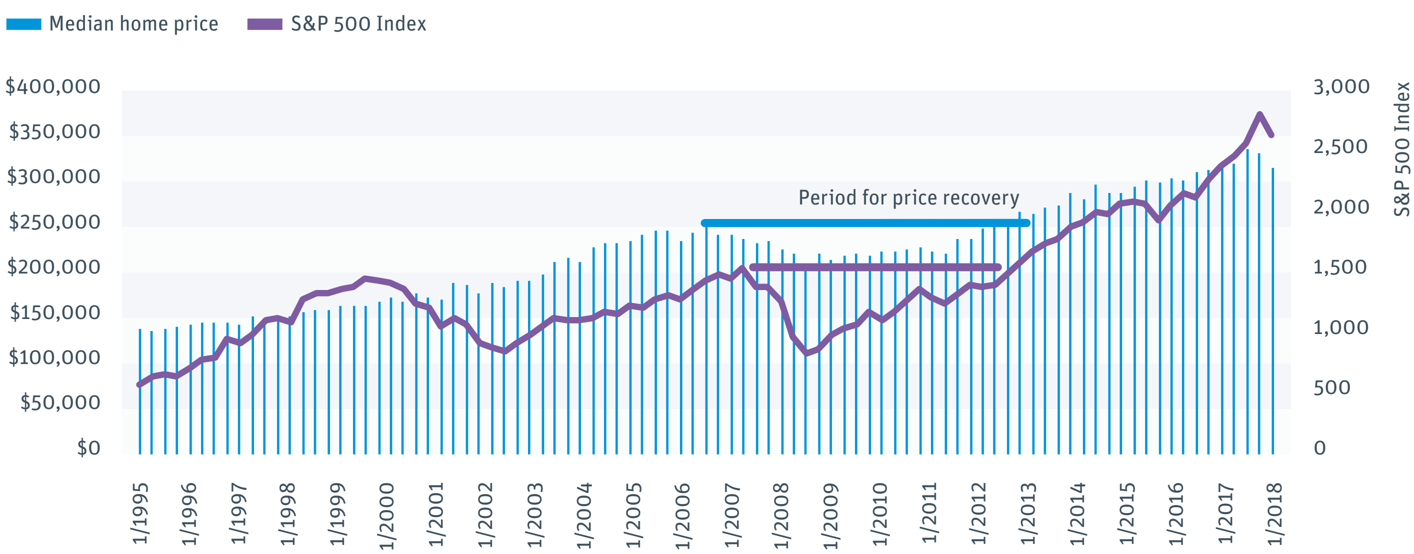
For several years after the crash, those first-vintage recession graduates found themselves standing in place, competing with newly minted graduates for the limited entry-level work while the economy recovered. To this day, many young adults still feel like they are trying to catch up.[35]

Figure 20: **Growth in college enrollment**



Sources: Statistica.com, National Center for Education Statistics, 2017 Digest for Educational Statistics

Figure 21: **Trended price changes to US stocks and homes**



Sources: Federal Reserve, Standard & Poors

Older adults financially recovered — slowing buying patterns

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 needed more stimulus, the Fed began a quantitative easing program,[36] the purpose of which was to calm the banking system, improve the employment situation and stabilize prices. In the process, they reflated 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 their earlier levels. Since then, median home prices have increased by 28 percent and the S&P 500 has risen by 68 percent (see figure 21).

Who participated in the financial recovery? Largely, it was older Americans — Gen X 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. To make matters worse, they were also loaded down with student debt. These are the consumers we're depending on for growth.

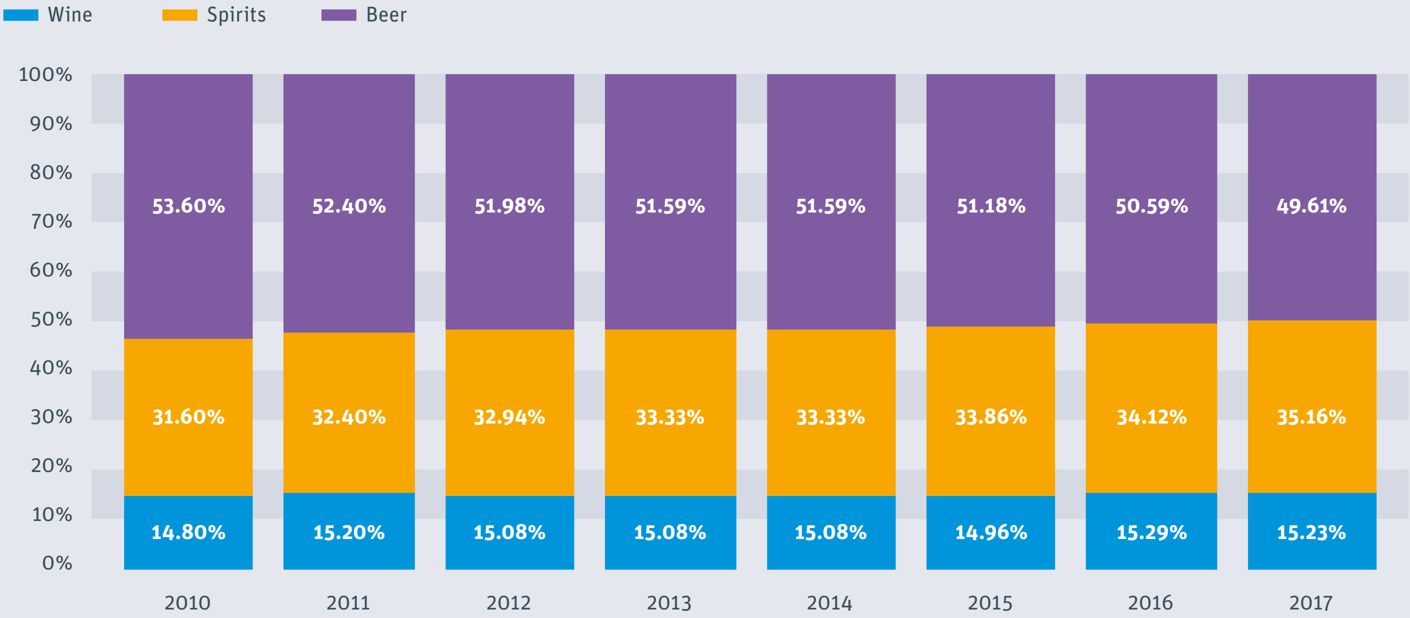
The uneven financial recovery that had millennials stuck in time, and older generations moving ahead, has created a tearing in the evenness and flow of consumer spending that we've framed as the "Indulgence Gap."

The unanticipated delay in spending by the millennial cohort will take time to normalize and look familiar. Millennials will take their place as consumers of luxury items and premium wine in due time, but first they need to make progress in their careers. That means, for a time, they will spend more of their money on basic needs, such as housing and diapers, instead of luxuries, such as vacations, premium cable and fine wine. Economists differ on their projections about the length of the lag, but their estimates range from five to 10 years.

The uneven financial recovery that had millennials stuck in time, and older generations moving ahead, has created a tearing in the evenness and flow of consumer spending that we've framed as the "Indulgence Gap"

The beer example

Figure 22: **Ethanol market share of the US consumer**



Sources: National Beer Wholesalers Association, Alcohol and Tobacco Tax and Trade Bureau

After a strong 20-year run of growth starting in 1961 driven by the mature generation, the beer industry began to see reversals in volume sales as the mature generation aged and the boomer and Gen X cohorts moved away from mass-produced beer.

The large breweries sowed the seeds of their own decline when in the 1970s they continued an intense focus on scale,[37] increased efficiencies, protectionism and marketing to spur new growth, instead of producing the better-quality beer that consumers wanted. That consolidation led to an increasingly blander mass-produced product. Illegal home brewing emerged as a consumer solution, and by 1978 the movement became so popular, Congress passed an amendment that ended the federal restriction on home brewing.[38]

Starting in 1981, beer hit its high point in sales, and total volume began to turn negative. But like premium wine in the US, craft beer emerged as a meaningful growth segment, gaining cult-level popularity in the mid-1990s with younger consumers.[39]

Gen X maintained the interest and growth in craft beer through the 2000s when millennials started adopting and evolving the product as their own. Today, craft beer and imports have each grown significantly, with craft beer now responsible for 12.7 percent of the US beer market by volume and more than 23 percent of the market by revenue.[40]

Like the larger wine producers, the major brewers have been through a period of craft acquisitions and brand introductions to get back into the consumer game, and to this point, it's been a successful approach in muting the otherwise painful volume declines in total beer sales.

With the beer industry losing market share to both wine and spirits (see figure 22), it's not entirely surprising to see anti-wine advertising emerge as a tactic from beer companies.[41] But with volume declines at the doorstep for total wine sales, at some point soon both the beer and wine industries may need to find ways to work together to identify new alcohol beverage consumers.

With volume declines at the doorstep for total wine sales, at some point soon both the beer and wine industries may need to find ways to work together to identify new alcohol beverage consumers

Millennial alcohol beverage preference

Premiumization today spans all the alcohol beverage categories, whether it's craft beer, craft spirits or premium wine. The millennial prefers craft beer and craft spirits over wine, though. Most reports cite the growth of craft beer and spirits as coming primarily from the millennial cohort.

Most of the growth we're seeing in the wine business today is from Gen Xers and boomers. The millennial is responsible for very little of the current growth in wine

In contrast to craft beer and spirits, most of the growth we're seeing in the wine business today is from Gen Xers and boomers. The millennial is drinking wine in the $8–$12 range but counter to most press accounts is responsible for very little of the current growth in wine. The question has to be asked: Is the US wine business losing the young consumer?

While all indications point to the stagnation in the young consumer's move to wine today, we have to note the median age of millennials is only 30 years old, with the oldest 38 years of age. As history shows, it wasn't until boomers reached the average age of 35 that their wine preference really emerged.

That said, other atmospherics leave a question about whether the millennial will ever advance to premium wine as prior generations did.

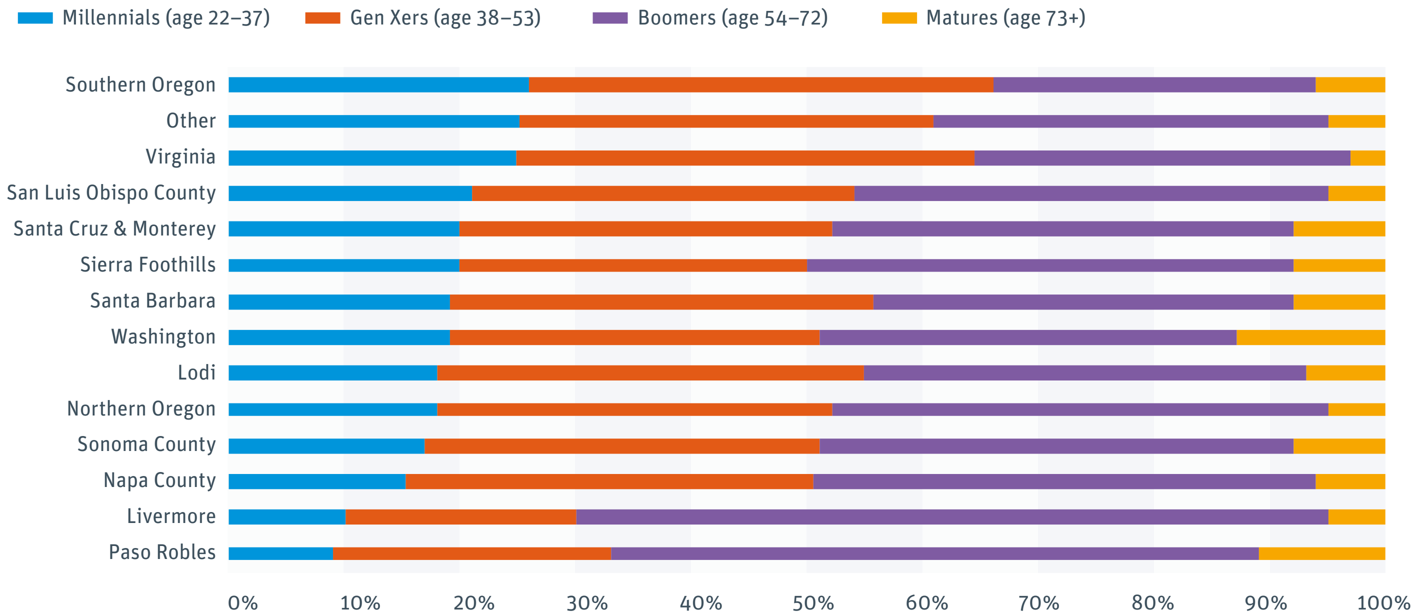
Boomers came into the growing premium wine business when US wine pricing was much lower, even on an inflation-adjusted basis, and they were in a better place financially. They could afford wine. Beer was falling out favor with the large producers paying inadequate attention to better-quality options,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

The millennial is a frugal hedonist as I've often said. They are looking for value, but in the premium segment.

In figure 23, the trend is apparent — millennials show more impact in the lower-priced wine regions at the top of the chart. Obviously, there are regional implications for counties at the bottom and questions to be answered if the cohort stands off from the higher-price-point American Viticultural Associations (AVAs).

Other atmospherics leave a question about whether the millennial will ever advance to premium wine as prior generations did

Figure 23: **Regional consumer demographics in 2018**



Source: 2018 SVB Annual Winery Conditions Survey

Cumulative negative health messaging

Neo-prohibition, the original

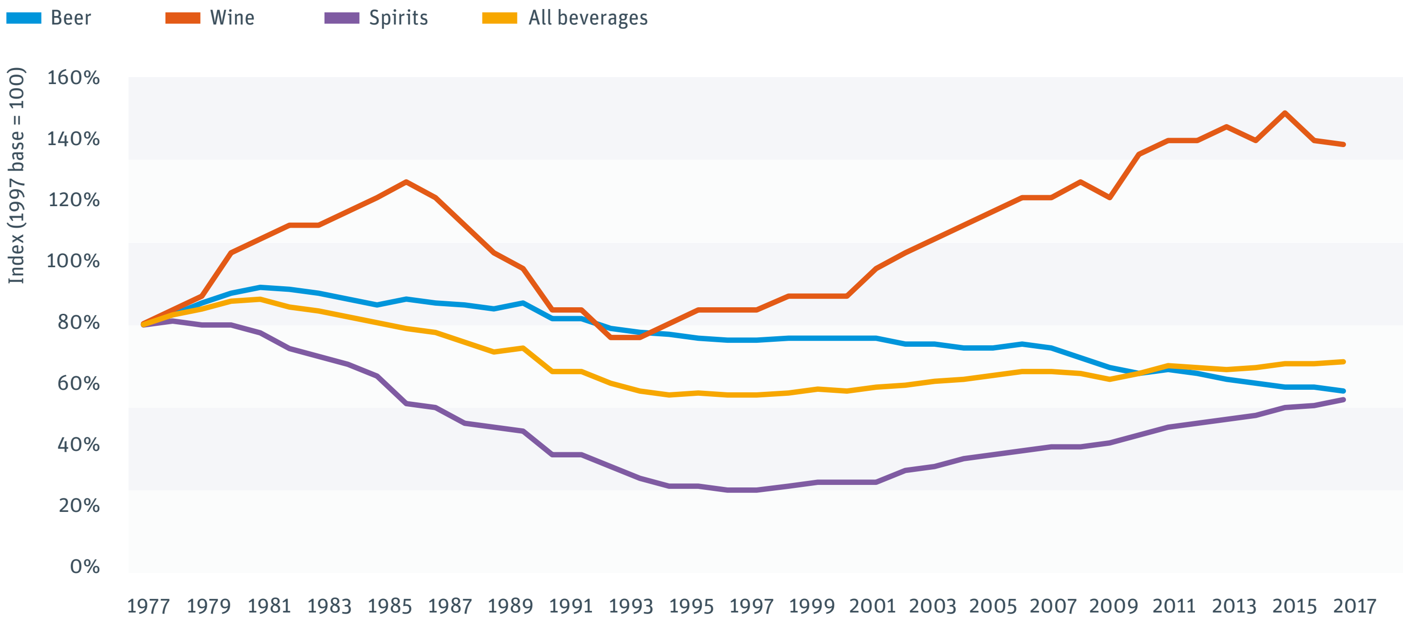
Starting in the early 1980s, a group of loosely related private and public advocacy organizations, special interest groups and governmental agencies organically aligned with the goal of reducing or eliminating the harmful effects of alcohol consumption in the US.

Like the Prohibition movement earlier in the 20th century, neo-prohibition included diverse groups such as religious organizations that viewed drinking alcohol as sinful; activist organizations whose primary goal in this case was eliminating deaths from drunk driving;[42] 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, which included government health warnings about alcohol and the addition of a government warning on alcohol beverage labels

Figure 24: **Percentage change in per capita ethanol consumption in US**



Estimated data for 2017

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

The growing clamor culminated with the Anti-Drug Abuse Act of 1988,[43] 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.[44]

The neo-prohibition message was confronted on national television on November 17, 1991, when 20 million viewers in the US heard the CBS *60 Minutes* broadcast on the French Paradox,[45] immediately causing a spike in red wine consumption. That was followed in the mid-1990s with widespread acceptance of the Mediterranean diet[46] and later punctuated with the publicized work of Dr. Arthur L. Klatsky,[47] a Kaiser-Permanente cardiologist who demonstrated the health benefits of moderate alcohol consumption over both heavy and non-consumption.

With the positive medical reports, per capita wine consumption soared starting in 1994 when baby boomers hit their consuming stride. Spirits consumption showed some modest positive change shortly thereafter due to Dr. Klatsky's findings and the premiumization trend (see figure 24).

The cumulative weight of the three studies, proving 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, though. Since the French Paradox story was aired on *60 Minutes*, numerous health organizations have expended considerable time and money to produce alternative research that calls into question the original research findings.[48]

With the studies coming to different conclusions and causing confusion, and with a refresh of Government Dietary Guidelines at issue, 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."[49]

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

The conclusion of the report was "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, gaining significant traction. Europe is ahead of the US in directing consumer sentiment away from alcohol consumption.

This year in Europe, 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 wine is bad for you.[50] The cumulative weight of the international messaging and anti-alcohol studies has been effective[51] and has once again emboldened US regulators to promote additional restrictions on alcohol consumption.

In January 2018, the National Academies of Sciences, Engineering and Medicine[52] produced a study that supported their call to lower the alcohol-impaired driving limit from 0.08 to 0.05 nationally.[53] Despite overwhelming evidence that counters the study's findings,[54] 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. Texas and Oregon are now debating lowering their DUI limit to 0.05.[55]

Quietly, in January of 2018, the US Department of Health and Human Services (HHS) deleted the Government Dietary Guidelines that said moderate drinking could lower the risk of heart disease,[56] ignoring their own prior findings by the NIAAA.

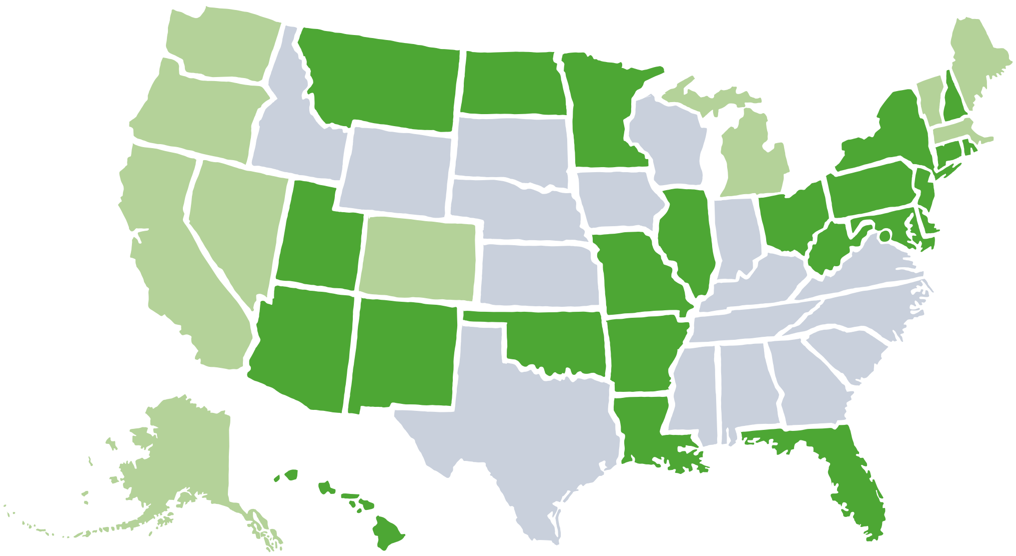
We have returned to the neo-prohibition era in this debate. Alcohol consumption is being equated to opioid addiction again.[57] The government is rolling back dietary guidelines and issuing new directives from the US Preventive Services Task Force that recommend all primary care physicians routinely ask about, and counsel patients on, unhealthy levels of alcohol consumption.[58]

The youngest consumers are health focused, explaining the explosive growth in health beverages in the US.[59] Compared to the boomer generation who ate "if it wasn't bad for you," the current generation wants to consume things that "are good for you."[60] Influenced by the current messaging, young consumers are consuming less alcohol than prior generations.[61]

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

In January of 2018, the US Department of Health and Human Services (HHS) deleted the Government Dietary Guidelines that said moderate drinking could lower the risk of heart disease, ignoring their own prior findings by the NIAAA

Figure 25: **Marijuana legalization status**



Source: Governing.com

Cannabis

Following the passage of Amendment 64 in Colorado and Initiative 502 in Washington in 2012, both of which legalized the recreational use of marijuana for the first time in the US, the question started to be asked about substitution. Is cannabis a strong substitute[62] 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[63] 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. One analyst who reviews tax data 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 cannabis was actually a complement[64] and encouraged wine sales in the same way that higher popcorn sales stimulates added butter sales?[65]

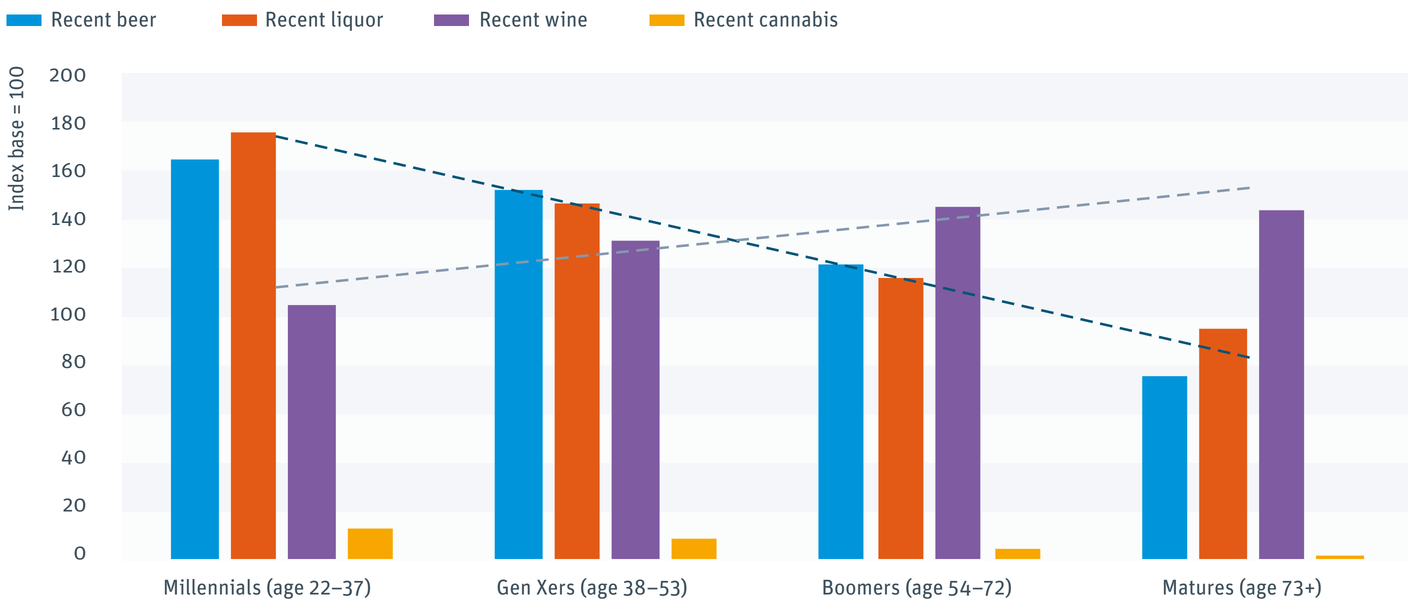
I don't think anyone doubts cannabis is a growth industry — particularly if we take into account all the illegal sales of marijuana that were already taking place. We can just pretend we're starting from zero, except the Cannabis Consumers Coalition conducted a well-run study and determined that among other things, 64 percent of current marijuana buyers had been users for 10 years or more.[66] That 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. Earlier in 2018, *Forbes* printed an article[67] that covered collaborative research[68] between the University of Connecticut, Georgia State University and Universidad del Pacifico Lima that concluded 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.[69])

On the other hand, research released in Sweden this year[70] covering observations from 1989 to 2016 among more than 140,000 adolescents concluded that marijuana was neither a substitute for nor a complement to alcohol.

Figure 26: **Current consumption of alcohol and cannabis by cohort**

Adjusted for current consumer base of each



Sources: Scarborough Research, SVB Analysis

So if there is a substitution effect of cannabis for wine, it will show up in younger consumers' purchasing patterns

There are some practical facts to consider in arriving at a conclusion. While there is a range of data, most reports suggest 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.[71] Somewhat regular alcohol consumers represent around 60 percent of the adult population.[72] Given the disparity in consumer populations, it would be difficult for the 13 percent to strongly influence the other 60 percent, even if all 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 most of the research I've reviewed. The typical description of a regular cannabis user today is a 26-year-old male. So if there is a substitution effect of cannabis for wine, it will show up in younger consumers' purchasing patterns.

Figure 26 represents information I pulled together from several different research reports and sources. It shows the difference in preference between beer, liquor, wine and cannabis in the adult population in the US. Adjusting for the difference in the consumer base, you can see how a young consumer skews more to beer and liquor and less toward wine, but as consumers age, they develop a preference for wine.

Millennials show the strongest preference for spirits, beer and cannabis and the lowest preference for wine among all cohorts

Millennials show the strongest preference for spirits, beer and cannabis and the lowest preference for wine among all cohorts. However, as consumers age, their preference for liquor, beer and cannabis tends to drop, while their preference for wine increases.

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.

With this kind of investment and promotion, what we see today in consumption patterns could easily change

Just this year, one of the world's largest alcohol producers, Constellation Brands, invested $4 billion in Canadian cannabis producer Canopy Growth.[73] Later in 2018, Francis Ford Coppola partnered with a Humbolt County, California, marijuana farmer to produce a product line under his brand.[74] 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.[75] With this kind of investment and promotion, what we see today in consumption patterns could easily change.

My conclusion thus far is marijuana and fine wine have largely different social uses and aren't substitutes or complements, which mirrors the Swedish finding. That's not to say a premium wine consumer would never inhale. It's saying 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, so I could envision some substitution effect in lower price points for beer and spirits, since the user today is indexing younger where the preference is for spirits and beer instead of wine.

The promotion of cannabis could change the dynamic if more companies and celebrities like Francis Ford Coppola start to promote the product. For today, we can say cannabis isn't helping wine consumption, and for the young consumer, legalization is probably hindering the adoption of wine as a preference.

Cannabis isn't helping wine consumption, and for the young consumer, legalization is probably hindering the adoption of wine as a preference

7 Forecasting wine demand

Taking a measured look at all of the research on consumer demand and information we have on sales channels gives us the opportunity to see what's impacting wine sales today and come to a conclusion about sales tomorrow.

- The mature generation is having a smaller impact on consumption due to age and fewer consumers.
- For the boomers, there are several impacts. While there are 10,000 retiring each day, the good news is that the cohort is showing they are going to work past retirement age, live longer and consume wine longer than expected. On the other hand, mortality and health are slowing the volume they consume today, and the acceptance that they will soon be living on fixed incomes is reducing their spending on wine for years to come and causing them to be more value conscious.
- Gen X is the current growth cohort for the wine business. They consume wine in quantity and are near the peak of their spending years. A smaller generation to start, their ability to continue to support sales growth in the wine business will be limited, but next time you see one of the forgotten Gen X drinking wine, thank them for what they do!
- The millennial is both the greatest opportunity for the wine business and the cohort most at risk of disappointing on expectations tomorrow. Today, they are more spirits and beer consumers. Their focus on health against the backdrop of reports focusing on the negative health effects of alcohol consumption makes them likely to be lower-volume consumers of wine in the future compared to prior generations. The Indulgence Gap is retarding their spending on premium wine, and cannabis is likely playing a small role in delaying their spending as well.

The millennial is both the greatest opportunity for the wine business and the cohort most at risk of disappointing on expectations tomorrow

Because of the aforementioned, price pressure for wine is not up. In fact, it's fair to say at this point that premiumization has almost run its course, with slowed volume and no clear tailwind pushing consumption substantially higher.

The strong US economy has been a contributing factor to better sales overall and particularly important for the performance of premium wineries in 2018. For the luxury end of the market, the wealthy will be there to buy even if the economy becomes softer in 2019.

Looking out for the next five years, in an interesting collision of consumer preferences, as millennials age and become more substantial in the workforce, I believe they will gradually spend more on wine, as prior generations did, but perhaps at reduced volumes and average price points. At the same time, retiring boomers will move down the price ladder and into more modest bottle prices as they also pull back in their volume purchased. The result is that both generations will consider price more important than the average consumer does today. In the next 10 years, there will be a price range for premium wine sales where the two major consuming cohorts meet; that sweet spot will grow and become important to all wine companies.[76]

In the next 10 years, there will be a price range for premium wine sales where the two major consuming cohorts meet; that sweet spot will grow and become important to all wine companies

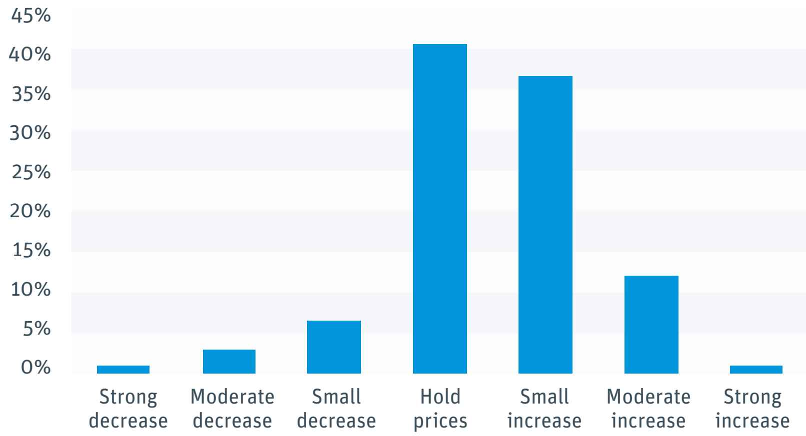
Our forecast is that Gen X will surpass the boomers as the dominant purchase cohort in 2022, and the millennial cohort will surpass the Gen Xers by around 2027 to become the largest fine wine–consuming generation.

For the off-premise retail store channel, sales will grow between 0.5 percent and 2.5 percent, while volume will decline between negative 0.5 percent and positive 1.5 percent. The fine wine segment will show growth consistent with 2018, between 4 percent and 8 percent.

8 Bottle pricing trends

The consumer's willingness to pay more for better quality wine is called trading up in some industries, but it's called "premiumization" in the wine business. Besides a butchering of the English language, it's really not an apt term because "average" often measures the wrong thing.

Figure 27: **Wine producers hope to take price increases in 2019**



Source: 2018 SVB Annual Winery Conditions Survey

Figure 28: **Average price increases by SKU and price bands**

52 weeks ending 11/2018

Current price point	Average annual change	Average percentage change
$0–$2.99	$0.05	2.01%
$3–$3.99	$0.05	1.47%
$4–$4.99	–$0.07	–1.03%
$5–$5.99	–$0.08	–0.83%
$6–$6.99	–$0.01	–0.12%
$7–$7.99	$0.01	0.26%
$8–$8.99	–$0.01	0.00%
$9–$9.99	–$0.05	–0.41%
$10–$10.99	–$0.06	–0.44%
$11–$11.99	–$0.03	–0.14%
$12–$12.99	–$0.02	–0.11%
$13–$13.99	–$0.01	0.00%
$14–$14.99	$0.01	0.14%
$15–$15.99	–$0.05	–0.30%
$16–$16.99	–$0.05	–0.22%
$17–$17.99	–$0.17	–0.89%
$18–$18.99	$0.07	0.45%
$19–$19.99	$0.02	0.19%
Average	**–$0.02**	**0.00%**

Source: Nielsen Beverage Group, November 2018

In the case of wine, we are really seeing a decades-old trend of decline in market representation from the mature jug-wine consumer, juxtaposed with the emergence of the premium wine–loving baby boomer and Gen X consumers.

In our 2018 Annual Winery Conditions Survey, we asked family winery owners about their bottle pricing expectations for 2019 (see figure 27). Those owners have been dealing with rapid cost escalation in fruit price and labor rates and a more difficult selling environment requiring additional sales and marketing expenditures, both in DTC and with wholesalers. Not surprisingly, half of the respondents expect to take some type of increase.

But what you want and what the market will bear are separate issues. When the year is up, we might find 20 percent who were able to execute on minimal price increases[77] in the above $20 segment but likely flat to lower bottle price in below $20 price segments.

What happened to premiumization? Shouldn't price hikes be automatic? While consumers are still spending *slightly* more on average, premiumization as we have known it is in its final phases in this cycle. It was actually very difficult to increase prices in 2018, as detailed in figure 28, which is a review of narrow pricing bands and established brands within those bands sold in retail stores.

As indicated, the average bottle was barely able to hold its price last year across all price points, with the exception of the highest price bands where less than 0.5 percent increases were possible.

In the introduction, we asked why, with the economy hitting on almost all cylinders and a large cohort at the consumption doorstep, is sales growth sagging? I think we've answered the question now. The boomers are rotating off their market-leading place as wine buyers, and millennials, as a consequence of damaged financial standing, cumulative negative health messaging and cannabis legalization, are not adopting wine as hoped.

So what do we do about it?

9 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 that strategy has always been limiting.

The basic philosophy under which the tasting room and club models are executed is a reflection of 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 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 the focus on value and brand creation has since fallen on the tasting room and wine club to the exclusion of other strategic options.

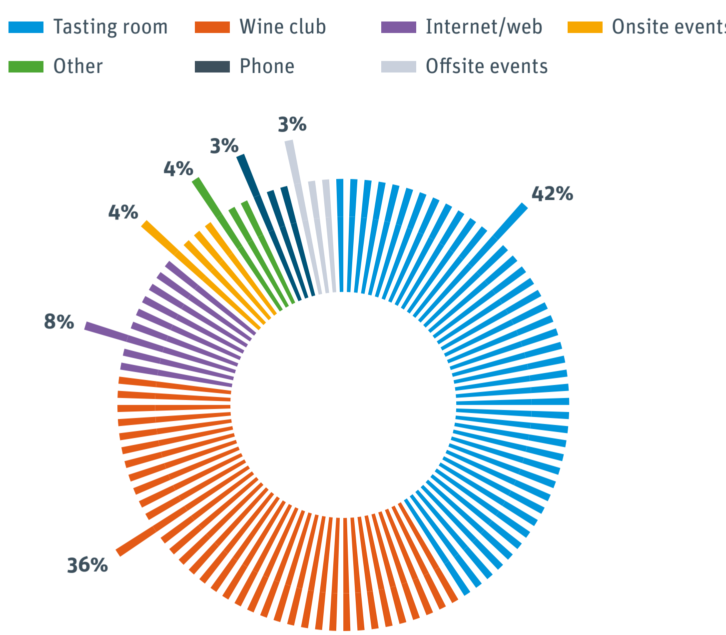
In an increasingly digital world, what industry would insist that its consumers first come to its place of business to buy its wares?

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 come to its place of business to buy its wares?

That is what wineries insist upon today with the tasting room and club models. But now growth even in that important channel is also showing fatigue.

Figure 29: **Direct sales mix for the average winery**



Source: DTC Sales Mix for the Average Winery

Cracks in the tasting room model

The average winery today receives 42 percent of its DTC revenue from tasting room sales and 36 percent of its sales from the wine club (see figure 29). This means of a winery's direct sales today, 78 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 facility by some means of transportation, pay for wine at 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 visitors who wander into wine country without a plan. They work with concierges, livery companies and tourism bureaus.

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

While average checks are still increasing from tasting room sales, in Napa and Sonoma counties and the state of Washington, visitation has been dropping noticeably for some time (see figure 10). Oregon, Virginia and New York, with lower-priced SKUs and tasting fees, are demonstrating better success. Even more perplexing is the realization that those same places showing decelerating tasting room traffic are also experiencing record levels of tourism in their area. How can that be explained?

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

Today, if your full focus is on a tasting room and club strategy and you put balloons in 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, or 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.

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 doing what you're already doing. The growth isn't in delivering better hospitality, seated tastings, planning club events or refining your hospitality training.

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

- 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"

Direct to consumer — where we go next

When I try and describe where we have to go next as a family-run industry — taking the experience on the road, getting in front of consumers who are a perfect fit for your wine but live 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.

We have to take the experience on the road, and we need ideas

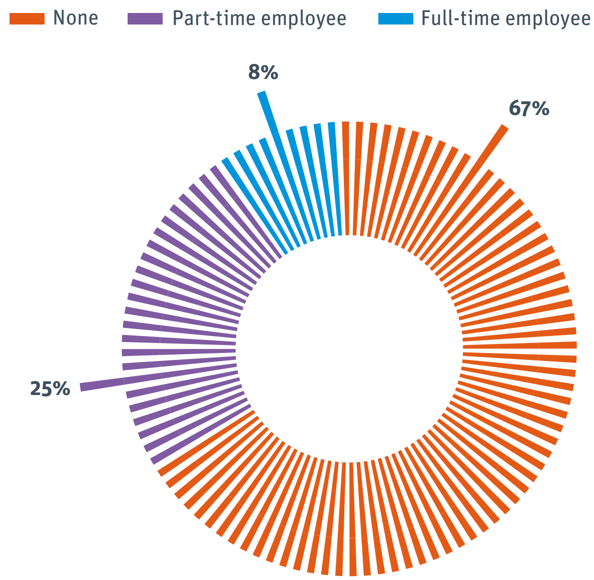
The reality is that nobody has the formula for selling wine to a consumer who has never tasted or heard of your brand. New customer acquisition away from the tasting room is still largely untested and an unknown, so the solutions will evolve with new and transformed service providers and consultants, 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 a charity wine auction to raise money for something important regionally. 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 favorites list of music 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.[78]

Figure 30: **Consumer data analytics person**



Source: 2018 SVB Annual Winery Conditions Survey

In the SVB Annual Winery Conditions Survey this year, we were curious to learn how many wineries had someone assigned to maintaining their customer database and analyzing consumer data. Today, 8 percent of wineries have a full-time position covering that role, and another 25 percent have someone doing it part time (see figure 30).

For the two-thirds of wineries that don't have that role covered, this 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[79] that are being evolved for the wine business to help target new consumers who are outside the current model and keep the ones you have longer.

10 Grape harvest, M&A and supply

The wine business is cyclical. Some years, we have a light yield and are underplanted to a variety, causing spikes in grape prices. Other years, we are overplanted following a string of heavy years, lowering prices. Any action we take in the short term seems to have marginal predictable impact because cycles are so long-lived and Mother Nature in the end has veto power.

Figure 31: **Regional harvest quality in 2018**

Source: 2018 SVB Annual Winery Conditions Survey

2018 harvest

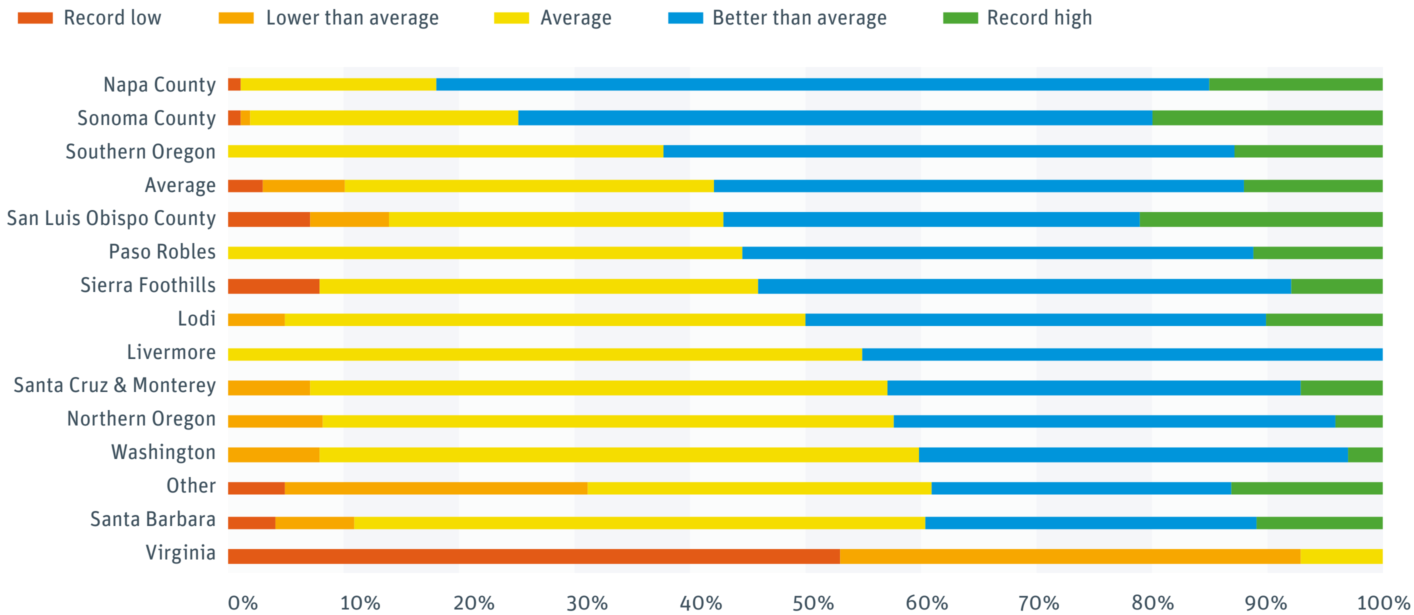
Although California and Washington seldom have the kind of harvest variation that France does, we do have our share of vintage variation — and 2018 was one of those dream years, with Napa taking the award for the combination of best quality and yield. But most counties and regions reported both above-average yields and great quality (see figure 31).

Virginia was the major exception due to summer hurricanes that ruined both the yield and quality of the year.[80] New York did not participate sufficiently in the survey this year to be broken out but is represented in the “Other” region. It, too, had significant rain to deal with but nothing as severe as Virginia.

The 2018 vintage in the Willamette Valley was another best of show in a string of them. Defining the normal climate in Oregon is anyone’s guess today. In 2018, both spring and summer presented dry conditions without heat spikes and were followed by cool fall conditions that extended hang time. Other areas within Oregon reported one notch below the perfect conditions of the Willamette Valley.

Washington had another strong year. Growers described near-ideal conditions with the exception of some hot temperatures that gave way to a cooler fall and an ideal harvest.

Figure 32: **Regional harvest yield in 2018**



Source: 2018 SVB Annual Winery Conditions Survey

Bulk wine and grapes

The California bulk market was described as being "in balance" throughout 2018 before the harvest, but sluggish bulk sales belied a different situation, with buyers and sellers wondering who was bluffing. Sellers were holding on, expecting more than buyers were willing to pay through most of the year. We forecasted the 2017 California yield would come in at 3.8 million tons in this report last year, but the actual yield came in with a surprise at 4 million tons as a result of a heavier yield in the Central Valley.

While the heavy 2017 harvest had something to do with sluggish grape sales through 2018, sales and volume declines noted earlier in this report also had a role to play as wineries apparently weren't bluffing. They had all the wine they needed.

Based on early estimates for the 2018 harvest, expectations are for a larger and perhaps record yield this year in California and Oregon. In the annual "anyone's best guess" contest, we are expecting a record California harvest of 4.45 million tons, reflecting the nearly 60 percent of wineries that are reporting better-than-average yields in figure 32.

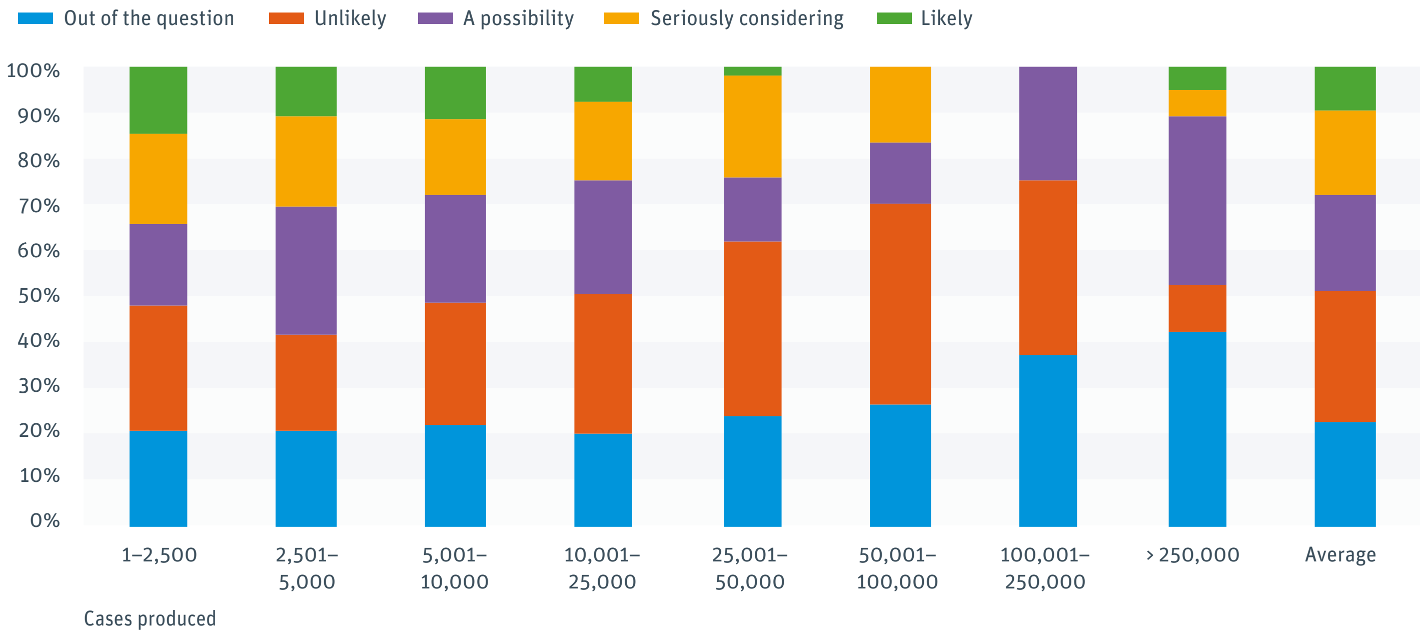
Subsequent to the 2018 harvest, the bulk market has rolled over and capitulated, and now oversupply has become a common topic. Moving by the liar's-dice phase of the cycle, we are now showing our cards and getting to that part where we see how far grape and juice prices will drop before buyers are interested again.

Finding some improved pricing on grapes will be useful for California wineries that have seen five-plus years of price increases, which have been difficult or impossible to pass on to consumers.

For growers hoping to see a quick recovery from expected price declines, the message is mixed. While this isn't the year 2000 when we were severely overplanted, we won't be able to grow our way out of this oversupply as we did back then. The oversupply could be shallow or extended, depending on what happens to the 2019 harvest, and/or any other demand shock such as economic softness. Another record yield would not be welcome under any scenario.

In the Pacific Northwest, Oregon will have a record yield due to non-bearing acreage beginning to produce, combined with excellent 2018 growing conditions. Washington should be near a record yield but perhaps just below when the 2018 harvest is counted up.

Figure 33: **Likelihood of selling winery in five years**



Source: 2018 SVB Annual Winery Conditions Survey

Land and M&A

Despite the heavy unrelenting upward trends 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. We aren't predicting the decline of vineyard prices — just a pause for all but the most sought-after pieces. Oregon will likely see increasing vineyard values for another year.

With the major players largely content and digesting their current acquisitions, the M&A market will now slow down and evolve to a place where the sellers will discover they have waited just a little too long to begin the marketing process, and sales prices will fall somewhat from the prices being paid more recently, just because there are fewer buyers.

Figure 33 is from the 2018 SVB Annual Winery Conditions Survey, and you can see the wineries considering sale today fall in the more difficult-to-sell, smaller case–production categories.

Vineyard transactions are likely to continue for the present. We are noting that some financial investors are taking some chips off the table already, but expectations and patience for financial investors aren't typically the same as a family winery that can enhance the financial return with vertical integration and a longer time horizon for a hold.

The M&A market will now slow down and evolve to a place where the sellers will discover they have waited just a little too long to begin the marketing process

Of course, there will always be the buyers who have cash and will bottom feed, larger production facilities with strong brands that will attract buyers, and the iconic historic properties that come up once in a lifetime and attract very high prices.

With smaller growth options, we may see an increasing appetite for the acquisition of new esoteric brands that might already have wholesale presence and could help increase sales in a company with otherwise flattening growth.

Overall, there will be a diminishing appetite for acquisitions through 2019 compared to the pace of closings represented in figure 34.

Figure 34: **Selected closed M&A transactions in 2018**

Closing date	Target	Acquirer	Assets acquired	Location
January	Layer Cake and Cherry Pie	Vintage Wine Estates	Brands	Napa, California
January	Benton-Lane Winery	Huneeus Vintners	Brand and facility	Monroe, Oregon
January	Tamarack Cellars	Vintage Wine Estates	Brand and tasting room	Walla Walla, Washington
January	Maison Bleue	Willamette Valley Vineyards	Brand and tasting room	Walla Walla, Washington
January	Bellacosa	Deutsch Family Wine & Spirits	50% interest in brand	North Coast, California
January	Lolea Sangria	Zamora Company	Brand	United States
February	Cross Canyon Vineyard	Hancock Natural Resource Group	Vineyard	Paso Robles, California
March	Freixenet S.A.	Henkell & Co.-Gruppe	50.7% of outstanding shares	Sant Sadurni d'Anoia, Spain
April	Acrobat	Foley Family Wines	Brand	Eugene, Oregon
April	Vintage Wine Estates	AGR Partners	Minority investment	Santa Rosa, California
April	Heitz Cellar	Gaylon Lawrence	Brand, facility and vineyards	St. Helena, California
May	Rancho Real Vineyard	E. & J. Gallo Winery	Vineyard	Santa Maria, California
May	Sierra Madre Vineyard	E. & J. Gallo Winery	Vineyard and Sierra Madre trademark	Santa Maria, California
June	Accolade Wines	Carlyle Group	100% of company	Sydney, Australia
June	Various locations	E. & J. Gallo Winery	Brand	Multiple regions worldwide
June	Codorníu Raventós Group	Carlyle Group	Majority stake	Haro, Spain
July	Outpost Wines	AXA Millésimes	Brand, facility and vineyards	Napa, California
August	Kosta Browne Winery	Duckhorn Wine Company/TSG	Brand, facility and vineyards	Sebastopol, California
August	Beso Del Sol Sangria	The Wine Group	Brand	Sourced in Castilla-La Mancha, Spain
August	Weidert Farm	Farmland LP	Large farm (vineyard potential)	Walla Walla Valley, Washington
August	Truett-Hurst Inc.	Precept Wines LLC	Wholesale (control label) business	Healdsburg, California
August	Stony Hill Vineyard	Long Meadow Ranch	Majority stake in brand, facility and vineyards	Calistoga, California
September	Duck Pond Cellars	Great Oregon Wine Company	Brand, facility and vineyards	Dundee, Oregon
September	Swanson Oakville Vineyards	Huneeus Vintners	80-acre vineyard with winery site	Oakville, California
October	Parker Station	Guarachi Wine Partners	Brand	Central Coast, California
October	Vista Hills Vineyard	The Family Coppola	Facility and vineyards	Dundee, Oregon
October	7 Deadly Zins	The Wine Group	Brand	Lodi, California
October	Saracina Vineyards	Taub Family (Palm Bay International)	Brand, facility and vineyards	Hopland, California
November	Qupé	Vintage Wine Estates	Brand	Central Coast, California
November	Shenandoah Vineyards	Michael Shaps Wineworks	Brand, facility and vineyards	Shenandoah Valley, Virginia

Source: Zepponi Company

11 Endnotes

1. Mediterranean Diet, *The American Journal of Clinical Nutrition*, Volume 61, Issue 6, June 1, 1995, Pages 1402S–1406S. The French Paradox, *The Lancet*, Volume 339, Issue 8808, June 20, 1992, Pages 1,523–1,526.
2. List of largest wine-consuming countries.
3. This report was written in November 2018 when the US economy was very strong. Some US equity weakness associated with a range of factors, including a desynchronized global growth theme, fear over a trade war, Fed actions on interest rates and a strong dollar, has made many wonder if we're near an economic peak with nowhere to go but down. Nevertheless, outside of a volatile stock market, the fundamentals of the economy still remain strong as of this writing. Goldilocks Economy.
4. Richard Fry, "Millennials Projected to Overtake Baby Boomers as America's Largest Generation," *Pew Research Center*, March 1, 2018.
5. The Winery Owners' Confidence Index is created using the Annual Winery Conditions Survey that's conducted in October of each year. Winery owners are asked whether a given subject is a positive, negative or neutral factor in running their business. For example, if an owner viewed the economy as a positive factor in their current business success, they would answer positive. The raw positive answers are netted against the negative responses to create the index.
6. Esther Ciamachilli, "Heavy Rains Have Ruined Virginia's Wine Grapes This Year," *WAMU*, October 18, 2018.
7. Linda Jones McKee, "Challenging Growing Season in New York," *Wine & Vines*, September 27, 2018.
8. I'm never wrong. It's the alternative facts that mess up my always-accurate predictions.
9. Silicon Valley Bank's Peer Group Analysis (PGA) Database is a proprietary information set that includes both client and non-client 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.
10. Wines Vines Analytics, November results.
11. Note: If you are a small winery, and if the industry ever enters an extreme shortage phase again, when a wholesaler tracks you down and tells you they have changed and will never leave you, before handing over all of your sales, consider talking to a therapist.
12. In normal demand theory, an increase in price leads to a decrease in volume sold. In the case of wine bunching around $9, the change from sales declines to sales growth is so stark, a producer selling a wine for $8.75 will probably see volume increase if they increase the price to $9.25. I believe that makes the below $9 price segment economically inferior goods, and above $9 normal goods, and at some point higher, the demand curve is straight up and down when it becomes a luxury good. For someone working on their Ph.D. in economics, there is a research paper in there. Let me know when you figure it out.
13. Wines Vines Analytics shows total US wine sales, including sales from DTC, were up 4 percent in dollars through October, compared to Nielsen Beverage data that shows total US sales up 1.4 percent.
14. "Central Valley Growers Pulling Grapevines," *California Agriculture*, Volume 57, Number 3, July 1, 2003.
15. "Growing the USA Market Is the Focus Following 20 Per Cent Growth in Australian Wine Exports in 2017–18," *Wine Australia*, July 24, 2018.
16. Gabriel Stone, "Chile Adapts Strategy to Global Change," *The Drinks Business*, September 10, 2015.
17. Sam Meredith, "Argentina's Central Bank Hikes Rates to 60% as the Currency Collapses," *CNBC*, August 30, 2018.
18. "Frugal hedonism" is a term I coined to describe a young consumer trend. Younger consumers understand artisanship and quality. They appreciate nice things just like the generations before them. But instead of consuming as much as they desire using credit cards as the boomers did, younger consumers prefer to live in smaller homes, reduce their rent, avoid consumer credit, drive less expensive cars or 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.
19. Nielsen CGA on-premise information.

20. Almost 4,000 neighborhood bars have closed since June 2013 according to Nielsen CGA.
21. "Why Did Membership in Fraternal Organizations Die Out Over Time?," *The Sociological Mail*, September 26, 2018.
22. According to Nielsen CGA on-premise data, the chains represent 17 percent of the restaurant/bar market, with the independents representing 83 percent. Chains are up almost 3 percent in dollars and 1 percent in volume, while independents are up 2.5 percent in dollars and 0.6 percent in volume.
23. In 1957, out of all wine consumed by Americans, 62 percent was fortified dessert wine and only 6 percent was sold as bottled imports. In that year, Gallo introduced Thunderbird, a 20 percent fortified wine which became the first "pop wine," followed by other entrants such as Ripple and Wild Irish Rose, all known for being inexpensive, sweet and heavy on alcoholic content. Albright G. Zimmerman, "From Thunderbird to White Table Wine: The Wine Story of Recent America," *The Journal of American Culture*, Fall 1979.
24. Joseph Temple, "Looking Back at 5 Wine Trends From the 1980s," *The International Wine & Food Society*, May 1, 2015.
25. Neo-prohibitionism.
26. John Haffner, "Study: Millennials Drink Nearly Half of All Wine in the US," *USA Today*, February 15, 2016.
27. 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.
28. Amy Reiter, "Millennials Are Drinking a Whole Lot of Wine," *Food Network Dish*, March 1, 2016.
29. Wendy Wang and Kim Parker, "Record Share of Americans Have Never Married,"*Pew Research Center*, September 24, 2014.
30. Quoctrung Bui and Claire Cain Miller, "The Age That Women Have Babies: How a Gap Divides America," *The New York Times*, August 4, 2018.
31. Laurie Goodman, Jung Hyun Choi and Jun Zhu, "The State of Millennial Homeownership," *Urban Institute*, July 11, 2018.
32. Drew DeSilver, "In the U.S. and Abroad, More Young Adults Are Living With Their Parents," *Pew Research Center*, May 24, 2016.
33. The 2008 Financial Crisis.
34. Christopher Kurz, Geng Li and Daniel J. Vine, "Are Millennials Different?," Finance and Economic Discussion Series 2018-080, Board of Governors of the Federal Reserve System, November 2018.
35. Tami Luhby, "Many College Grads From the Great Recession Are Still Trying to Catch Up," *CNN Business*, May 25, 2018.
36. Quantitative Easing.
37. By 1978, there were only 89 breweries left in America, an all-time prohibition low.
38. The modern craft beer industry has its roots in H.R. 1337 introduced by Wisconsin Representative William A. Steiger as an amendment to a transportation bill. Alan Cranston, a senator from California, added an amendment that legalized home brewing on a national level. Teetotaling President Jimmy Carter then signed the law on October 14, 1978.
39. Ranjit S. Dighe, "The Craft Beer Explosion: Why Here? Why Now?," *Process: A Blog for American History*, July 6, 2017.
40. National Beer Sales & Production Data, Brewers Association, 2017.
41. E.J. Schultz, "'Stop Your Wine-ing' Says MillerCoors in Campaign for New Beer," *Ad Age*, February 7, 2018.
42. Mothers Against Drunk Driving (MADD) and Students Against Destructive Decisions (SADD).
43. The Alcoholic Beverage Labeling Act (ABLA) of the Anti-Drug Abuse Act of 1988, H.R. 5210, is a United States federal law requiring that (among other provisions) the labels of alcoholic beverages carry a government warning.
44. President Clinton introduces a call for a nationwide 0.08 maximum standard for drunk driving.
45. Morley Safer, "French Paradox" (video), *60 Minutes*, November 17, 1991.
46. Mediterranean Diet.
47. Arthur L. Klatsky, M.D., "Moderate Drinking and Reduced Risk of Heart Disease," *Alcohol Research and Health*, Volume 23, Number 1, 1999.
48. J Ferrières, "The French Paradox: Lessons for Other Countries," *Heart Journal of the British Cardiovascular Society*, Volume 90, Issue 1, 2004.
49. State of the Science Report on the Effects of Moderate Drinking, National Institute on Alcohol Abuse and Alcoholism, December 19, 2003.
50. James McAuley, "Wine Is Bad for You, France's Health Minister Warns. It's Not Going Down Well," *Miami Herald*, March 6, 2018.
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53. Bill Chappell, "Utah Cuts DUI Alcohol Limit to Lowest Level in US; Law Also Affects Gun Owners," *NPR*, March 24, 2017.
54. Jackson Shedelblower, "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.
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56. Justin Scheck and Tripp Mickle, "With Moderate Drinking Under Fire, Alcohol Companies Go on Offensive," *The Wall Street Journal*, August 22, 2016.
57. Kelly Wynne, "Alcohol Is Killing More People per Year Than the Opioid Crisis, and Most Deaths Are Young Women," *Newsweek*, November 17, 2018.
58. Screening and Behavioral Counseling Interventions to Reduce Unhealthy Alcohol Use in Adolescents and Adults, US Preventive Services Task Force Recommendation Statement, November 13, 2018.
59. Emma Liem, "Consumers Are Demanding More From Their Beverage Experiences," *Food Dive*, January 22, 2018.
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61. Joel Achenbach, "Teenagers and College-Age People Drink Less While This Group Pours Another Round," *The Washington Post*, April 16, 2018.

62. Substitute Goods.

63. Anecdotal evidence in this context means I heard a bunch of wine salesmen talking about legalization ruining their sales quotas in one wine shop after pot was legalized.

64. Complements, Complementary Goods.

65. That's another good example of a complementary good.
Cannabis consumption has been found to stimulate popcorn demand, Italian ice-cream bars sales and Diet Dr Pepper consumption.

66. Larisa E. Bolivar, "2017 Report on Cannabis Consumer Demographics and Consumption Habits," *Cannabis Consumers Coalition*, May 2017.

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68. Michele Baggio, Alberto Chong and Sungoh Kwon, "Helping Settle the Marijuana and Alcohol Debate: Evidence From Scanner Data," University of Connecticut, Georgia State University and Universidad del Pacifico, Lima.

69. Rob McMillan, "Weed Is Impacting Wine Sales," *SVB on Wine*, January 28, 2018.

70. Isabella Gripe, Anna-Karin Danielsson and Mats Ramstedt, "Are Changes in Drinking Related to Changes in Cannabis Use Among Swedish Adolescents? A Time-Series Analysis for the Period 1989–2016," *Journal of Addiction*, Volume 113, Issue 9, September 2018.

71. Christopher Ingraham, "How Many Americans Regularly Use Pot? The Number Is, Errr, Higher Than You Think," *The Sacramento Bee*, April 20, 2017.

72. Alcohol Facts and Statistics, National Institute on Alcohol Abuse and Alcoholism, August 2018.

73. Michael Sheetz, "Corona Beer Maker Constellation Ups Bet on Cannabis With $4 Billion Investment in Canopy Growth, *CNBC*, August 15, 2018.

74. Bill Swindel, "Film Director Francis Ford Coppola Jumps Into Cannabis Industry," *The Press Democrat*, November 1, 2018.

75. Will Yakowicz, "Forget Kombucha and Coconut Water. Cannabis Is the Next Beverage Trend," *Inc.*, June 11, 2018.

76. I know exactly where that sweet spot will be, but I'm only telling our customers.

77. When owners read that perhaps 20 percent may be able to take a modest price increase, I expect 50 percent of owners will believe they are part of that 20 percent.

78. 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.

79. Emetry and Customer Vineyard are two companies applying big data resources to aggressively drive revenue to the winery vs. passively waiting for customers to walk in the door.

80. Jim Law, "A Growing Season for the Books," *Grape Press*, Fall 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.