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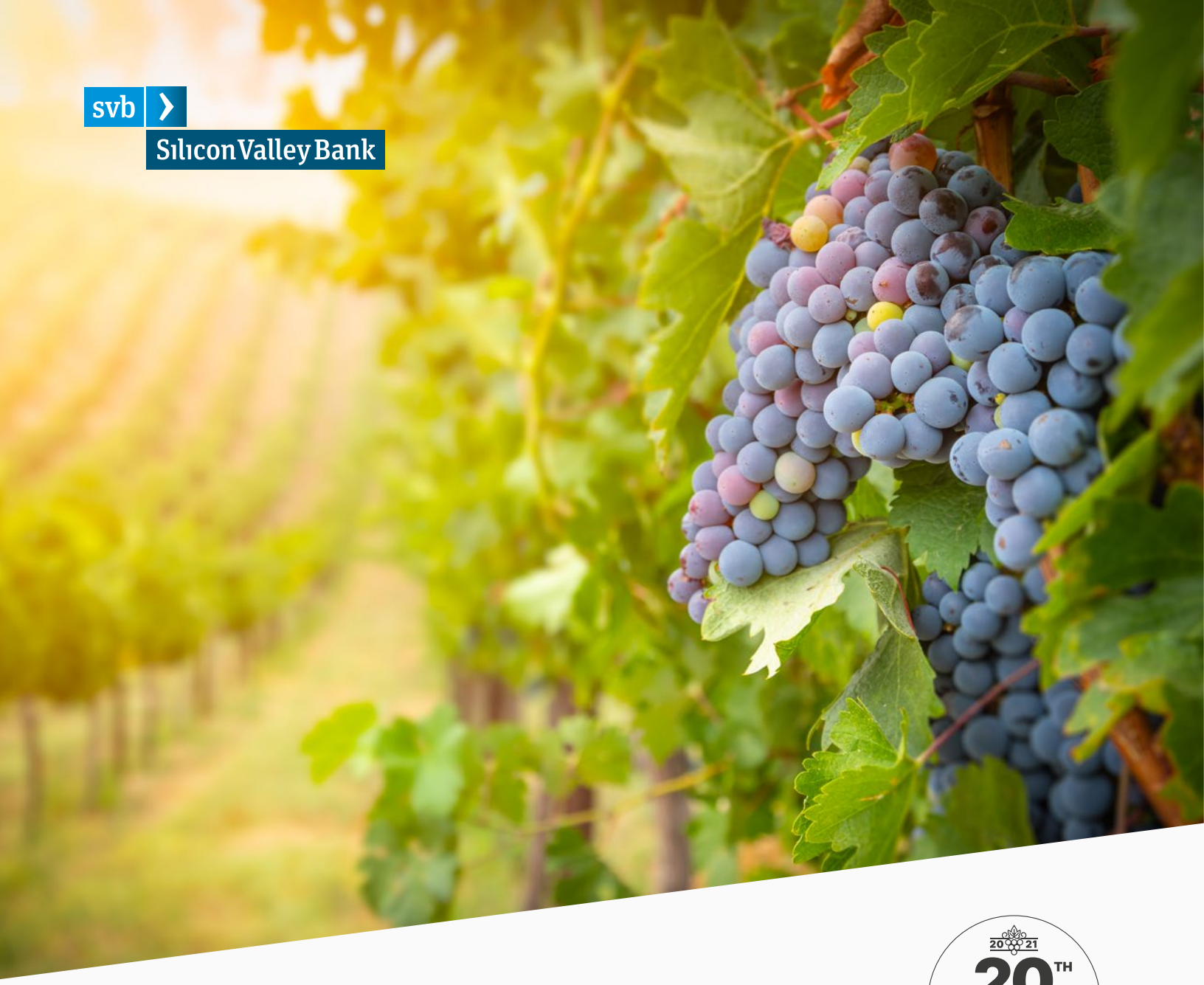

2021 20TH ANNIVERSARY ISSUE

State of the US Wine Industry 2021

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1 Introduction

"It is not the mountain we conquer but ourselves."

Sir Edmund Hillary, c. 1954

2020 will go down as the year in which we answered the heretofore rhetorical question, what else can go wrong? It was a long year of successive "didn't see that coming" issues that had stark impacts on US retail sales, consumer behavior, technology, the economy and the wine business, not to mention on human lives, which makes speaking about business at all seem trivial.[1] That said, life includes business, and we have to keep living.

Despite the unimaginable challenges 2020 posed, we can also admire the year for the way that the wine industry — known for its glacial adaptation to change — took on the obstacles of a worldwide pandemic head-on and found new approaches to sell. Those adjustments allowed about a third of wineries to have better sales than their prior year,[2] while larger producers improved their abilities to get wine into bottles, trucks and grocery stores before sellouts. The lessons learned will shape strategy for the next decade.

Looking back, it may be hard to recall that at the beginning of 2020, despite a good economy, the wine industry in the US had some significant cracks showing. It was in a position of acute oversupply, something that should take years to clear. Sales growth was near zero for the first time since 1993 and negative in the first two months of the year. Discounting in off-premise channels was prevalent; on-premise sales were declining; and small winery sales growth was positive but dropping into the middle single digits while larger wineries were demonstrating flat sales growth at best. Grower returns and bulk wine prices were falling as fruit was left hanging in every region in the western states. That was the landscape at the start of 2020, but together the pandemic and the West Coast fires changed the situation in ways nobody could have dreamed.

Beginning in March 2020, COVID-19 restrictions led to one of the most rapid declines of employment in US history. While all economic dislocations have disproportionate impacts, this recession particularly hurt those service industries that require the close proximity of employees and customers, including all leisure, hospitality and tourism businesses and, of course, smaller family-owned wineries.

It also affected lower-wage earners more than higher-income earners. Since wine is a beverage that tends to attract higher-income consumers, the net result was surprising strength in the grocery channel for higher-priced wines, and at the same time, we saw renewed interest in sales of lower-priced wine from shoppers looking for value.

Analysts differ on the final industry sales growth rate for 2020. The source data were harder to get and synthesize due to COVID-related work disruptions. But we believe total growth in wine volume was about 1 percent, plus or minus about 1 percent depending on December data. That's an improvement over the prior year.

In the same way this pandemic-fueled recession hit some industry sectors harder than others, it also had a disproportionate impact on business models. Premium and luxury producers that were unable to sell in closed restaurants and tasting rooms were sent scrambling, while large producers that owned the off-premise channel with large partner wholesalers had the enviable problem of being caught short of product to sell as sales rerouted through grocery and drugstores.

As the year advanced, with all the layoffs and health restrictions impacting our lives, many of us began to think that things couldn't get worse — that we'd paid our dues, grudgingly adapted to health restrictions we expected to be short-term and would soon see the picture improve, especially as restricted reopenings began across the county.

But that cautious optimism changed on the West Coast on August 16, when a dry lightning storm from a deteriorating tropical storm off Baja California pushed through Central California into Southern Oregon, sparking hundreds of fires.[3] Over the following 30 days, those fires ruined hundreds of thousands of tons of grapes in California and Oregon, all but ensuring that the worldwide pandemic, as world-altering as it had been, would not be the defining attribute of the vintage.

The Glass Fire[4] in Napa a month later added to the regional pain, creating another smoke event for the North Coast, depressing tourism and ruining or significantly damaging close to 30 wineries in Napa, along with substantial quantities of the best cabernet sauvignon grown in the world.

As we consider the possibilities and planning required for the year ahead, we stop to consider our top-level advice from the *Annual State of the Wine Industry Report 2020*: "The winners of tomorrow will be the wineries that…critically evaluate their organization's capacity to react, develop solutions and execute quickly, then evaluate their success or failure to continuously improve. Those companies will take sales from those that continue to run their businesses the way they have for the past 25 years and stick with strategies that have always worked before. The winners tomorrow will be intrepid and willing to try new approaches that change the status quo."

Obviously, we weren't talking about wineries reacting to the pandemic, since that wasn't an issue when the report was released and while we have a decent track record, we didn't see that one coming.

The message from last year still proved accurate and only accelerated the obvious need for change. For many wineries, the pandemic was the final straw that forced action — and for those that adapted, their reward was often better year-over-year results at the expense of another wine company.

- In the weeks following the shelter-in-place orders, the average family winery saw its internet sales rise from less than 1 percent of its sales to more than 10 percent of total sales.

- Wineries that made the effort to collect and maintain good customer lists, including cell numbers, started calling for business. Phone sales, which didn't even register as a sales channel in 2019, became a meaningful source of revenue for many wineries that tried it in 2020.
- Digital video sales strategies also flourished and have replaced a portion of the in-person experience. Wineries discovered how to take the experience on the road,[5] forever breaking the long-held belief that a winery experience could only take place at the winery.

While all attention during 2020 was rightly riveted on personal and business survival with everyone in reaction mode, long-standing industry issues were still present below the surface. These included a well-financed and coordinated anti-alcohol movement; disengaged, health-minded young consumers; unevolved marketing; and a lack of investment in digital sales, all of which will severely impact the wine business long after this pandemic ends unless we pay attention.

Those issues have been driving the disappointing sales growth metrics over the past six years. With boomers accelerating their retirement due to COVID-19,[6] the need to attract young consumers is more pressing than ever. The successes of the past 25 years can't be repeated without evolving the industry message and without an industry marketing organization coordinating that message and providing a counterargument for anti-alcohol claims.

To say 2020 was a difficult year is an understatement. While bruised, most of us are back at our craft with hopeful anticipation as we move toward a COVID-free world. While I can say with confidence that 2021 will be better, I can also say that "normal," when we get there, will be different from what we left. There are new issues that need to be planned for.

We believe this report will inform your team's thinking about the niche you occupy within the wine business, help you anticipate potential 2021 scenarios that will require planning and guide you toward joining other successful wineries that have adapted to changed market conditions and new opportunities. We hope it will inspire you to get creative about possibilities with your strategic planning, and that engaging in that process may help you improve your chances of success in the year ahead.

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2 2020 predictions in review

We have been extensively researching the wine business since 1991 and making public forecasts for 20 years. Some years we properly characterize a market change. In other years, our findings might be off in timing or even wrong. The events of 2020 introduced more chaos than anyone could have predicted, but we will once again review the forecasts made last year, just to keep score.

Our lead statement last year was:

"Our 2020 forecast is made with the expectation that the US economy will remain steady, without a recession."

In January, we were focused on a record bull market amid the uncertainties of trade wars in China and the EU and a looming US presidential election. We obviously did have a recession in 2020, albeit from an unpredictable angle. That detracted from our normally prescient performance, as you'll see.

What we got right

- We predicted that the 2019 California crush would be 3.95 million tons. Harvest from 2019 came in at 3.9 million tons.[7] Given the number of unharvested grapes from the 2019 season, even getting within 50,000 tons was close to a miracle with so much acreage being uncontracted.
- We led the chorus, starting in 2019 and extending into early 2020, that the grape supply in California was acutely long.
- We noted that we were transitioning to a period of low-to-negative sales growth as an industry. That statement continues to be accurate, though somewhat obscured by strong off-premise sales.

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What we got partially right

- We said bottle price increases would be rare in 2020. The trend of increasing price had clearly waned across the business, and with the acute excess, discounting was the only normal way to remove excess volume. We never considered that smoke and fire could destroy supply. It turned out that family wineries selling direct to consumer had to discount after shelter-in-place orders, but bottle prices for larger production wineries with access to grocery stores firmed and rose as consumers flooded the off-premise channel.

What we got wrong

- We predicted a sales value growth range between 3 percent and 7 percent for the premium wine segment and between minus 2 percent and 0 percent for total wine sales.[8] The total forecast was close, but the guess on the smaller premium wine segment was materially high. Sales growth in that segment will likely come in between minus 5 and minus 10 percent.
- With the acute supply excess at the beginning of 2020, we thought we would see good sales volume growth. Sadly, that prediction didn't pan out, and if December 2020 is soft, volume growth for still and sparkling wine will come in close to 0 percent.
- With long supply and flat-to-lower sales growth at the start of 2020, we offered a prediction that grape prices would take years to stabilize and would do so at lower levels than those of the prior several years. As discussed later in this report, the ensuing unpredictable events of 2020 brought current grape supply into balance, and grape pricing actually improved modestly instead of lingering at low levels. That said, there is still too much planted acreage on the West Coast, and grape pricing is below that of prior years.
- We noted that premiumization was nearing its apex as a trend. However, shelter-in-place orders drove up the sale of higher-priced wines in grocery stores. The same can't be said for direct pricing in smaller premium wineries where discounting was common.

3 2021 US wine business predictions and observations

"Chaos was the law of nature; order was the dream of man."

Henry Adams, 1907

2020 was a year of reacting, but 2021 will be a year of two phases: continuing to execute in a COVID-restricted mode during the first part of the year, then moving away from emergency responses once the wide distribution of a vaccine signals a move into a post-COVID world. The timing is still an unknown as of the date of this writing, but there is a consensus forming that vaccines will be widely available around early summer. What that will mean and how the wine industry will navigate the return of normal life are critical parts of 2021 planning.

The post-COVID world won't be the same one we left in early 2020. There will be many permanent changes we will need to consider, such as the shift to working from home, the increasing relocation of consumers to the suburbs and the acceleration of consumer online sales, which will take sales away from other channels. Even the best-run wineries in 2019 won't find the same level of success in 2021 unless they evolved in 2020 and continue to do so in 2021.

At a very high level, the channel shifting that took place in 2020, particularly in off-premise grocery, will unwind with many nuances that will be discussed more fully later in the report.

Restaurant sales will return in 2021 when restrictions are loosened, with locals leading the way in the tourist towns of Wine Country; however, we won't see a return to pre-COVID on-premise conditions for years — if ever. In the longer term, the permanent closures of restaurants will result in reduced selling opportunities on-premise. Restaurants will also incrementally move away from full-service seated models to new revenue-generating strategies, particularly home delivery and curbside to-go models, neither of which favors alcohol sales. The expectation for many restaurants is that their wine inventories will be minimized and streamlined into smaller offerings.

Obviously, the largest variable in timing for a return to normal business conditions is a fully immunized population. Making a firm prediction is well outside our abilities as industry analysts, but because the timing of vaccinations does impact planning and budgeting, we must make an educated guess.

Getting a green light for unrestricted business openings before the summer of 2021 seems overly optimistic as of this writing. Many unknowns remain, including the FDA's degree of rigor, the production of sufficient doses, solving for countless logistics questions surrounding distribution, unanticipated side effects that might slow the program, the physical time needed to vaccinate an entire population twice and a material anti-vaccination movement.[9,10,11]

While large public companies have had an easier time weathering the pandemic thanks to their ability to raise money, small companies (such as local restaurants and wineries) have not been so fortunate. A second round of fiscal stimulus was held up by party politics in 2020 and only passed at the end of the year, but hopefully that will help to bridge the economy through what are likely to be difficult conditions in the spring.

Top-level forecasts

- Our 2021 forecast is made with the expectation that the US economy will continue to recover as vaccines and therapeutics gain traction.
- The pandemic experience will have owners thinking more about the strategy of focusing sales into narrow channels.
- The experience of repeated fires and smoke damage will prompt owners to consider the need to diversify supply sourcing.
- The high level of liquidity in the markets looking for a return will attract new investors who expect improving industry conditions and warmer M&A activity (which cooled during 2020).
- For the sake of scenario planning in hospitality businesses, we are predicting we'll have a 25 percent reopening by April 15, a 50 percent reopening by June 15, a 75 percent reopening by August 15 and full reopening by October 15.
- There will be a reversal of the COVID-induced channel shifting as we reopen.
    - Overall wine sales will be sluggish until business restrictions are lifted, but wine sales will gather momentum through the year.
    - Restaurants will come out of this damaged and will need new investment. Wine sales through the restaurant channels will not recover to pre-COVID levels in 2021 and, more likely, for many years.
    - Wineries with direct-to-consumer models will focus on COVID-era strategies in the front half of the year but finish 2021 with strong sales.
    - Retailers with existing online sales strategies will have a strong year.
    - As hospitality, cruise lines, airport and airlines, concerts, sports and the like rebuild, there will be strong demand from consumers and a bounce for overall sales in 2021 that may not be sustainable past 2022. We think the consumer will celebrate in 2021 and make up for many postponed life events.

Supply

- When 2020 totals are calculated, we are guessing that California will have crushed 3.3 million tons, which would be the smallest harvest since 2011. The Pacific Northwest harvests in both Oregon and Washington will also come in smaller than normal.
- Supply in the West is largely balanced going into 2021, but overall growth rates in sales will still be modest, and some acres of vines will still need to be removed in California and Washington in particular in order to sustain the balance.
- Grape and bulk prices will stabilize at lower levels than we've seen in the past five years. Buyers will remain cautious on price.
- California vineyard prices in premium regions will remain lower than their prior high points, flattening in the best areas and softening in secondary regions.

Demand

- Retiring baby boomers seem to have a long tail and fortunately aren't quick to run to pasture. They continue to buy wine at all price points, but their buying seems to be moderating, both on price and volume, as they age. Online sales will be a growth channel for the boomer at home.
- The rotation to younger consumers is not an even trade on an economic basis, but the under-40 cohorts are where we will find growth in the next decade. In the next five years, 27.9 million Americans will cross normal retirement age at 66, while 30.3 million will cross age 40. That is too much buying power to ignore.
- Millennials aren't engaging wine as hoped. They lack financial capacity, having been slow to get into their careers after the financial crisis that started in 2007. They have a current preference for premium spirits and craft beers, which have a better value per serving.

Price

- Premiumization, a move to higher-priced wine, is nearing an apex but will continue in 2021 as deferred celebrations and reduced supply stall the expected change.
- Overall pricing should hold in both off- and on-premise sales, as well as in the direct-to-consumer channels, as demand for alcohol and special occasions goes through a spurt of temporary growth.

Seven tailwinds

Despite the setbacks of 2020, there were underlying trends that proved positive for the business and will have lasting impact:

1. Shelter-in-place orders, the work-from-home trend and restaurant closures created the necessity for family meals at home. Wine was added back to the family dinner table, and consumers adapted to online shopping and at-home delivery.
2. Families who were able to work from home saw some expense savings that position them for an expected push in spending in a post-COVID era.
3. With all competing entertainment venues closed, outdoor wine tasting found new converts through the summer of 2020. There are indications that younger consumers were slightly more intrepid than older consumers in making winery visits. While guest counts were lower, the average ticket from winery guests was higher this past year.
4. Wine proved again that it is recession-resistant. While many stocked up on everyday wines at the supermarket, consumers also rapidly switched to online options, either because their selections weren't available in grocery stores or because doorstep delivery was viewed as safer. Many consumers will continue online wine buying in a post-COVID world.
5. Digital wine tastings took flight during the year alongside the popularity of Zoom video conferencing.
6. Phone sales found new success when tasting rooms had to limit visitors or shut down entirely.
7. Once there is clear success with defeating the virus, consumers will act on pent-up demand to celebrate in groups, which will likely boost alcohol consumption in 2021.

Seven headwinds

Business survival and personal safety were often the focus of 2020. But other issues, some of which were discussed last year in the *Annual State of the Wine Industry Report 2020*, still need to be addressed for wineries to find sustainable long-term success:

1. Channel shifting to off-premise grocery received a large volume of press coverage during 2020. It was a spectacular data point, but when the US reopens, off-premise sales will unwind and consumers will find other channels to satisfy their demand. The grocery channel is likely to see negative sales growth, while direct-to-consumer, online and restaurant sales will show positive growth rates.

2. The challenge of recruiting younger, health-conscious, multicultural consumers into the wine category, combined with the aging of the older core wine consumer, remains. Both consumer groups have different values and spending patterns. The wine industry has done little to alter their marketing message to attract or retain either consumer cohort. We are perhaps the only major consumer product without an industry marketing organization.

3. Anti-alcohol messaging continues to grow while guidelines from a variety of government and health organizations loosely apply science to influence consumption, taxes and regulations; for example, see the recent effort to change the USDA Dietary Guidelines,[12,13] which would have reduced the recommended number of daily drinks for men, and the renewed push to add cancer warnings to labels.[14,15,16] There is currently no wine industry organization willing to provide scientific balance for the press and lawmakers by directing attention to the mountains of scientific research that point to lower mortality rates from moderate wine consumption.[17]

4. The wine industry is made up of an exceptionally fragmented producer landscape without an industry marketing organization to unify the industry's voice, provide data or properly leverage and support current consumer marketing trends.

5. While 2020 brought supply into temporary balance in most regions, there are still too many acres planted and/or insufficient growth in demand to maintain healthy grape pricing. If total volume demand remains flat or decreases, that will recommend additional removals. A large harvest is still an unwelcome event.

6. The need to invest in sales channels other than the tasting room has never been more apparent, and yet there are few good examples of wineries that have succeeded with data-driven approaches and internet sales.

7. The labor supply is limited, and the price for labor is increasing.

4 Sales channels

Were total wine sales up or down in 2020?

2020 required everyone to focus on the moment because of legislated and unnatural business conditions. We were all reacting — consumers, industry and the government alike.

With all the channel shifting this past year, sales expanded in certain areas and contracted or disappeared in others, such as tasting rooms and restaurants. But what about total wine sales? Were they up or down? The answer is that total sales were higher...or lower, depending on which analyst you choose to read.

Figure 1: **Preliminary US wine market volume**
9-liter equivalent cases (in thousands)

	2019 domestic	2019 imported	2019 total	2020 domestic	2020 imported	2020 total	% change domestic	% change imported	% change total
Still wines	255.38	83.17	338.55	258.94	83.95	342.89	1.39%	0.94%	1.28%
Bulk imports	21.84		21.84	24.00		24.00	9.89%	0.00%	9.89%
Sparkling wine	12.54	16.60	29.14	12.76	15.65	28.41	1.75%	–5.72%	–2.51%
Subtotal	**289.76**	**99.77**	**389.53**	**295.70**	**99.60**	**395.30**	**2.05%**	**–0.17%**	**1.48%**
Flavored wines*	7.48	9.75	17.23	5.84	25.61	31.45	–21.93%	162.67%	82.53%
Total	**297.24**	**109.52**	**406.76**	**301.54**	**125.21**	**426.75**	**1.45%**	**14.33%**	**4.91%**

*Includes sangria, coolers, agave-based wine and flavored wines mostly from Canada and Mexico.

Note: Chart produced 11/2020. Subject to downward revision if December sales are light.

Source: bw166

Final sales totals for wine will be difficult to get right for 2020 because making estimates means cobbling together information from multiple sources, some of which are opaque as to their data sourcing. Some analysts base their estimates on tax receipts. But with several tax changes, tariffs and delays in government reporting, it has been difficult to get timely or accurate information.

All analysts create their models by piecing together data from proprietary and purchased sources. In prior years, those models have worked well enough, with adjustments made over time to accommodate new data sources or changes to data collection methods. But all of the previous approaches to full-industry sales estimates must be tossed out the window this year, thanks to the closure of restaurants and tasting rooms and the ensuing channel shifting.

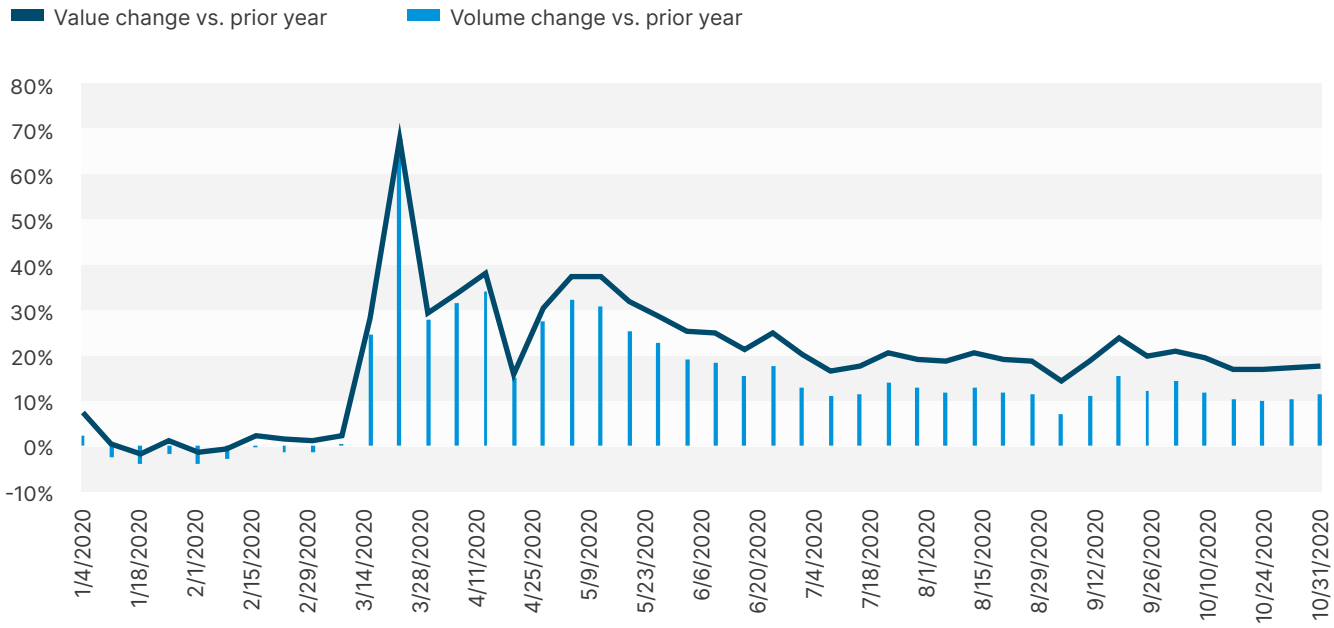
Without some consistency in the amount of wine sold through various channels, the calculations normally included for adjustments don't work. No matter who is presenting the information this year, it will be subject to understandable revision.

That said, Jon Moramarco from bw166 is as transparent as anyone and does a diligent job with an early estimate (see figure 1). His preliminary prediction for year-end 2020 volume sales is that total sales will be 1.28 percent higher for all of 2020. Growth in flavored wines, including agave and fruit-based wines, will take full-year volume wine sales growth to 4.91 percent. Total retail sales on value will, however, come in lower than prior years because restaurants substantially mark up their wine. Year-end restaurant closures, with added COVID restrictions and the possibility of lower December sales overall, might lead to downward revision of 1 percent to 2 percent.

Our full-year 2020 prediction, made in January 2020, was for higher volume sales, simply because we had an acute excess and wine needed to get sold. We also predicted lower value sales given expected discounting. So, the bw166 year-end estimate for 2020 is consistent with our start-of-the-year projection. Of course, the reasons we used to build the prediction were wrong, so it's hard to take a bow given that we got it right but for the wrong reasons. It feels like winning a NASCAR race only because everyone else crashed at the starting line.

Off-premise sales and changes

Figure 2: **Off-premise volume and value changes in 2020 vs. prior year**



Source: Nielsen

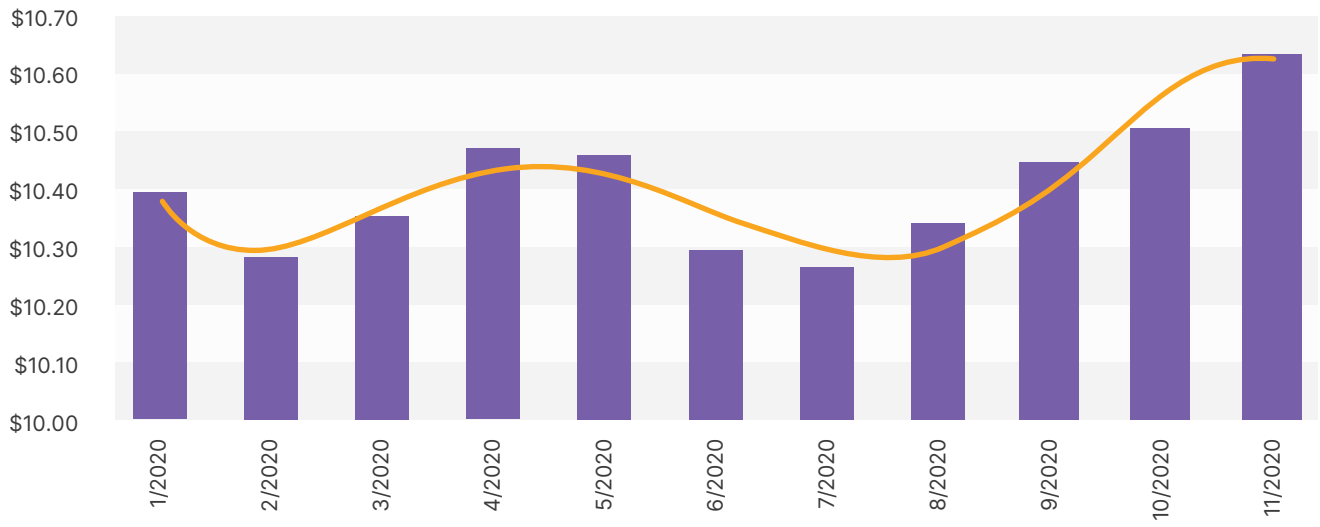
The coronavirus lockdowns and closures created an advantageous position for large producers, as they had access to grocery and drugstores through wholesale partners, while small producers were at a disadvantage, with less access and little leverage. Larger producers started the year oversupplied and discounting, but within months they had exceeded their wildest expectations for off-premise sales and were dipping heavily into the bulk markets to fill orders.[18]

When talking to our smaller clients during that period, we learned that many attempted to rotate away from restaurants and into wholesale but with little success, especially from March through May, when wholesalers had too much activity and too many logistical problems to think about taking on new SKUs.

The initial lockdown orders in March created panic buying or pantry stuffing, as some called it — a situation where the consumer's motivations to buy wine and toilet paper were similar. No longer were specific attributes (e.g., color, price or volume) the most important selling factors. What mattered was not running out![19] Figure 2 shows volume and value changes for wine in 2020; the pronounced spike represents the panic buying that coincided with the initial stages of the pandemic in the US.

Grocery and drugstore pricing fluctuated during the year consistent with the pandemic's phases. When there was too much inventory at the beginning of 2020, price and volume action was trending lower. Then hoarding behavior took center stage, and average pricing climbed, then softened as businesses and restaurants started reopening. Somewhere between March and June, the acute excess in the off-premise channel came into balance, setting the tone for stronger grocery prices in the fall, further strengthened by the second round of business restrictions. The gap between the bars and the line in figure 2 shows how the price started lower than volume sales early in the year and by the end of year had flipped, with the price gap expanding.

Figure 3: **Month-to-month average price changes of top 100 best-selling SKUs off-premise**



Source: Nielsen

There are many changes taking place that will impact grocery sales. The rise in work-from-home behavior has meant that fewer people are commuting and shopping near their workplaces and more people are leaving large cities for suburbs and larger homes.

It's not just a US trend. You can find plenty of stories of migration in the UK, Europe and Australia, the latter of which has the COVID outbreak under control.

While the data aren't yet clear, there is a strong argument to be made that this migration is based more on employees wanting to work from home versus escaping COVID, and if that is indeed the case, the change is permanent.

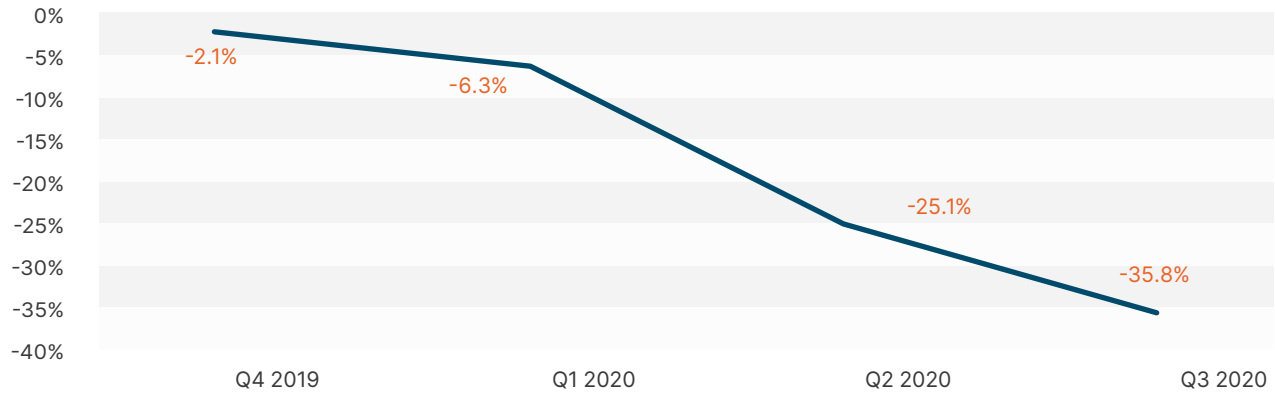
For wineries selling off-premise in large cities, certain stores might likely decline in importance for their brand, while stores in suburban regions where the winery's brand hasn't been dominant might pop up as better sources of business.[20] What does all that mean for 2021 off-premise?

Forecast

We expect 2021 will show positive year-over-year growth rates in off-premise accounts from January through the second week of March 2021, but there is little likelihood we will see positive growth rates from then onward given the 60 percent spike in sales in March of 2020 and substantial growth rates thereafter. That will be hard to repeat.

At some point as business restrictions are lifted, we will see negative growth rates in off-premise as sales shift back to on-premise, direct-to-consumer and online sales. Confusing the situation, a noticeable rotation of consumers from large cities to smaller cities and suburbs will lift some grocery locations in suburbs and sink some locations that for years have been points of strength. For savvy operators that apply data to their strategies, there will be opportunities to boost their brand in cities once believed to be less important.

Figure 4: **Restaurant wine depletions from distributor stock, year-over-year comparison**



Source: SipSource

On-premise sales and changes

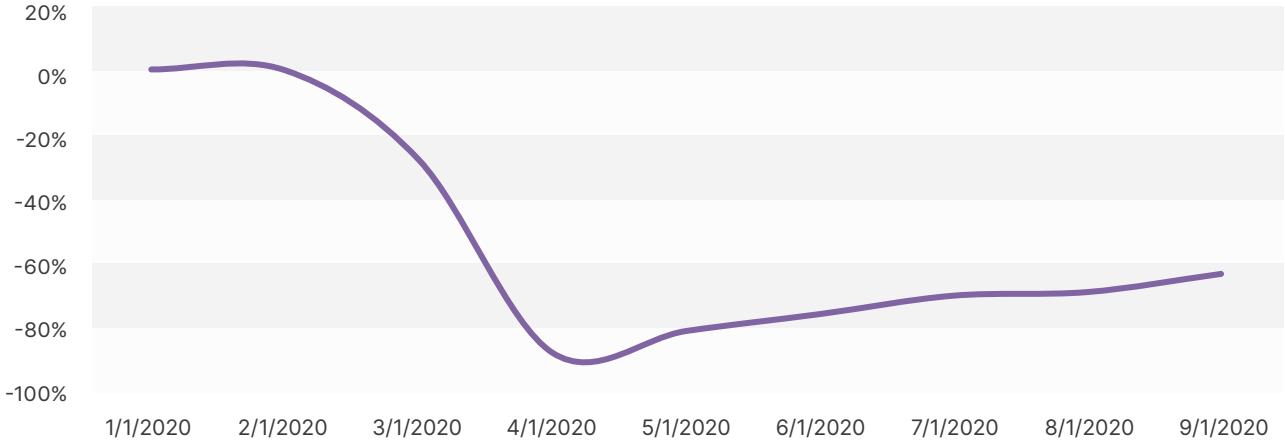
Restaurants have experienced their worst year since the Great Depression and perhaps the worst ever; even during the Depression, people were allowed to go into a restaurant, but in 2020 public health orders closed indoor dining outright, throwing restaurants a bone in the form of take-out ordering.

Depletions from wholesalers started the year on a down trend, and it never improved (see figure 4).

The accumulation of adverse factors has made the term "restaurant apocalypse" popular in the restaurant trade. How bad was the impact?

Through November 2020, over 2.1 million jobs were lost in the restaurant business,[21] and 16 percent of restaurants (one in six) have been forced to close. Figure 5 shows year-over-year declines in restaurant sales, exceeding 80 percent at the bottom of the curve.

Figure 5: **Year-over-year changes to on-premise wine sales**



Source: Nielsen CGA

Hit particularly hard were the small independent restaurants, which are often a primary point of sale for wine produced by small family wineries.[22]

The restaurants faring the best were those with drive-thru options, curbside pickup and/or app-based ordering and home delivery options, such as pizzerias, delis, food trucks, fast food and coffee shops. There are several potential ideas in that list for family wineries looking to diversify or enhance their sales strategies.

The largest restaurant closure rates have been in the states with high urban rents, such as California, Nevada and Hawaii.[23] According to Yelp, 61 percent of restaurant closures will be permanent, though there is no question that new capital will come in from entrepreneurs and that new startup restaurants will gradually replace many of the permanently closed restaurants. Conservatively, that process will take four to five years.

And the forecast for how vaccines will impact the dining experience remains clouded for the foreseeable future.

- New vaccines show high levels of initial effectiveness, but no one knows yet how long the protection will last.
- As of this writing, 39 percent of people in the US say they probably or definitely won't get a vaccination for COVID-19; of that group, 18 percent say they definitely won't get it.[24]
- Even with a highly effective vaccine, the best hope is to contain the virus, not eradicate it.[25]

Given those facts, it is unclear what health protocols will remain even when vaccination is widely available. Some epidemiologists suggest that we will be dealing with a notable level of infections and deaths for perhaps another five years.

While we would all like to think the virus will be eradicated and we'll be able to go about life as before, if the five-year estimate is close to reality, then restaurants, hotels, bars, airlines, cruise lines — and perhaps all hospitality-related industries, including wineries — will have mandated health restrictions longer than they hope, and probably will have to deal with permanent consumer changes going forward.

If a vaccine is widely available by the start of summer, it would seem likely that social distancing and health mandates, including reduced indoor seating capacity, will remain into the fall of 2021 in many, if not most, regions. And even if all health restrictions are removed earlier, the question has to be asked: What will consumers look for in their dining and tasting room experience?

The trend of communal dining in restaurants will certainly be difficult to retain. The future of crowded service for single diners at bars (or wine tasters at wineries) is harder to predict. In some settings, the desire for social interaction might trump safety fears.

Many people hope city governments will continue the COVID trend of establishing dining districts where streets are closed, repurposing the space for tourism and dining.[26] That sounds like a great idea to me, but hoping for political solutions isn't a dependable strategy.

Research firm Mintel noted in a September 2020 report that nearly 60 percent of diners were uncomfortable dining indoors. To attract indoor diners now and during the post-COVID era, restaurants have spent tens of thousands of dollars per location to install air-purification systems, advertising their effectiveness against COVID-19.

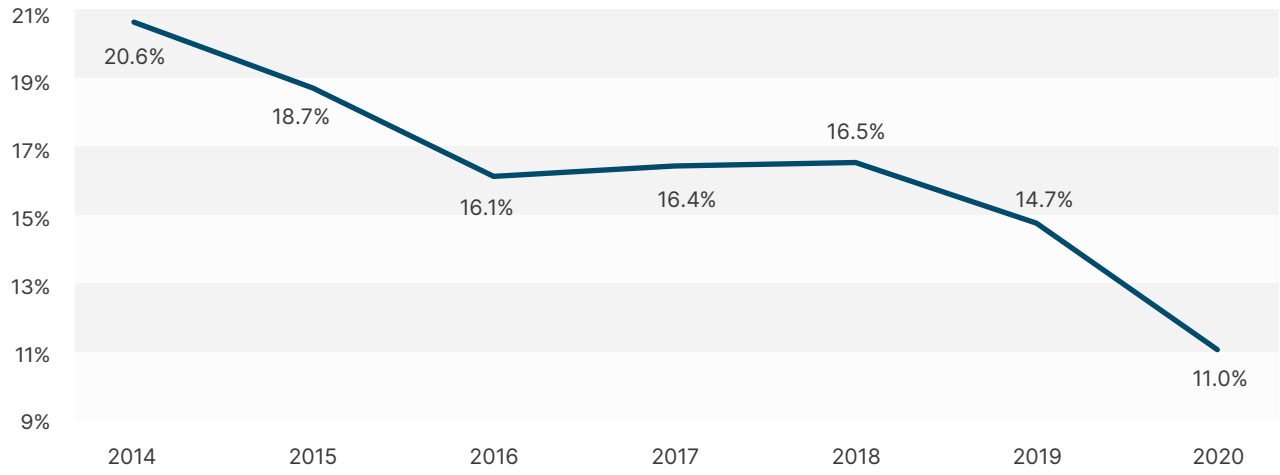
When restrictions are lifted, locations without that investment might have a more difficult time attracting diners or might have to change their indoor capacity to compete. Will advanced filtration encourage a diner to come back to an elbow-to-elbow eating experience in 2021? My guess is that consumers will gradually feel safer and come back to a crowded service environment, but it won't happen right away.

In the meantime, we are going to see restaurants evolve their businesses to include survival techniques picked up during the pandemic, such as apps focused on meals to go, walk-up service and curbside pickup, just to make it through what is certain to be a multiyear recovery. Some of those strategies will be needed in wineries as well, particularly early in 2021.

Another factor to face is that many bars and restaurants have sold off their wine cellars to survive the closures and restrictions. Most restaurants will probably not return to the practice of maintaining extensive wine inventories, certainly not in the near term. Alcohol beverage lists will be slimmed down and simplified too.

Another headwind for restaurants and bars in large cities coming out of COVID restrictions is going to be the slow return of leisure and business travel.

Figure 6: **Winery restaurant sales as percent of total winery sales**



Source: SVB Annual Winery Conditions Surveys 2014–2020

Business travel alone accounts for a majority of the profit for hotels, airlines and restaurants in major cities. Wine sales can't expect to see growth without those travelers frequenting on-premise accounts. In a recent study, McKinsey & Company concluded that business travel will return in phases at a slower rate than leisure and tourism.[27]

After the Great Recession, leisure travel took two years to recover, and business travel took four. Unsurprisingly, smaller in-person sales and client meetings are expected to return faster, with large industry trade coming later. Leisure travelers are likely to come back in waves. Almost 45 percent of respondents in a Destination Analysts survey said that their first post-COVID trip will be a vacation.[28]

Apart from all the COVID-19 issues, one factor to consider in restaurant sales is the cost per serving for wine. According to Nielsen, it costs $1.02 for a 12-ounce serving of beer off-premise, $0.88 for a 1.45-ounce serving of spirits and $1.51 for a 5-ounce pour of wine. That means wine is 72 percent more expensive and that the lower price per serving is a clear part of the success story of spirits today, particularly considering how restaurant markups magnify the nominal price difference between a serving of spirits and a glass of wine.

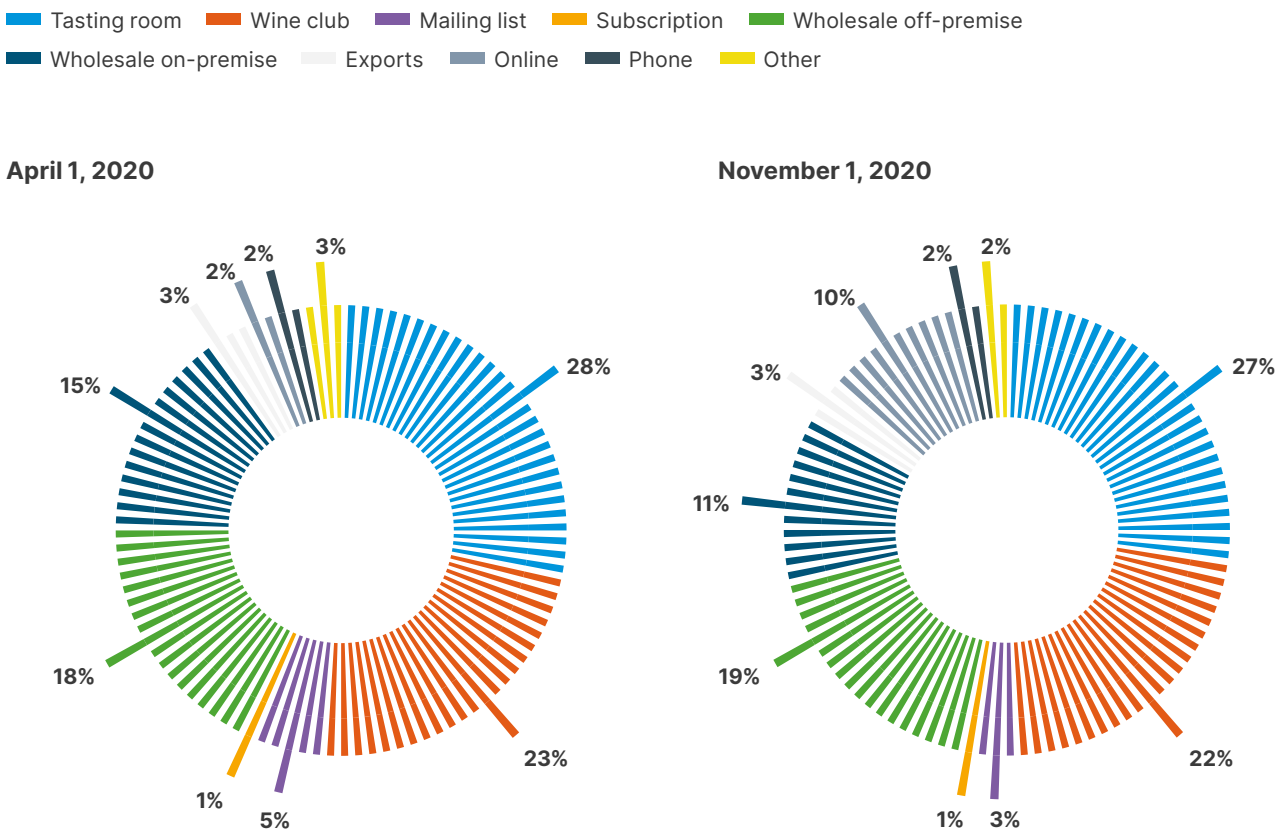
FORECAST

What does all that portend for the wine business? When business reopens, we foresee an initial surge of locals returning to dine — particularly to those restaurants that are ahead of new hygiene and air-quality expectations. That will be followed by regional tourism and, last, international tourism and large conventions in a multiyear process.

While those factors will delay recovery, there will be a permanent loss of thousands of restaurants, an enduring move to delivery models using Uber Eats and DoorDash, continued curbside and walk-up service and likely a shift toward lower total dining room capacities. None of those trends are positive for alcohol sales.

While wineries had 14.7 percent of their sales moving through on-premise in 2019, with that figure dropping to 11 percent in 2020, the combination of restaurant closures, post-COVID consumer behavior changes and possibly extended health mandates on restaurants makes it unlikely that 2021 will see a material recovery of wine sales in restaurants, though there will be a very large percentage increase compared to 2020. That will be small solace.

Figure 7: **Average winery's sales channels**



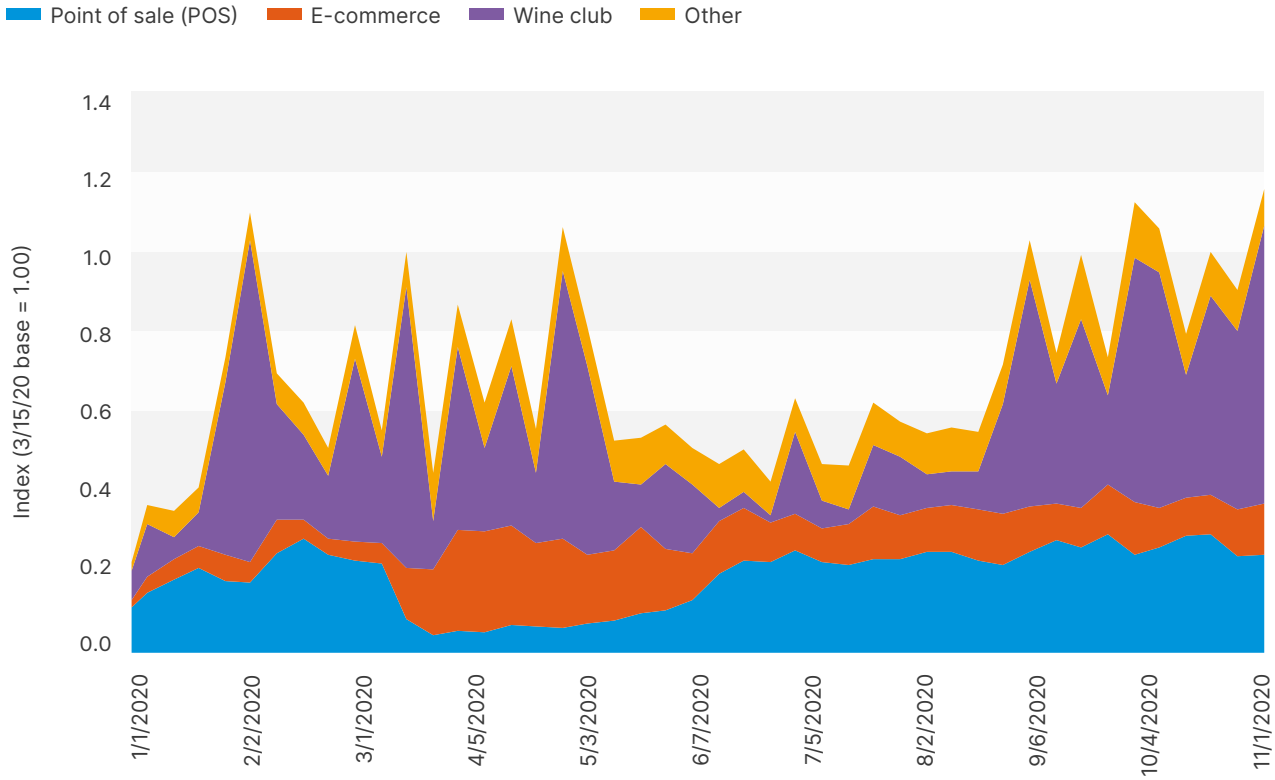
Source: SVB Annual Winery Conditions Survey

Direct-to-consumer sales

In mid-March, when shelter-in-place orders were being issued on the West Coast, the smaller premium and luxury wineries were gobsmacked by the realization that restaurant sales (representing 15 percent of total sales) and tasting room sales (representing 28 percent of sales) had just been cut by fiat.

Fully 43 percent of sales would vanish...or so it seemed at the time (see the left pie chart in figure 7). But the facts of what happened aren't as stark as our earliest fears allowed us to conclude. We never reached the place of having zero in-person sales.

Figure 8: **Direct-to-consumer channel movement in 2020**



Sources: Commerce7, vinSUITE, SVB

Activity measures from point of sale (POS) terminals show that wineries did slow, but even with complete lockdowns, there was still the occasional cellar-door sale — made, I'm sure, with complete compliance with all relevant restrictions and regulations. See figure 8.

After owners picked themselves off the floor, within days wineries began to discover new ways to sell from closed tasting rooms, and POS terminals started to flicker. Solutions included using apps to schedule curbside pickups,[29] turning tasting room personnel into phone solicitors, hosting digital tastings and even promoting home delivery as an option for locals.[30]

With wineries facing layoffs, many decided to give phone sales a try and shifted their tasting room staff to start selling via phone from their own homes in March and April.

It wasn't a successful solution for everyone. A substantial number of wineries hadn't maintained lists of non-club members or their cell numbers. But for some, phone sales became a material part of their sales and engagement strategy with their members and customers, representing up to 10 percent of total sales in some wineries.

Club sales in March and April were another surprise. Staring down the throat of the most rapid drop in US employment since the Great Depression, owners were debating whether they should have a spring wine club offering or not. Past recessions have always included a period of tight-fisted behavior, and the popular view at the time was that the pandemic was a 90- to 120-day event, so waiting might be the better path.

Figure 9: **Growth in direct channels**

Channel/segment	Total sales growth	Total number of orders	2019 average order	2020 average order	Growth in average order
Club	−5.18%	−8.98%	$184.68	$192.38	4.17%
POS/tasting room	−37.43%	−42.31%	$66.35	$71.96	8.46%
E-commerce	153.04%	190.67%	$280.50	$244.19	−12.95%

Source: vinSUITE

Fortunately, everyone with whom I'm acquainted went through with their planned club offering, and remarkably, while there were some membership drops from the club and total orders were lower on average by 9 percent (according to vinSUITE data backed by hundreds of thousands of transactions), the average order increased by 4 percent and total club sales did much better than anyone dared to dream. (See figure 9.)

As we've pointed out in the *Annual State of the Wine Industry Report* in past years, the tasting room model had reached an apex in effectiveness and the sales approaches used by most wineries were in need of an adjustment. The term I've used for off-winery selling options is "taking the experience on the road."[31]

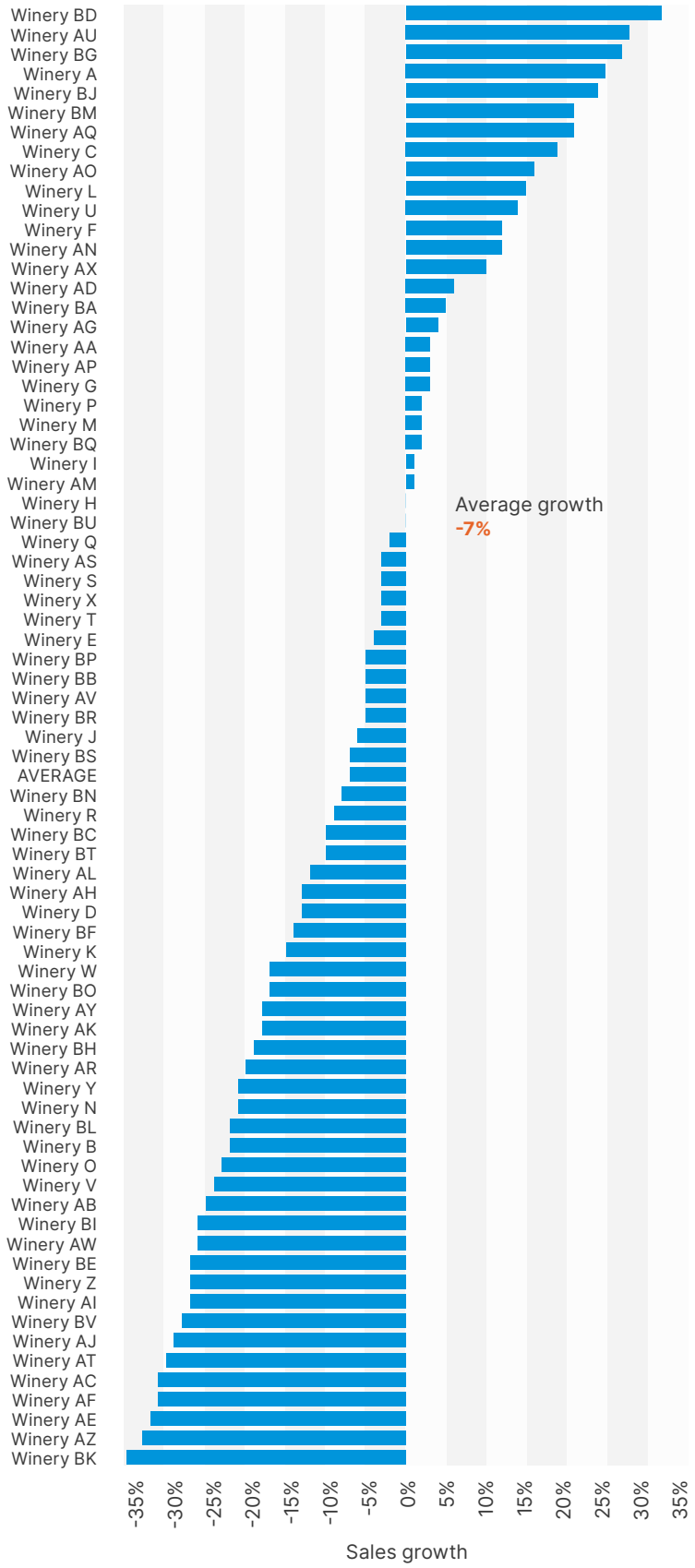
The pandemic exposed the industry's overdependence on the tasting room model in a new way. Until 2020, wineries had been getting nearly all of their club signups from tasting room visitors — and club is a critical source of revenue. In talking to many owners, we became aware of some wineries that were ahead of the curve with Zoom tastings and eventually were able to incorporate strategies that included signing up new club members. According to Commerce7 reports, by year-end 2020, 27 percent of new club signups originated through digital means.

Evolving the way new club memberships are harvested outside of the tasting room will be another important component of future winery success.[32]

After sales improved in early April, supported by a gradual reopening that allowed for restricted in-person visits, POS credit card orders started to increase, and by July POS sales had returned to near normal levels. While many wineries were restricted to outdoor tastings, with limited indoor tastings in some areas, there was wide agreement that average checks were higher, which the data support (see figure 9).

It might seem as if all of the POS sales from April to July were truly lost to the winery, but the sales just came through different means — reinforcing the fact that wine sales are not discretionary purchases for wine consumers.

Figure 10: **Sales growth rates of West Coast premium wineries**
(six months year-to-date through June 2020)



Source: SVB PGA Database

What flew under the radar in the spring of 2020 was the advent of online wine sales for smaller family-owned wineries. Yes, you read that right: the *advent* of online wine sales.

While all readers know that wineries have been selling online since about 2000, for most wineries that means they have a shopping cart — nothing more. That's not my idea of e-commerce.

The explosion in online sales is reflected on the left pie chart in figure 7: Prior to COVID-19, average online sales were only 2 percent of total sales. By November 2020, online sales had exploded to 10 percent of total sales (figure 7, right pie chart) — and yet that growth still isn't really due to e-commerce but to passive online sales driven by consumers who wanted a particular brand or were unsatisfied with wine sold only in grocery stores and searched for something better on Google.

The combination of online and POS sales produced total revenue close to normal POS sales. And as noted in figure 8, online sales after July continued at a higher rate. That's an indication that online sales aren't going back into the closet in 2021. But if you were the beneficiary of passive online sales, you absolutely have to take the opportunity to bring e-commerce into your winery and harvest the consumer who will permanently change a portion of their wine acquisition to online. If you don't invest, those sales will go to another winery.

Winery owners — and farmers, for that matter — are persistent. Adaptation is a normal part of their DNA when faced with a crisis, and it seems like there is always a crisis. While the ride was wild through the past year, average winery sales of those selling direct to consumer fell only 7 percent (see figure 10), with a third of wineries having better year-over-year sales than the prior year. That's a far better outcome than I would have guessed in March 2020.

Digital sales and investment

In a wine world that is essentially flat on volume consumption, the only way you'll find growth is by taking it from another winery. And fighting your neighbor winery for those consumers by putting balloons on your mailbox isn't the solution.

Of course, we have to continue to evolve the tasting room and club models, but the growth opportunity for tomorrow isn't going to come by doing what you're already doing — i.e., by waiting the pandemic out, delivering better hospitality, hosting seated tastings, planning club events or refining your hospitality training.

While the reopening of businesses will provide recovery sales, the growth opportunity for the small winery for the next several years is:

- Getting exposure to new consumers *who live elsewhere* and don't know you.
- Finding ways to sell to those consumers by convincing them to join your wine club digitally *where they live.*
- Building your brand regionally by evolving the concept of experience *away from the winery.*

My base premise for what will happen when the US begins to reopen in 2021 is that the channel shifting we've seen will slowly unwind — but only to the point where it runs up against permanent post-COVID consumer and business shifts. So, for instance, I believe online sales will see a permanent positive gain at the expense of wholesale. We won't unwind online sales back to 2 percent of total winery sales.

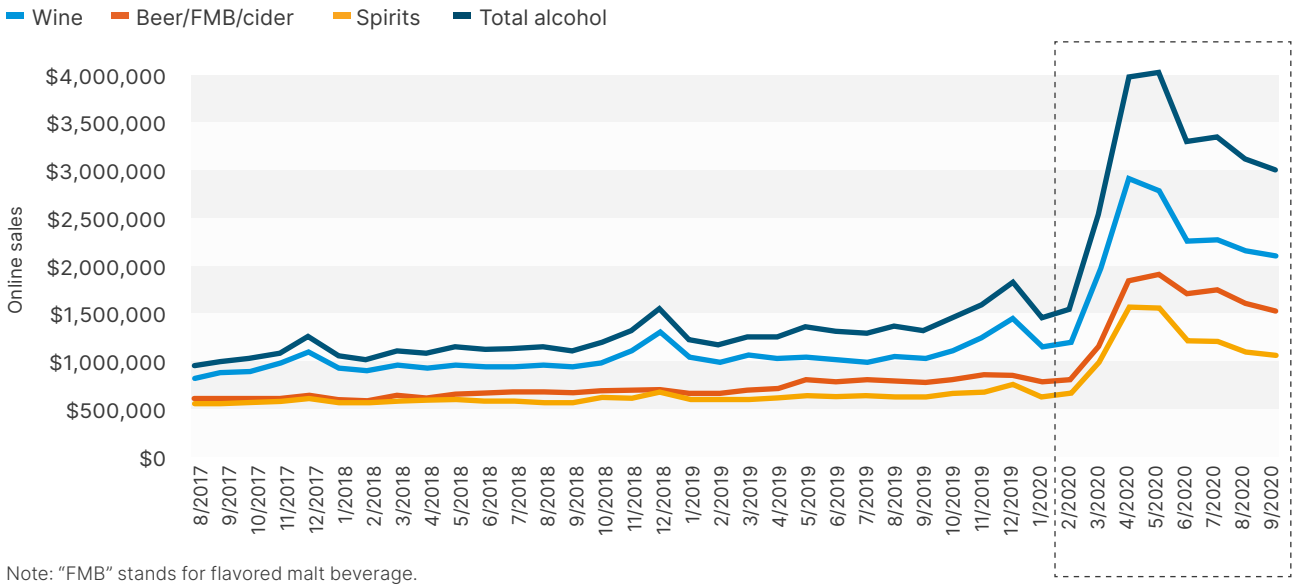
While some permanent consumer changes are hard to forecast, one in particular is quite easy: Large numbers of consumers will incrementally grow in their desire to shop online as their preferred means of shopping.

If you read that too fast, you should read it again because it's something Paul Mabray has been talking about for 15 years within the wine producer community, finding few believers.[33] While some can argue the advice was idealistic before, we are now at an inflection point because COVID-19 has accelerated many trends in the US that were already taking place, and online sales is one of them (see figures 8 and 11).

Online selling is, without question, the change agent that will deliver the greatest transformation to wine sales over the next decade. Online sales might represent 20 percent of alcohol sales in the next decade or sooner and at the expense of three-tier sales.

Figure 11: **E-commerce trends in alcohol**

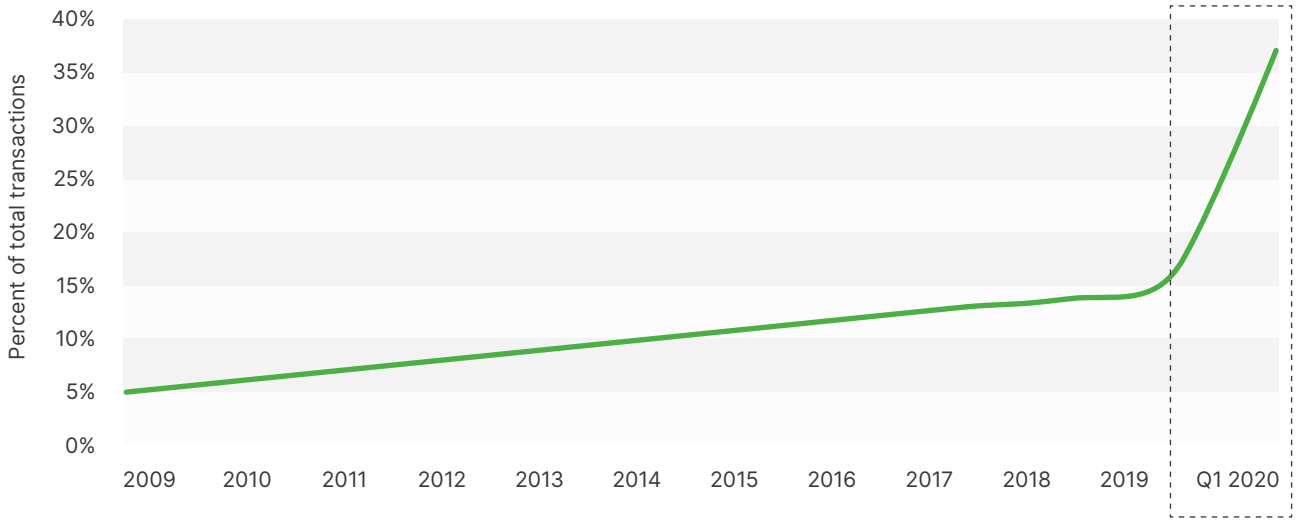
Explosive growth in COVID-19 period



Note: "FMB" stands for flavored malt beverage.

Source: Nielsen/Rakuten Intelligence

Figure 12: **E-commerce penetration**
10 years' growth in three months



Source: Drizly

Some quick stats to underscore the COVID-enhanced growth rates in online sales:

- Wine.com reported 217 percent growth in the first half of its fiscal year 2020.
- Naked Wine reported sales growth of 65 percent.
- IWSR predicted 2020 year-end online alcohol sales would increase by 86 percent to $5.6 billion.
- Drizly reported that US e-commerce penetration experienced 10 years' worth of growth at the pre-COVID pace in just three months between March and May 2020 (see figure 12).
- The small wine producer has seen 153 percent growth in online sales last year with an average order 300 percent larger than the average order in the tasting room (see figure 9).

When I've discussed the need to take the experience away from the tasting room in the past, one objection I've heard is about club signups: How will we get club signups with online sales? The answer is: Engagement. E-commerce is much broader than having a shopping cart on your site or sending an email with a URL and a discount. It includes using data to market to potential club members and personalizing web visits to the winery with automation. Commerce7 concluded that 27 percent of their clients' new club members in 2020 came from digital engagement. That may seem like a small number, but the lifetime value of a customer makes that a huge opportunity.

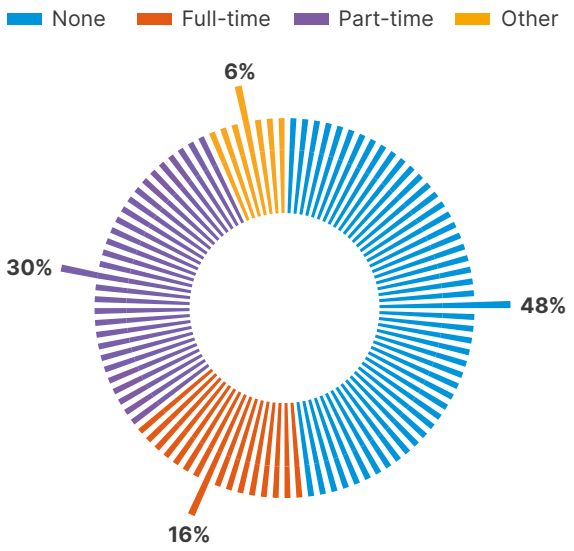
With consumers now learning how to incorporate work-from-home and home delivery into their lives, it seems apparent that the shift to online sales won't fully unwind post-COVID. Now the question becomes, how will you reach the consumer who is eating all meals at home? How will you connect with them over their dinner table? How will you provide streaming vino-entertainment that captivates viewers and captures sales and new members? How will you rethink differences between local club members who can visit the winery versus someone in Alabama who might come once in four years? You can have a digital membership with features that resonate with someone remote from the winery. In some cases, wineries are already taking the next step into a monthly subscription model.

The list of who is selling wine online most effectively today includes many companies that might have escaped your attention, such as Total Wine, Vivino, Walmart, BevMo, Drizly, Naked Wines and Wine.com. Unless you consider Naked Wines a winery, there are no wineries on that list, but what things can you duplicate from the success of these ventures?

While regulatory hurdles have held back direct-to-consumer and online sales since the advent of the internet, the move to online has been gaining momentum and could get even more interesting if the Supreme Court takes the *Lebamoff v. Whitmer* case and rules in the favor of wine retailers, allowing interstate e-commerce for wine retailers. If that comes to pass with a ruling in the summer of 2021, it will be easier to imagine a more rapid and massive change to the three-tier system, with e-commerce retailers buying directly from premium wine producers and selling directly to consumers nationwide.

Figure 13: **Data analytics person**

Do you have a person to review your consumer data?



Source: SVB Annual Winery Conditions Survey

That doesn't put wholesalers out of business. It puts them into the business where they are most effective — using their scale to dial in efficiencies as they connect the highest-volume producers with the largest physical points of sale. That is what wholesalers do at present.

I believe the alcohol distributors in the US also recognize the inevitability of this online consumer shift and are looking for hedges to their existing protectionist strategy. In addition to lobbying for the status quo at state and national levels, they are going to move to innovative business solutions. The partnership between Drizly and the Wine and Spirits Wholesalers of America (WSWA) is one such hedge,[34] and the announcement from Southern Glazer's that it is launching a business-to-consumer e-commerce team is another.[35]

Here's the point: If you are looking for incremental growth in 2021, it isn't going to happen by waiting for the vaccine to take hold and expecting existing channels to go back to where they were before. Consumers are changing in permanent ways that require your reaction.

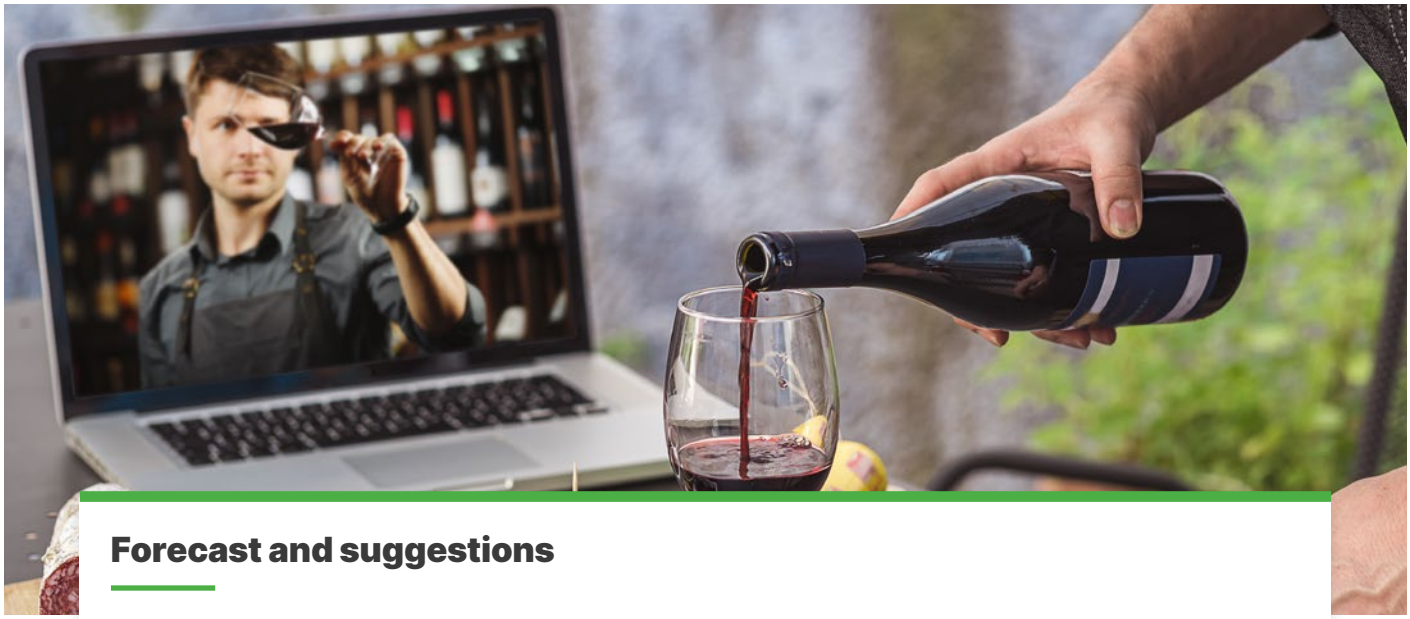
The question most often asked by owners wanting to move to improve their digital approach and e-commerce practice is, where do I start? Too often people start by purchasing tools.[36] But successful transformation starts with people, not tools. It's a cultural shift that requires buy-in from leadership to make digital impressions and online sales a priority.

And it needs to be said up front that an investment in digital and online will cost money before producing a return. The resistance to that fact within the industry will hold back success, but there has never been a better time to try because consumers are looking for you and they are buying wine.

All wineries today have data, but almost half don't have anyone looking at it (see figure 13). Most haven't thought through new strategies, such as how to attract club members remotely, and will never find those solutions without hiring someone on the team who understands the digital opportunities.

There is no single surefire method for customer acquisition, and every winery is going to have to learn what works for their brand across search, social and more. The good news is that digital marketing allows for many small tests with quick and direct feedback.

Hiring a professional digital person to train wine people is a key part of success versus the more typical model of promoting someone on staff to learn and implement best practices in e-commerce. The wineries that had the best results when the pandemic hit were those that had professional digital marketers, e-commerce directors and digital consultants at the ready.



Forecast and suggestions

There will be growth in the tasting room because you were closed for part of 2020. But to continue growing in 2021, you can't use all of the same approaches you used pre-COVID because consumers have changed.

Focus your thinking around incremental growth. Which channel segments will do better with reopening and which will recede? Where will you find incremental growth over the next two years as the new normal takes hold?

In 2021, while we wait for vaccines, use that time to maximize your successful 2020 sales strategies. Then evaluate your customers' purchasing journey, noting how they interact with your winery at every point — from entering the winery to checking out at the tasting room and walking away with wine. Do the same with your digital store, from visiting the landing page to unpacking wine at home.

While tasting room sales will come back as business conditions allow, be prepared for a lag as intrepid and local customers venture out before more cautious and distant travelers. We do expect a spike in purchases in 2021, as consumers will have pent-up demand to celebrate restored freedom, making up for delayed events like weddings.

The investment in digital marketing and online sales will be critical for your success. Online sales could easily be responsible for 20 percent of total sales before 2030 — with lower overhead than a tasting room.

Direct-to-consumer sales have suffered in recent years because the tasting room model was set up to get all club signups and a large part of direct sales through the chokepoint of a tasting room. Most of your future growth opportunity lies elsewhere. With 27 percent of new club signups in 2020 coming via the web and Zoom tastings, the industry has proven that you can get club members without insisting they get on a plane to visit your winery. That is a huge opportunity when you consider the lifetime value of one club member.

If you are part of the nearly 50 percent of wineries that have no one reviewing your consumer data, consider taking the leap and getting on the right side of that benchmark. Look to hire someone from outside your company — a full-time or part-time employee or an agency, but someone with expertise in digital marketing and internet sales strategies.

Finally, consider how you connect with your customers, what your messaging is, why your company exists and how it relates to new consumer values. Create a community and provide digital ways that your club and customers can interact with each other laterally instead of always through top-down messaging. Evangelists are powerful agents, and transparent lateral messaging is a better sales tool than vertical communications from a company salesperson.

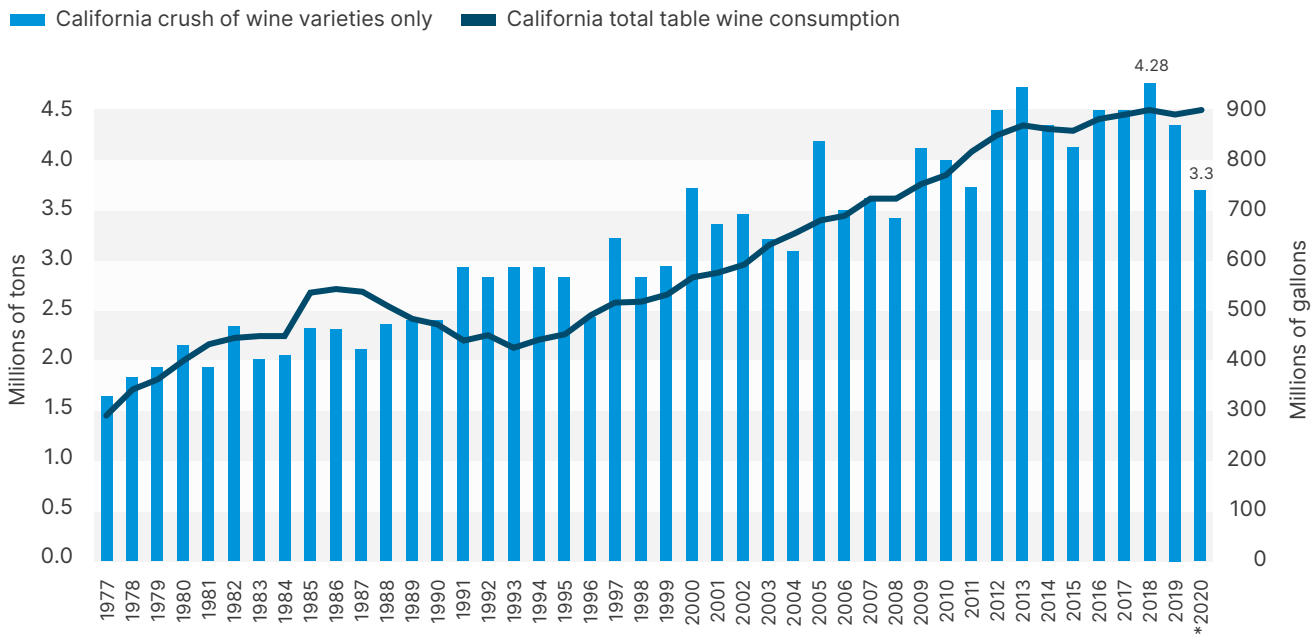
5 Harvest and grape and wine supply

"The farmer has to be an optimist or he wouldn't still be a farmer"

Will Rogers

Moving from acute oversupply to balance in months

Figure 14: **California crush of wine grapes vs. consumption of California table wine**



Sources: California Wine Institute, California Department of Food and Agriculture, SVB

*SVB estimate

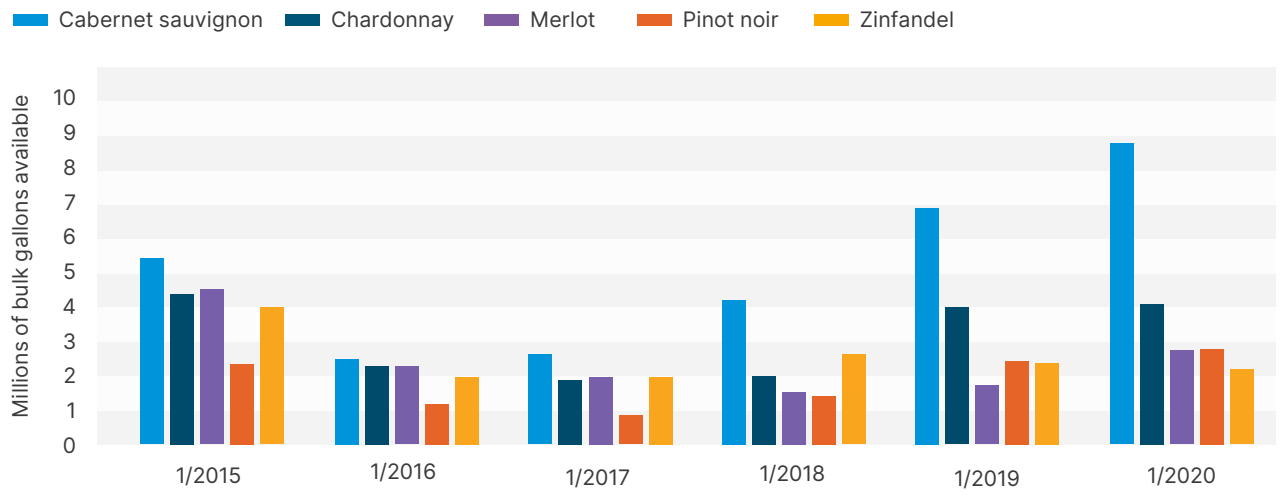
We have to acknowledge that getting good information on supply in the wine business is a challenge. Getting to the real data for supply at a single point in time would have to encompass the entire supply chain. It would start with a view of all varietals, the region where produced, acres in the ground by varietal and region, amount of nonbearing acreage by varietal and region, harvest volumes by varietal and price, bulk juice in winery tanks or coming into port sorted by varietal and intended price point, bulk and finished wine volumes in the cellar, and bottled wine in distribution and at the point of retail sale.

And no good model is useful without a demand forecast because you need to know how quickly wine is being drawn down. Plainly stated, the supply chain is complex, which puts a premium on people with good street-level intelligence and seasoned instinct.[37]

In January 2020, with our best information, we concluded that "we are at a position of oversupply across the entire supply chain. That extends through retail and every growing region in California at every price point" (see figure 15). We went on to offer up ideas about how many years it would take to rebalance supply by region: from three to as long as six years. By April 2020, that was no longer true.

Circumstances changed on the demand side in March, while they changed on the supply side in August. Less than one year from that forecast, with our current estimate of 3.3 million tons harvested in California for 2020 (the lowest tonnage since 2011), we are largely balanced across most regions and varietals as we start 2021 (see figure 14). How could we move from acute oversupply to balance in months?

Figure 15: **California bulk wine inventory**



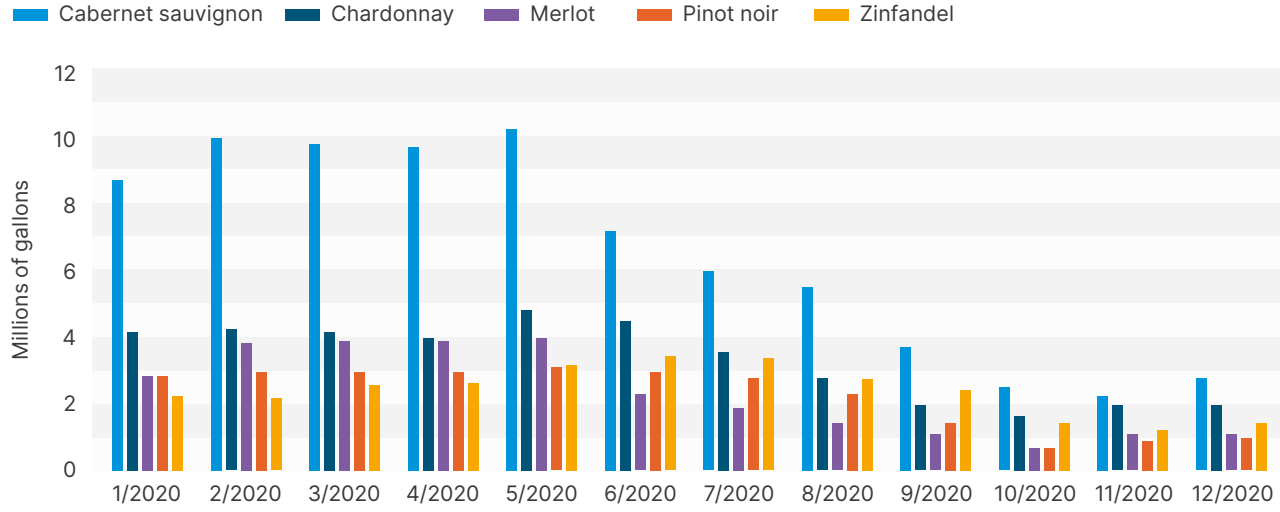
Source: Ciatti

Finding balance through shifting channels

After several years of good-sized harvests and flattening consumption starting in 2015, a supply bubble began to form and burst with the record 2018 wine-grape crop in California[38] (see figure 14). The phenomenon snuck up on the industry because it was somewhat hidden by slowing demand growth, and frankly our industry isn't suited to openly address bubbles as they form due to the negotiations that take place between wineries and growers.

Lacking definitive information, growers and wineries try to cherry-pick available data to benefit their own negotiating position. Wine and grape brokers play the statesmen, parsing their words to keep from offending either winery or grower, and most of the time, we end up more confused about grape supply at any given time and therefore are slow to react. Supply issues only become clear when we hit obvious long or short positions.

Figure 16: **California bulk wine inventory changes**



Source: Ciatti

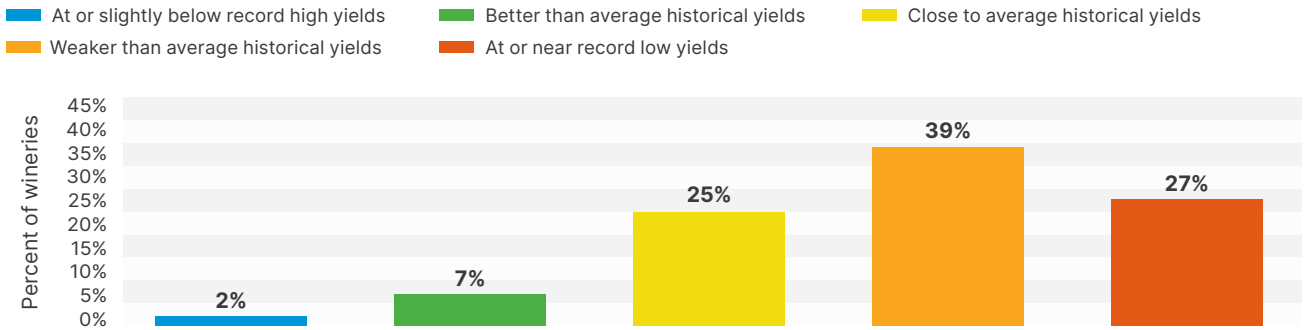
February 2020 was one of those times, and the plain-spoken Jeff Bitter, president of Allied Grape Growers, said, "California is oversupplied by at least 30,000 acres of wine grapes. We need to pull them out. It just has to happen." That kind of clear leadership is rare because it comes with the risk of offending constituents, but it was advice that was needed.

The supply situation changed overnight in March 2020, when the shelter-in-place orders began to take effect and panic buying set in. The larger producers that grow and purchase a lot of fruit in the Central Valley weren't prepared for the high volumes demanded. Even though they started out the year oversupplied, by May they had worked through their oversupply in cellar, and by June those wineries started to buy down excess bulk wine to match off-premise demand, cleaning out that supply (see figure 16). With the large producers still short of product, the 2018 excess Central Coast supply was next to get bottled, though it was purchased at California appellation prices.

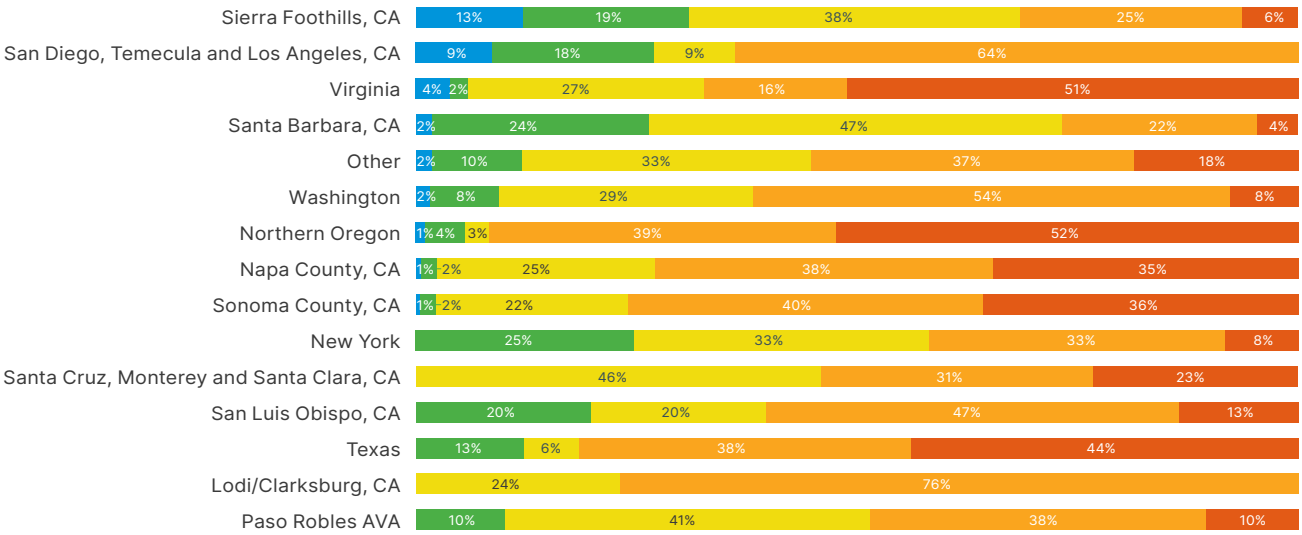
As hard as it is to believe, the high-volume/low-price end of the market was close to being in balance before summer was over. But the lower-volume/higher-priced North Coast had significant tons of fruit without contracts headed into harvest. And with wineries just starting to open up to limited numbers of visitors, the problem of excess supply would not improve just from tourism and tasting room activity buying down wine inventory.

Finding balance in unorthodox ways

Figure 17: **Harvest yields in 2020**



Regional harvest yields in 2020



Sources: SVB Annual Winery Conditions Survey

Then came August 16 and the never-before-seen dry lightning storms that spread wildfires across Central California into Southern Oregon in several large fire complexes, burning 4 million acres in California alone and leaving cities in the West under unhealthy air conditions for weeks on end.

Napa was particularly hard-hit by the Glass Fire, which started on September 27, the second major fire of the year. The Glass Fire cut through the heart of Napa Valley, damaging or destroying dozens of wineries and luxury hotels.[39]

Oregon's fire season ended with a record-breaking 1 million-plus acres burned over a three-week period beginning with the dry lightning storms and extending to September 8, when arid and windy conditions created the perfect environment for wildfire. Washington too suffered, with 700,000 acres burned. Most damage there started on September 7, when high winds and dry air sparked 80 fires, burning nearly 300,000 acres in one day.

The losses of grapes due to smoke taint for the 2020 season will be counted in the hundreds of thousands of tons, though we will probably never know the full extent of the losses. Our analysis has pegged most of the grape losses to Napa, Sonoma and Northern Oregon, though losses occurred throughout the West, including Santa Cruz, Southern Oregon, Mendocino and Lake counties, Monterey, Lodi and Washington state. While atmospheric smoke impacted Paso Robles, there were minimal issues with smoke taint. Further south, Santa Barbara had no smoke issue this year, which is a welcome break for a region that has had its share of fires in recent years.

Fires allowed grape growers on the North Coast of California who might have entered harvest without being fully contracted the opportunity to get insurance payments from grapes that were tainted, and in some rare cases, that led to a better financial outcome.[40] In the same way, in some cases wineries that were oversupplied were able to use this as an opportunity to right-size their production volumes by turning away damaged fruit.

Some wineries harvested and vinified fruit when there was a question about taint, sorting the price out later with the grower or finding a path to disposal. Some wineries with tainted wine from their estates sold off their juice, and it was cleaned up and put into lower-priced bottles elsewhere.

When we look at bulk wine prices, it appears that the North Coast of California and Oregon were able to come into balance with the reduction in fruit and with lower starting yields from the fruit that was harvested — though I think everyone will agree this approach to finding balance is unorthodox and will hopefully never be repeated.

Yields throughout the US were smaller than normal, with no region reporting great yields. As shown in figure 17, respondents to the Annual Winery Conditions Survey judged the 2020 harvest yield to be the worst on record, with almost 40 percent reporting yields weaker than the historical average and 27 percent saying they had yields at or near record lows. Northern Oregon reported the weakest yields, and early indications suggest a drop of about 25 percent. That was followed closely by Texas, which had a difficult growing season throughout the year but with significant regional variation. Sonoma, Napa and Lodi were close behind, with about 75 percent of respondents reporting weaker than normal yields.

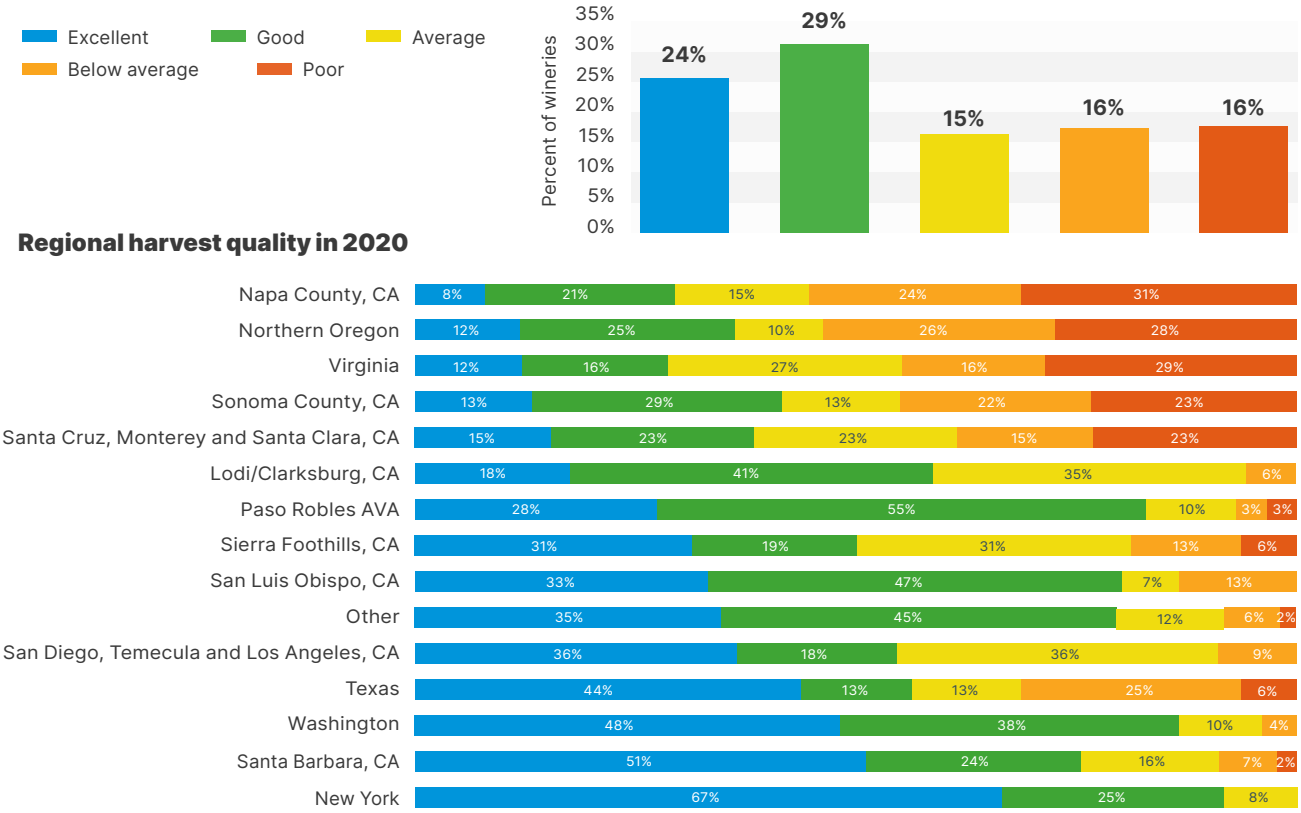
If there is any good news that can come from such a difficult year of uncooperative weather and disasters, it's only that these events happened at a time of abundant supply. Had this been a year when tanks were thin, we would be left with a lingering disaster, since you can't harvest more wine grapes than you grow. All you can do is source wine from elsewhere.

Interestingly, harvest quality was reported as generally good in 2020. For those who could harvest, it was one of those years that produced smaller berries, leading to greater skin contact and more concentrated flavor.

While the vintage might get criticism from wine writers, and consumers might be wary of getting smoke-tainted wine due to the extent of the smoke events combined with national news coverage, early indications are that when 2020 wines come to market, they might turn out to be at the top end of the quality spectrum.

New York reported the best quality of all reporting regions, with a warmer and drier growing season than average, accompanied by significantly reduced rainfall, which limited mold and rot pressure. Santa Barbara, Paso Robles and Washington also reported excellent or good quality, with Paso Robles and Santa Barbara escaping material damage from late-season heat spikes. Washington largely escaped smoke taint and reported warmer days than the cooler 2019 vintage. Most grapes were in before a freeze in late October.

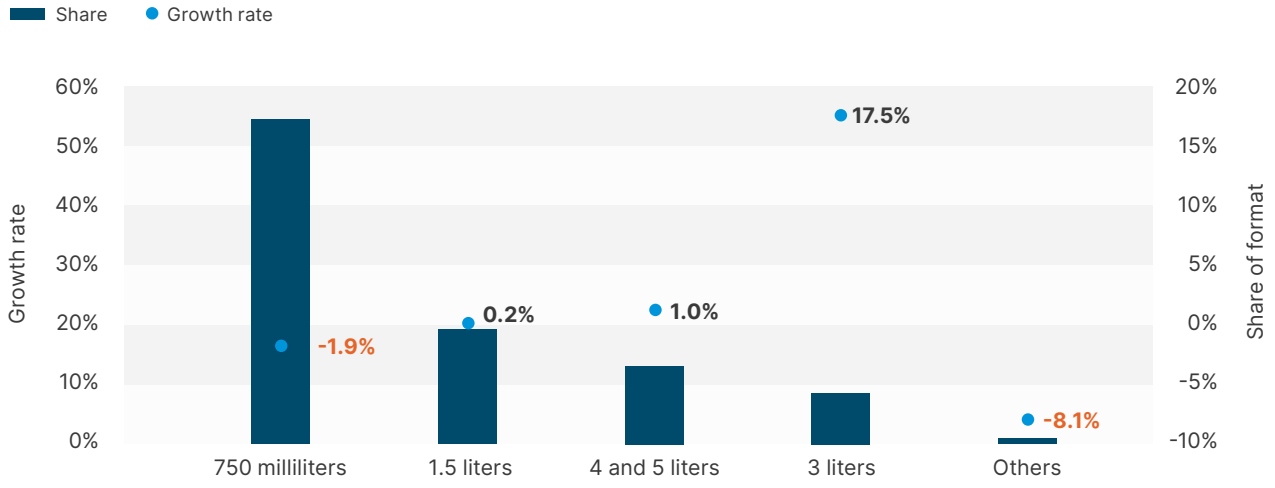
Figure 18: **Harvest quality in 2020**



Sources: SVB Annual Winery Conditions Survey

Formats, varietals and packaging

Figure 19: **Growth and market share of formats**



Source: SipSource, 9/2019

Alternative packaging is continuing to evolve. Over the past year, the growth rate of the 750-milliliter bottle format has dropped once more, and the smaller package sizes, which had positive growth last year (375-milliliter bottles, Tetra Paks, cans and 500-millliliter bottles) fell 8.1 percent combined (see figure 19). The smaller sizes were gaining in popularity pre-COVID, and there is every reason to expect they will resume that growth in a post-COVID world.

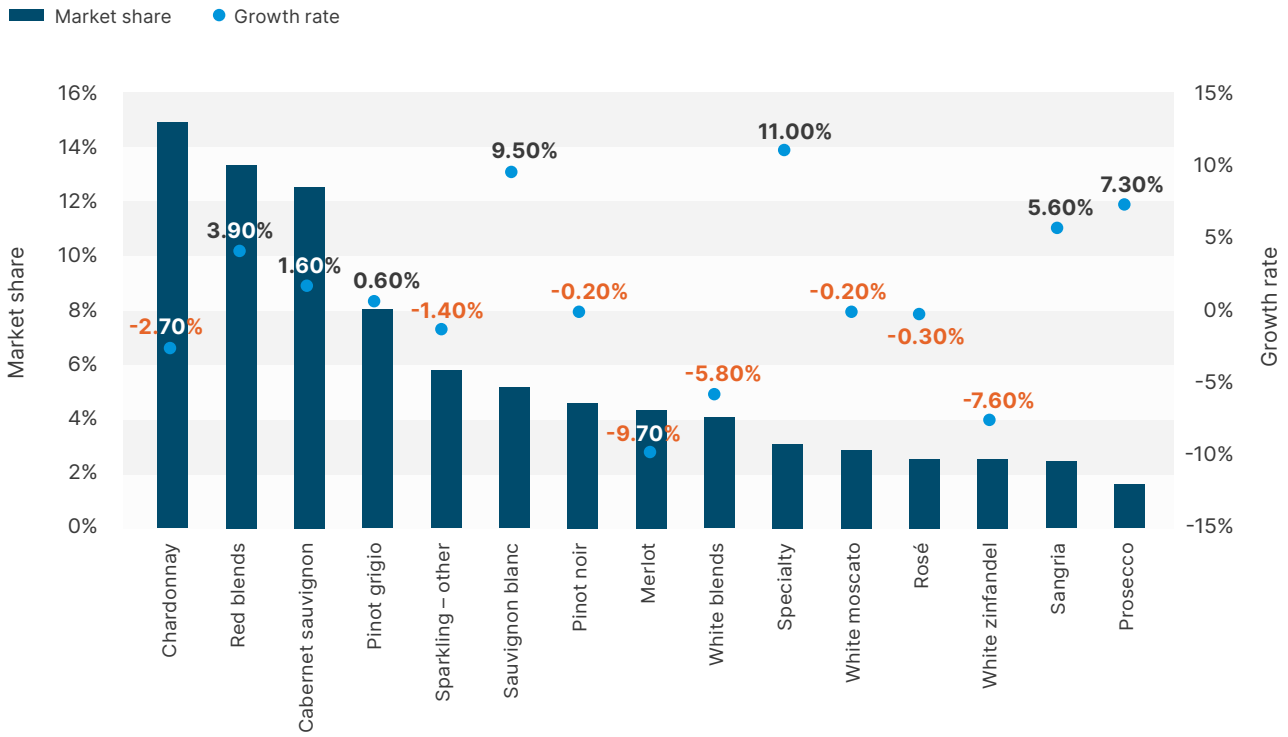
With the decline in the 750-milliliter format, something else has to be moving up strongly, and it turns out it's the larger formats that are growing — everything over the 1.5-liter category, but in particular the 3-liter category, which is capturing premium bag-in-a-box with a growth of over 50 percent. Why the spike in the bag-in-a-box format?

The 3-liter story used to be the old super-size boomer model of including more product at a lower price per unit and saving on packaging. That's how 2-liter soda came to be.[41] The value play there is to reduce packaging costs. With the other formats, packaging costs are actually higher, but the overall price of the product is lower.

COVID-19 has accelerated many trends, one of which is the early retirement of boomers. As boomers retire, they will join millennials as frugal consumers and change their consumption and spending. But as any wine lover will tell you, it's hard to drink good wine and go backward to lesser-quality wine. The premium 3-liter package suits that consumer, but with COVID we shouldn't rule out another source of growth — the millennial consumer, who is beginning to show modest positive growth in lower tiers of premium wine consumption.

The COVID-19 recession has been hardest on lesser-paid employees. At age 40, those on the outer edge of the millennial generation are well into their careers and are a well-educated population; in many cases, those with established professions have been able to work from home. These younger consumers are still frugal but can do the math on a 3-liter premium box of wine. For a young family now able to all be at home for dinner, premium box wine is a good solution.

Figure 20: **Varietal growth and share of market**



Source: SipSource

Movement in varietal share and growth rates is reflecting consumer changes too. While chardonnay is still the most popular varietal (see figure 20), its growth rate is negative for the second year in a row at negative 2.7 percent on a trailing 12-month basis, while misunderstood merlot shows the worst decline at almost 10 percent. And the bloom is officially off the rosé this year, with a growth rate slightly below zero.

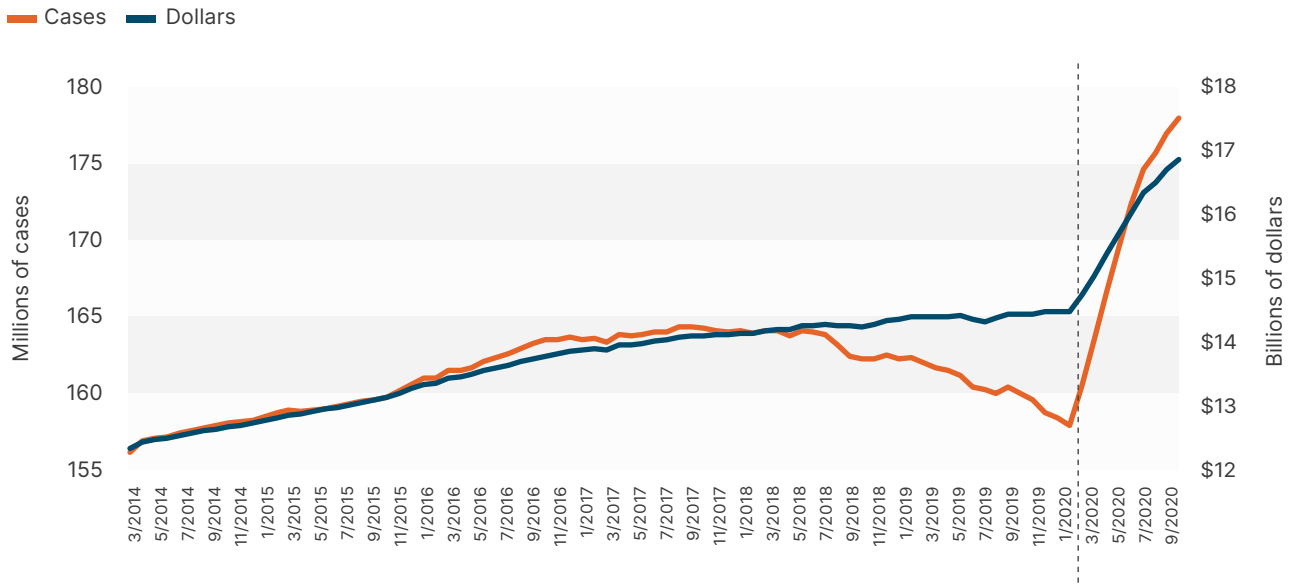
Red blends have made a comeback in 2020. After a negative growth year in 2019, the red blend category is back to a respectable 3.9 percent growth. But it's the sweeter and specialty wines that show more impressive growth. Specialty wines, in particular agave-based wines that blur categories and play off the popularity of tequila and margaritas, show impressive growth of 11 percent. Agave wine is much lower in alcohol content than tequila and plays to a health-minded consumer looking for fewer calories, in addition to drawing Hispanic consumers who are used to the product, which has been sold in Mexico for some time. Prosecco, sangria and sauvignon blanc are other varietals getting consumer attention.

Red blends have made a comeback in 2020. After a negative growth year in 2019, the red blend category is back to a respectable 3.9 percent growth. But it's the sweeter and specialty wines that show more impressive growth.

6 Demographics and marketing

The US wine industry isn't doing a good enough job of marketing and selling its product, often remaining wedded to successful strategies of the past while the culture and consumer have radically evolved.

Figure 21: **Long-term trend of off-premise retail sales (rolling 52 weeks)**



Source: Nielsen

A myriad of rapid shifts in 2020 — the greater numbers of boomers retiring, the increase in the work-from-home sphere, wider use of home delivery, a population shift away from major cities, a recession that has weighed more heavily on lower-level employees and the jarring growth rate of internet sales — have made the reading of trends much more difficult. All of the factors named above, and more, require consideration before you decide where to go with sales and marketing.

What happened to the pre-COVID long-term trends that were pressuring sales growth lower? Did they vanish? The answer is no.

Prior to March 2020, the US wine business was clearly hitting a ceiling in its ability to grow, largely due to a few fundamental challenges the industry hadn't fully accepted or addressed. We can't correct what we don't identify or acknowledge.

The growth rate of off-premise wine sales turned negative starting in 2017. But in March 2020, using just the grocery channel, that rate turned decisively positive (see figure 21), and news reports and anti-alcohol groups — applying surveys to consumption volumes[42] and citing Nielsen data — concluded that consumers sheltering at home were binge drinking.[43] None of that was true if we also take into consideration that many restaurants were closed and other venues and occasions were lost.

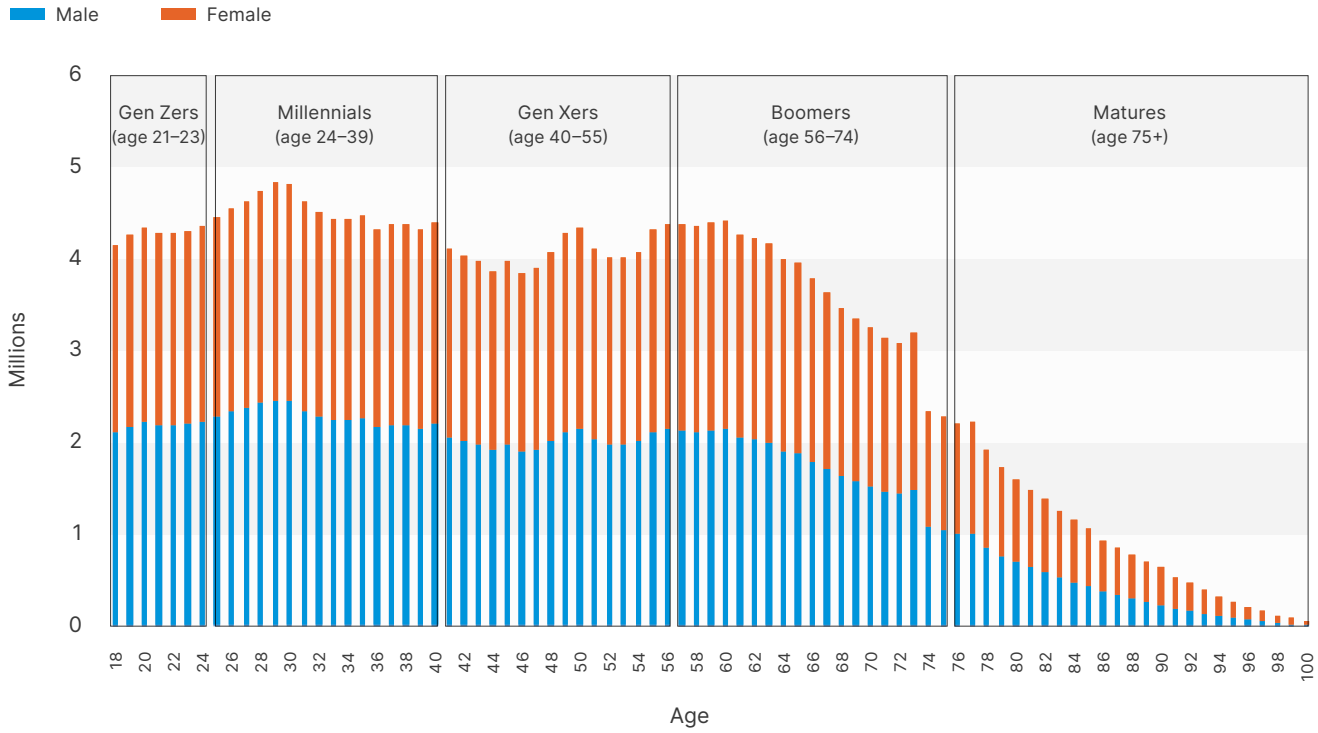
As of this writing, December 2020 sales are starting off poorly due to new lockdown orders in the US and will likely put the final growth rate of 2020 still wine sales between 0 percent and 1 percent, which is roughly equivalent to the US population growth of 0.6 percent. The consumer really hasn't been consuming more wine. Knowing we are still trending in the wrong direction for total sales, how will we recover the growth rates from past years that allowed everyone to prosper?

As we move toward a post-COVID world, we will need to address biased attacks on moderate wine consumption, invest in digital strategies and develop a marketing approach that addresses the rotation to younger, health-conscious consumers.

Consumption patterns: Millennials vs. boomers

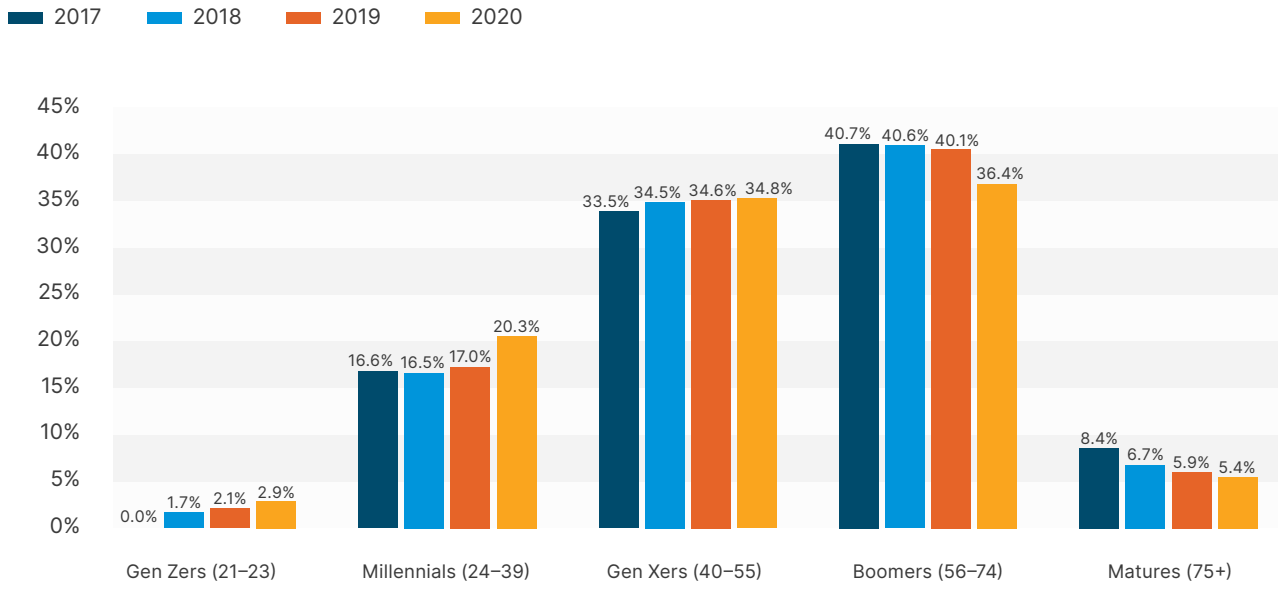
While the average age of wine drinkers continues to grow older, the neglected growth opportunity is selling to younger consumers, who have different values, are more health-conscious, have lower discretionary income and wealth, and are more ethnically diverse than previous generations.

Figure 22: **US population by age**



Source: US Census Bureau population estimates, 2019

Figure 23: **Wine consumption by cohort**

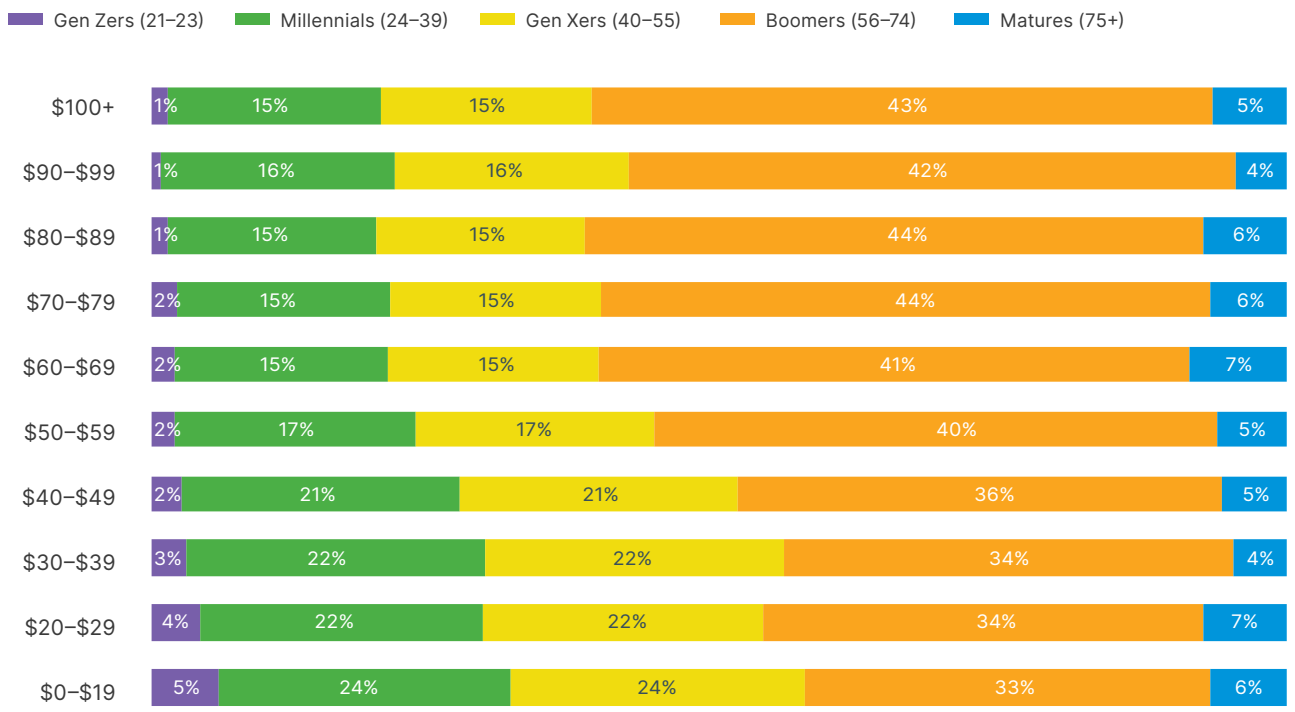


Source: SVB Annual Winery Conditions Survey

Each cohort is playing a role in the consumption shift in wine today (see figure 23):

- We are living with the sunset of the mature cohort, which has a median age of 88.5. Their numbers are in decline due to mortality and today represent only about 5 percent of consumption by value and less by volume.
- Baby boomers, with 70 percent of the disposable income and more than 50 percent of wealth in the US, are still the largest consumers of wine today. But as of this year, with only a single percentage point separating their consumption share from that of Gen X, they can't be considered the dominant group. Consistent with our forecast in this report starting in 2016 and each subsequent year, boomers should cede their top spot to the Gen X cohort in 2021. They are exhibiting changing spending patterns due to age, health and retirement concerns.[44] The median boomer will reach the normal retirement age of 66 in 2021. While the pandemic has convinced some to take early retirement, the good news is that many boomers will likely continue to work past normal retirement and continue to buy wine.
- Gen Xers have now lived through the two longest economic expansions in US history, are still in their prime spending years and are holding up their end of wine buying but no longer own the biggest growth rate in consumption — passing that honor to millennials as of this year.
- The millennial cohort is the largest growth opportunity for the US wine industry but has just started to show interest in the wine category — at a time when the growth of volume sold in the industry is near zero, depending on the analyst you listen to. This is the cohort that needs to be excited about wine in order for the industry to see anything close to the growth rates experienced in the 20-year period from 1994 through 2014 (see figure 14).

Figure 24: **Consumption by cohort based on winery's average bottle price**



Source: SVB Annual Winery Conditions Survey

In my view, the issue of greatest concern for the wine business today continues to be the lagging participation in the premium wine category by the large millennial generation. In just nine more years, the last boomer will pass age 66 and be eligible for full Social Security benefits.[45] What will the average wine consumer look like with the boomer in full retirement?

While millennials are competitive with Gen Xers in their consumption shares at lower bottle price points (see figure 24) and are interested in wine by all accounts, until the COVID period they hadn't made any noticeable movement to be premium wine consumers, holding firm at around 17 percent of the premium market, based on Silicon Valley Bank research (see figure 23). Given the lack of volume growth in the industry, it's somewhat difficult to determine if the growth in the millennials' consumption share was due to a real change in their behavior or simply resulted from more boomers sheltering in place compared to young consumers.

While the wine industry makes slow inroads to attract the young consumer, the luxury market has gone all in, adapting product offerings, digital communication and engagement strategies and evolving distribution channels. The comparison with the wine business is stark: About 20 percent of millennials consume wine, yet many more, 33 percent, consume luxury goods.

Figure 25: **Generational differences**

Value	Boomers	Millennials	Action
Support group	Family	Friends	Drive club socialization
Choice in food	Don't eat if it's bad for you	Only eat if it's good for you	List ingredients, calories; show how it's "better for you"
Business	Capitalism is the path to individual wealth	Wealth comes with social responsibility	Define your contribution to social values
Diversity	Civil Rights Movement drove change	Social and ethnic diversity drives change	Diversify in staffing, advertising and tasting room
Landfills and waste	Disposable culture	Green, reuse and repurpose culture	Lower carbon footprint with better packaging and sustainability strategies
Spending	Conspicuously	On important things	Improve wine value by selling on important personal values
Fun	Work before fun	With everything!	Embed into events, tasting room, marketing and communications

Source: SVB

The millennials' real progress in capturing premium wine share from boomers has been a delayed promise because of several factors, including their early preference for craft beer and spirits, questions surrounding the health of alcohol consumption and a delay in establishing careers, families and wealth compared with prior generations. But what has been made clear in the aftermath of the George Floyd murder and the ensuing protests is that young consumers expect more from brands they adopt and support.

Status-seeking boomers loved to display their wealth and success prominently. They were the generation that premiumized wine in America. Getting information about special soils, harvest dates, pH, the winemaker or a wine score allowed that consumer to indirectly reference the price of a bottle to their friends without coming right out and shouting it to everyone.[46]

The younger wine consumers now, having lived through the Great Recession and a pandemic, aren't destined to be consumers who will want to show off their wealth. They too will work for a better lifestyle, but they want to know that those who have wealth are contributing to a better world in some way, and instead of bragging about price, they would rather talk to friends about the good work that a brand and its owners are taking on (see figure 25).

In addition to sustainability, health and environmental issues, which have long been important to younger generations, today social justice, equity and diversity concerns are driving these consumers to place unprecedented pressure on companies to adopt these issues into their brand platforms. The social intersection between a brand and the consumer is increasingly connected to the decision to purchase particular products, including wine.

Future success in marketing to millennials depends on recognizing the things that are important to them versus what's important to boomers. That's not meant to imply we need to change our core brand or a traditional label, but we have to evolve and leverage the consumer's values when marketing wine.

Figure 26: **Sample snack food label**

Nutrition Facts

1 serving per container
Serving size 1 can (355 mL/12 fl. oz.)

Amount per serving

Calories 100

	%DV*
Total Fat 0g	**0%**
Sodium 20mg	**1%**
Total Carbohydrate 2g	**1%**
Total Sugars 2g	
Includes 2g Added Sugars	**4%**
Protein 0g	**0%**

Not a significant source of total fat, saturated fat, *trans* fat, cholesterol, dietary fiber, protein, vitamin D, calcium, iron and potassium.

*%DV = % Daily Value

During my last speech in front of a live audience in March 2020, I ended with the following statement: "Wine. It's the beverage young consumers want. They just don't know it." The strange reality is that it would be easy to start talking about wine in an evolved way and to reference the many things that are already a part of what we do and would resonate with younger consumers, yet as an industry we are not doing it.

Many in the wine business use sustainable farming practices and take great care in their winemaking by recycling water, avoiding the use of glyphosate, building and retrofitting with LEED Certification in mind and being good stewards of their land. Some use biodynamic and organic[47] farming techniques, but little of that shows up in marketing a bottle of wine today, and none of it appears in terminology and graphics the young consumer expects.

Eating healthy is a critical value of young consumers, and as consumers age, there is ample evidence that boomers are taking their cues from young people, adopting their own health-conscious diets and consumption patterns. In years past, of all alcoholic beverages, wine had scientific evidence to show that it was part of a healthy diet and lifestyle. Health touchpoints for the current consumer come from different indicators.

Look at snack foods today, and you will see that they often come in 100-calorie packages (see figure 26). Why is that? Because young consumers are conscious about their health, and weight is a factor in living a healthy life.

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

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

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

7 Cumulative negative health messaging

"Our country has deliberately undertaken a great social and economic experiment, noble in motive and far-reaching in purpose."

Herbert Hoover addressing the topic of Prohibition at the Republican National Convention, 1928

Let's just agree that the experiment Hoover referenced was a failure. Let's further acknowledge that moderate wine consumption is under attack, no matter what the science says about improved mortality and morbidity rates.

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 saw drinking alcohol as sinful, activist organizations whose primary goal was eliminating deaths from drunk driving,[48] 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.

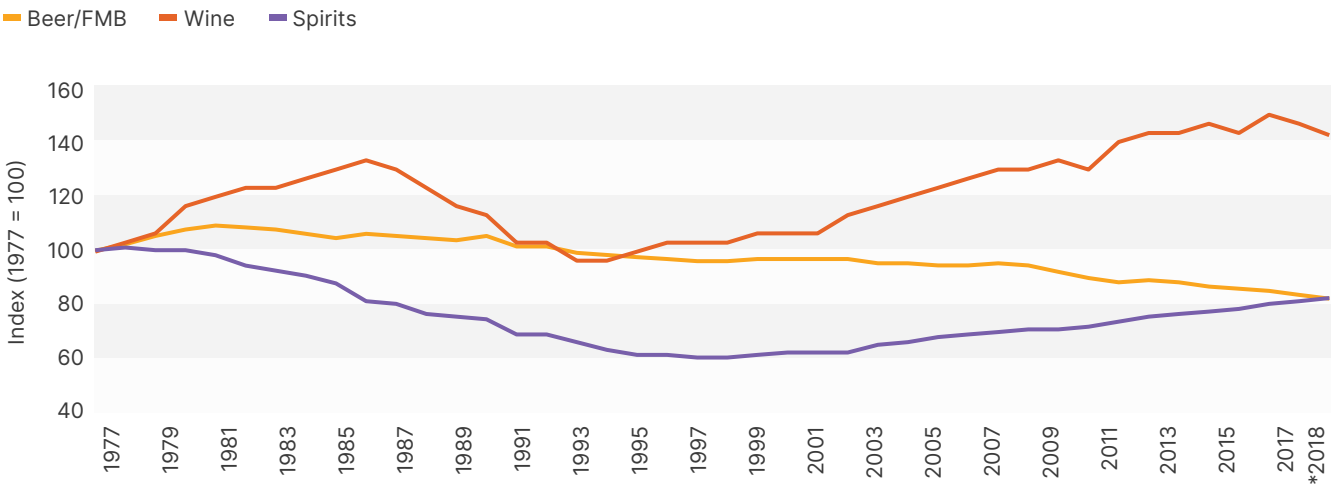
The growing clamor culminated with the Anti–Drug Abuse Act of 1988,[49] which included government health warnings about alcohol and the addition of a government warning on alcohol beverage labels.

On March 3, 1988, President Clinton, through the National Highway Traffic Safety Administration (NHTSA), introduced an administrative order for, and penalties against, any state not adopting a 0.08 maximum per se standard for drunk driving.[50]

The neo-prohibition message was confronted on November 17, 1991, when 20 million viewers in the US heard the CBS *60 Minutes* broadcast on the French Paradox, which suggested that wine consumption had health benefits.[51] It immediately caused a spike in red wine consumption. That was followed in the mid-1990s with widespread public acceptance of the Mediterranean diet[52] and later punctuated with the publicized work of Dr. Arthur L. Klatsky,[53] a Kaiser Permanente cardiologist who separated the discussion of moderate and heavy consumption and showed the health benefits of moderate alcohol consumption over both heavy consumption and, surprisingly, non-consumption. And subsequent work proved there were lower morbidity rates associated with moderate consumption.

With the positive medical reports, per capita wine consumption soared starting in 1994, when baby boomers hit their consuming stride, which coincided with their prime retail spending years. Spirits consumption showed some modest positive change shortly thereafter due to both Dr. Klatsky's findings and the premiumization trend (see figure 27).

Figure 27: **Percent change in per capita ethanol consumption**



Note: "FMB" stands for flavored malt beverage.

Source: National Institute on Alcohol Abuse and Alcoholism, Surveillance Report #113

*SVB estimate

The cumulative weight of the 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, but the anti-alcohol movement never stopped fighting the war.

Neo-prohibition, the sequel

Since the French Paradox story was carried on *60 Minutes*, numerous health organizations have expended considerable time and money to produce alternative research that calls into question or counters the original research findings.[54]

With the studies coming to different conclusions and causing confusion, and with a refresh of the government's Dietary Guidelines for Americans under discussion, in December 2003 the National Institute on Alcohol Abuse and Alcoholism (NIAAA) funded a study to review the empirical work done and "assess the strength of the evidence related to health risks and potential benefits of moderate alcohol consumption."[55]

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

> The cumulative weight of the world messaging and anti-alcohol studies has been effective and has once again emboldened US regulators to promote additional restrictions on alcohol consumption.

In 2018, the UK's Chief Medical Officer, Sally Davies, told a British television interviewer, "There is no safe level of drinking." Even more surprising was the statement by the French health minister, Agnès Buzyn, who said that wine was bad for people.[56] The cumulative weight of the world messaging and anti-alcohol studies has been effective[57] and has once again emboldened US regulators to promote additional restrictions on alcohol consumption.

Quietly, in January 2018, the US Department of Health and Human Services (HHS) deleted the dietary guidelines that said moderate drinking could lower the risk of heart disease,[58] ignoring their own prior findings by the NIAAA.

In July 2020, as everyone was busy dealing with a pandemic and recession, a handpicked panel of scientists with an anti-alcohol bias recommended to the Department of Agriculture and HHS that the USDA's dietary guidelines for alcohol consumption be reduced from two drinks per day for a man to one drink per day, the same as the guideline for women.[59] Public comment was closed off on August 13, leaving little time to respond.

> This was a small victory in a larger battle the wine industry isn't fighting.

While those who devised the prior guidelines focused on total mortality and decided that there were benefits from moderate consumption, this panel concluded that "because alcohol is not a component of USDA food pattern guidance, its added energy is discretionary and should be considered in the present context of high and increasing obesity prevalence." The panel then contemplated the relationship between alcohol consumption and "all-cause mortality," thereby including obesity, cancers and any other illness that anti-alcohol groups partially attribute to alcohol. It was another attempt to move the goalposts — no matter if science shows that people live longer lives when consuming wine moderately. We dodged a loss this time when the USDA rejected its own panel's recommendation and left the guidelines unchanged. This was a small victory in a larger battle the wine industry isn't fighting.

We have returned to the neo-prohibition era in this debate. Alcohol consumption is being equated to opioid addiction again.[60] 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.[61]

The youngest consumers are health-focused, which explains the explosive growth in health beverages in the US.[62] Compared to the boomers, who ate "if it wasn't bad for you," the current generation wants to consume things that are "good for you."[63] With today's messaging, young consumers are consuming less alcohol than prior generations.[64]

If we don't do anything to offer a counterargument, within the decade we should expect to see cancer warnings on wine bottles, no matter what the science proves. This labeling was adopted as law in Ireland in 2018 and in the Yukon Territories in 2020 and is being pursued in numerous other countries.[65,66,67]

Others are starting to take action. The spirits industry's trade organization, DISCUS, announced that it has added a full-time person to advise the organization and the industry on matters related to scientific policy and research.[68]

The Beer Institute likewise hired a senior director of health policy and regulatory affairs to "make sure public policy affecting our nation's brewers and beer importers is grounded in science."[69]

Despite the clear headwinds, the wine industry is the only alcohol beverage group without a trade organization willing to take on this work, and wine has the most positive story to tell of all the alcohol beverages.

"If we don't do anything to offer a counterargument, within the decade we should expect to see cancer warnings on wine bottles, no matter what the science proves.

8 The year in review

"Never forget to thank your past years because they enabled you to reach today! Without the stairs of the past, you cannot arrive at the future!"

Mehmet Murat ildan

No narrative on 2020 would be complete without a review of the conditions and timing of events that changed life for the consumer and the wine business. As noted in the Introduction, this year was one in which we answered the rhetorical question, what else can go wrong?

The events impacting the wine industry influenced decisions and shaped financial results. They are a starting point to discuss the permanent consumer and business changes that will be part of life in a post-COVID world and the ways in which business conditions created by COVID-19 will likely unwind.

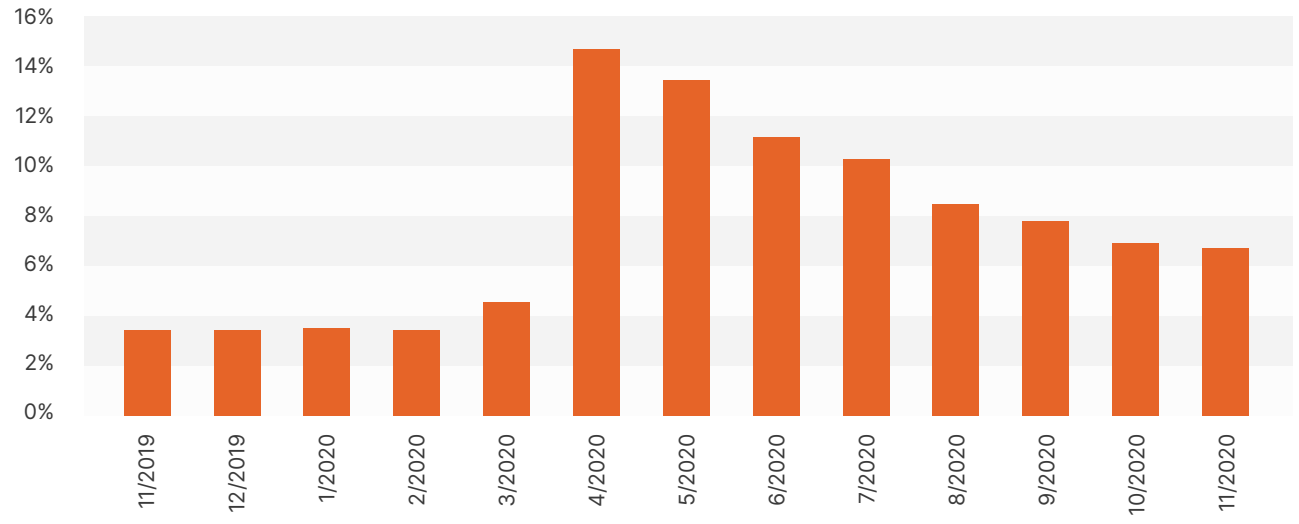
Surprise and shock: The first 90 days of the pandemic

In mid-December 2019, news of an unknown virus in Wuhan, China, started to gain minor notice in the US. On January 14, the World Health Organization tweeted that "there's no clear evidence of human-to-human transmission of the novel coronavirus." On January 21, the US Centers for Disease Control (CDC) issued a press release confirming that a patient in the state of Washington had contracted the novel coronavirus.[70] The CDC reported the "the risk of 2019-nCoV to the American public at large remains low at this time."[71]

In other news, the UK and US announced that they agreed to protect the wreckage of the RMS *Titanic*. In sports, the US fixated on the Super Bowl, which would be played in early February, while the wine world fretted over the announced tariffs on EU wine. In short, we went about our lives and paid little attention to the disarming statements from the WHO and the CDC regarding a virus believed to be confined to another continent.

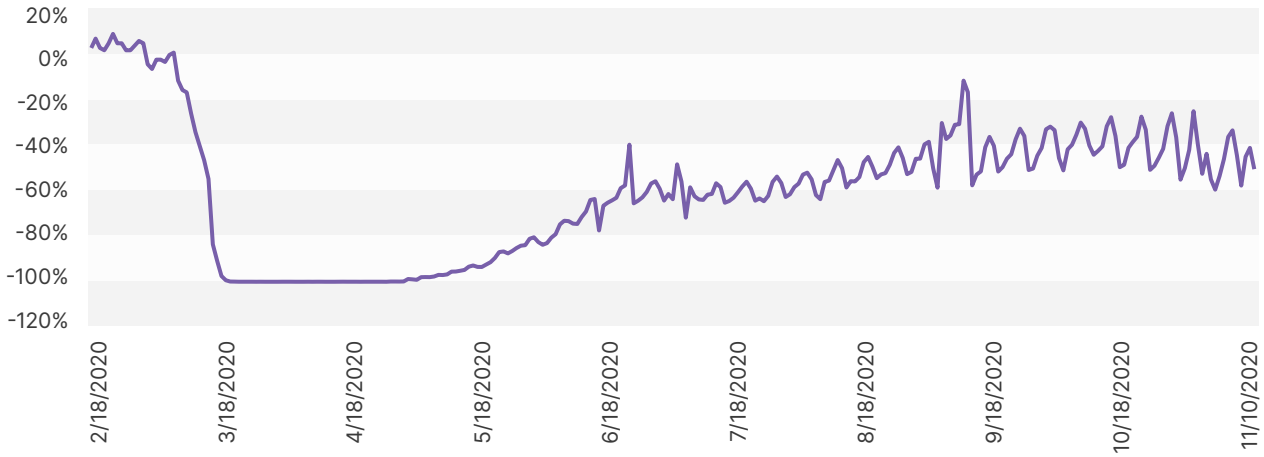
On February 13, the CDC reported the 15th case of the new virus in the US from a patient who was under quarantine along with the other passengers on a State Department–chartered flight from China.[72] On February 19, the S&P closed at a record high of 3,386, and the next day, the Bureau of Labor Statistics announced the US had an unemployment rate that was approaching an all-time low (see figure 28). The Fed's meeting minutes revealed that commissioners expected economic growth to continue at a moderate pace.

Figure 28: **US unemployment rate**



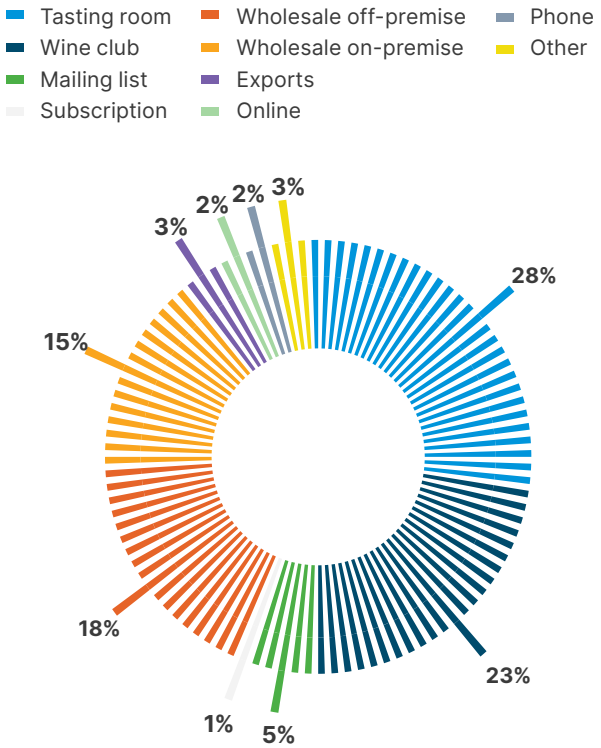
Source: US Bureau of Labor Statistics

Figure 29: **Change in number of seated diners in US restaurants vs. prior year**



Source: OpenTable

Figure 30: **Average winery's sales channels — April 1, 2020**



Source: SVB Annual Winery Conditions Survey

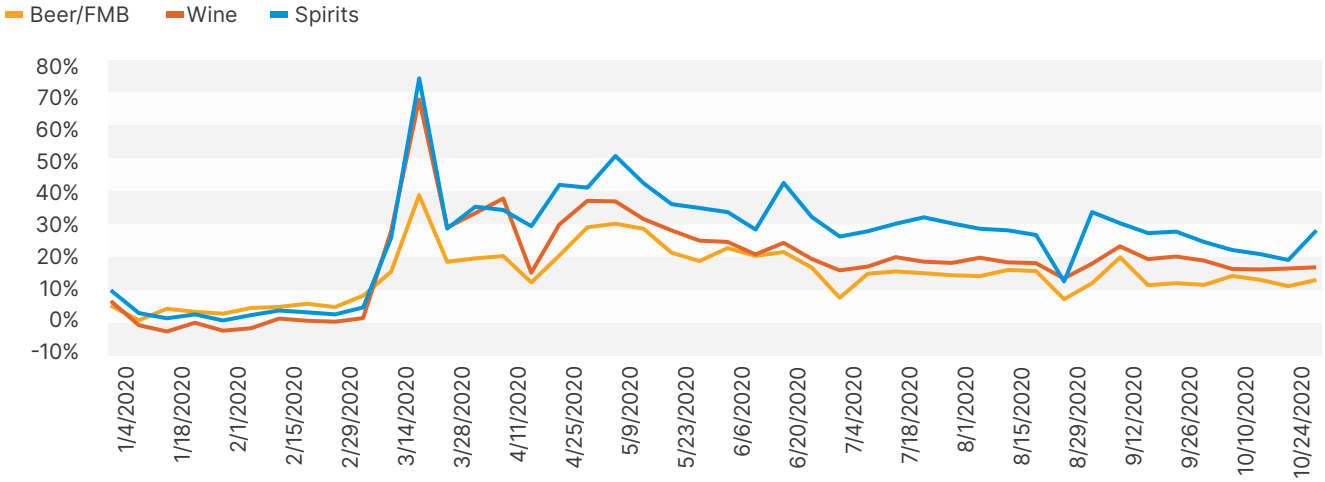
The country focused on the Democratic race for the White House.[73] News of the coronavirus was limited, such as a *Wall Street Journal* opinion piece critical of the Chinese response to their epidemic,[74] but as a country we were continuing about our daily lives without change. That would end a short three weeks later, when governmental actions to stop the spread of the coronavirus would alter life as we knew it, paralleling the events of a bad sci-fi movie.

On February 26, California announced the first case of community transmission in the US.[75] On March 1, New York reported its first case of the virus,[76] and on March 15, California Governor Gavin Newsom, in a startling announcement, called for the closure of all winery tasting rooms and bars.[77] The same day, the Federal Reserve in an emergency action ordered a new round of quantitative easing, dropping the fed funds target rate to between zero percent and a quarter percent.[78]

The next day, on March 16, California closed all dine-in eating establishments (see figure 29), and three days later announced that all Californians were to shelter in place and work from home.[79] Now the pandemic officially had everyone's attention.

The governors of Oregon and Washington followed suit on March 23, and by April 1, with 184,000 confirmed cases and almost 4,000 deaths in the US, governors nationwide had done much the same, nearly stopping business operations in the hospitality, leisure and tourism industries. The US was dramatically plunged into a recession with nearly record levels of unemployment (see figure 28).

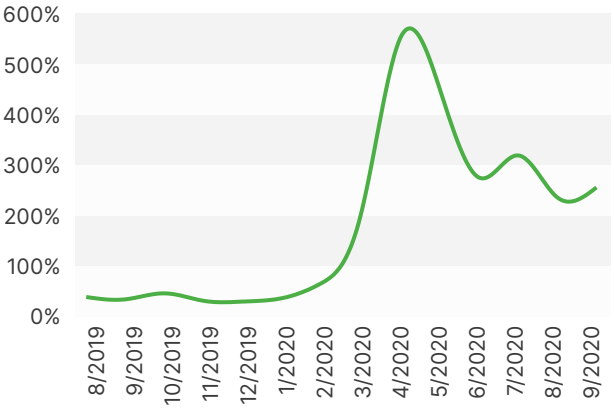
Figure 31: **Off-premise change in value vs. prior year**



Note: "FMB" stands for flavored malt beverage.
Source: Nielsen

Closed or severely restricted were many if not all tasting rooms, restaurants, sporting events, beaches and parks, shopping malls, cruise lines, airports and airlines, concerts, movie theatres, conventions, hotels, colleges, bars and nightclubs — virtually all commercial venues where wine was sold or consumed, a circumstance nobody had ever experienced, anticipated or prepared for.

Figure 32: **Change in online sales of alcohol vs. prior year**



Source: Nielsen/Rakuten Intelligence

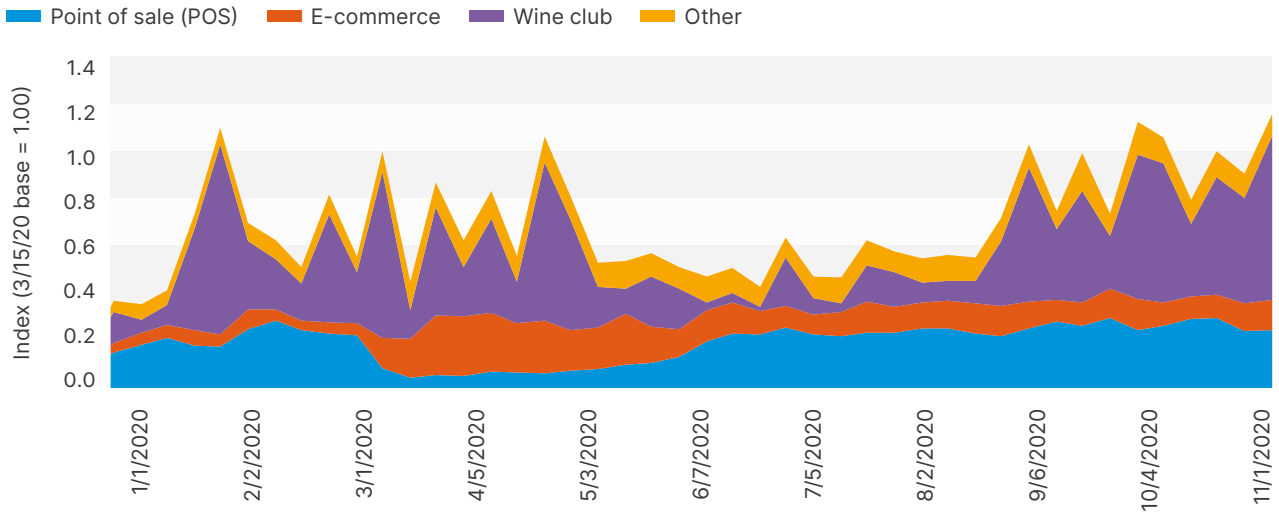
With existing supply channels fraying while families worked from home and struggled to define a normal routine, it didn't take long for new shopping behaviors to emerge.

Consumers started hoarding. Cleaning supplies, face masks, toilet paper and less-perishable food staples such as dried beans, rice, pasta and canned goods were among the first items to run short. With restricted business conditions, impacted consumers also took to the internet to order food, alcohol (see figure 32) and other items needed to live, work and homeschool their children. "Next-day delivery" from Amazon could mean next month.[80] Wine ended up being hoarded as a staple, and most analysts believe total wine volumes were running higher during the period.[81]

Family-owned wineries in March were coming to grips with the potential loss of 44 percent of their normal sales, and many were fighting for their businesses' lives. Yet larger production wineries with wholesale partners had to deal with unanticipated sales growth through grocery sales (see figure 31).

April and May were a time of remarkable transformation for family wineries as each reacted to tasting room closures by preserving cash, deferring capital expenditures and right-sizing or repositioning staff. Sales efforts shifted to online sales, digital tastings, curbside deliveries, phone sales and a tighter focus on connecting with club members by phone and digitally. Club shipments in the spring were almost universally strong.

Figure 33: **Direct-to-consumer channel movement in 2020**



Sources: Commerce7, vinSUITE, SVB

Tasting room sales through POS terminals nearly vanished, yet the consumer — unsatisfied by off-premise wine offerings — made up for virtually all of that lost revenue by shifting to online shopping (see figure 33). That's not to imply that wine producers changed their online methods. It's only to state the fact that consumers found producers' wine simply because the wineries' servers were plugged in.

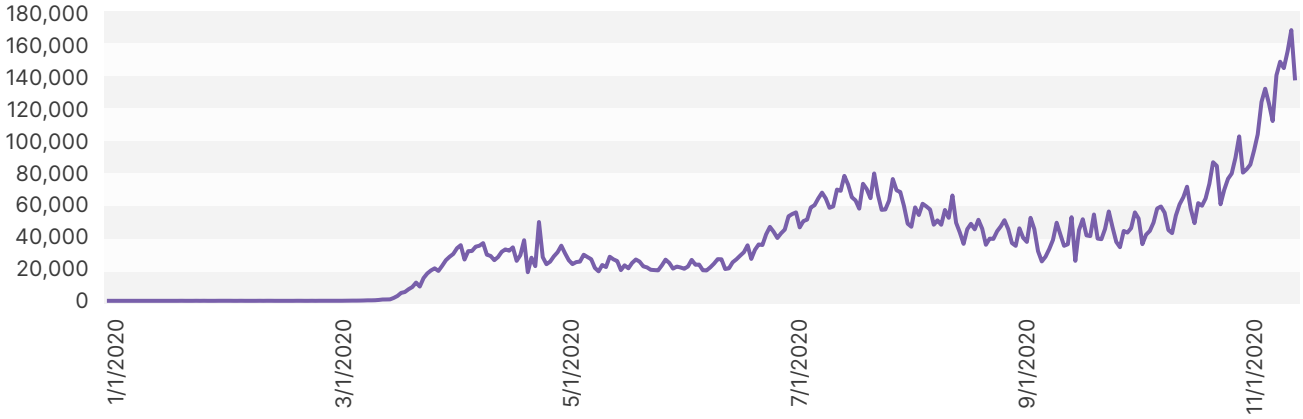
Meanwhile, the massive channel shift to off-premise (see figure 31) caused some grocery chains to close early and restock shelves. Unprepared for this massive spike in channel demand, production wineries, working with their wholesalers, repositioned existing stock that was destined for on-premise into off-premise. Even that was insufficient to meet demand, so the bulk wine market started to heat up, with producers first buying down the acute oversupply of 2018 bulk wine. When California-appellated wine became short, Central Coast wine started filling in gaps, though at California prices.

What is normal during a summer pandemic?

After battling through the shock of a spring lockdown and with the rate of infections flattening (see figure 34), people across the US were looking forward to summer travel and warmer days.

As we moved into June, some thought we might be through the worst of the nightmare, with a baseline set of behavioral standards and regulations we could sustain before getting a vaccine that would end the battle. Also, the arrival of summer in the Northern Hemisphere brought with it hope that COVID would behave like the flu and subside until fall. What else could go wrong? It turned out there was more.

Figure 34: **Daily new COVID-19 cases in the US**

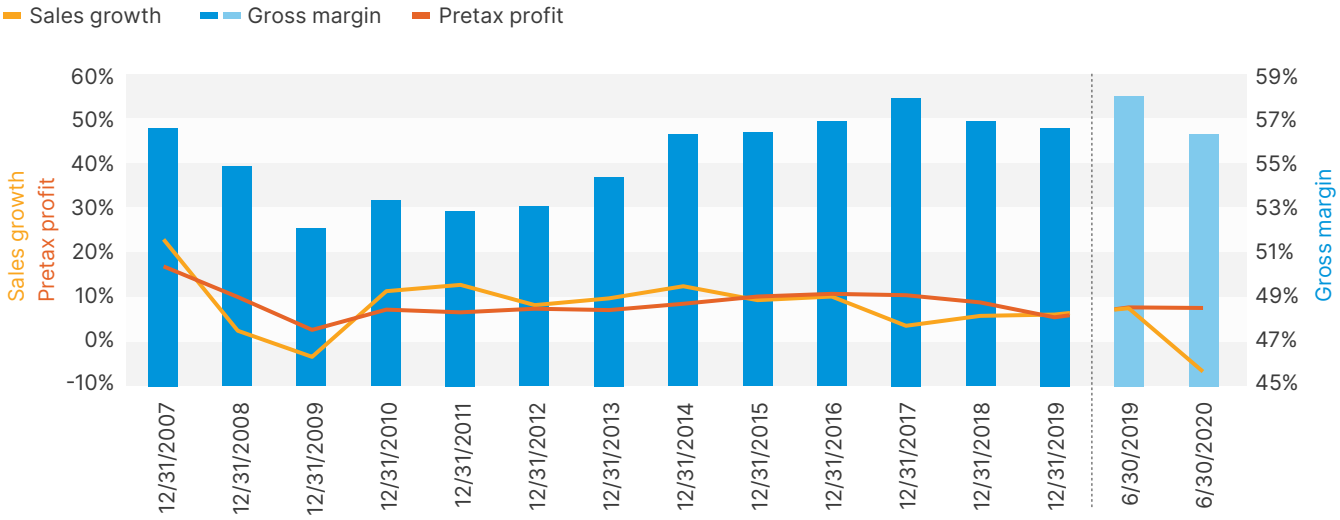


Source: Our World in Data

In late May, the dark cloud of George Floyd's death, and the ensuing protests and riots across America, emphasized the deep divide in the nation.[82] Wearing or not wearing masks, tightening or restricting business regulations — all debates became part of the divisive atmosphere. Part of the country called off celebrations for graduations, weddings, Memorial Day and Independence Day (all occasions in which wine might be consumed), while others continued with their traditions and a growing number of people decided to ignore the health warnings altogether in day-to-day life.[83]

By July 15, the infection rate had ballooned to 75,000 per day (see figure 34), dashing earlier hopes for an end to the health crisis. Across the country, new restrictive health orders for business and travel were issued.[84]

Figure 35: **Premium winery income statement averages**



	Dec 2007	Dec 2008	Dec 2009	Dec 2010	Dec 2011	Dec 2012	Dec 2013	Dec 2014	Dec 2015	Dec 2016	Dec 2017	Dec 2018	Dec 2019	Jun 2019	Jun 2020
Sales growth	22.3%	2.0%	−3.8%	10.8%	12.2%	7.7%	9.2%	11.9%	8.8%	9.6%	3.1%	5.3%	5.6%	7.0%	−7.1%
Gross margin	57.1%	55.3%	52.4%	53.7%	53.2%	53.4%	54.8%	56.8%	56.9%	57.4%	58.5%	57.4%	57.1%	58.6%	56.8%
Pretax profit	16.3%	9.5%	2.2%	6.7%	6.1%	6.9%	6.6%	8.0%	9.6%	10.2%	9.9%	8.3%	5.0%	7.2%	7.1%

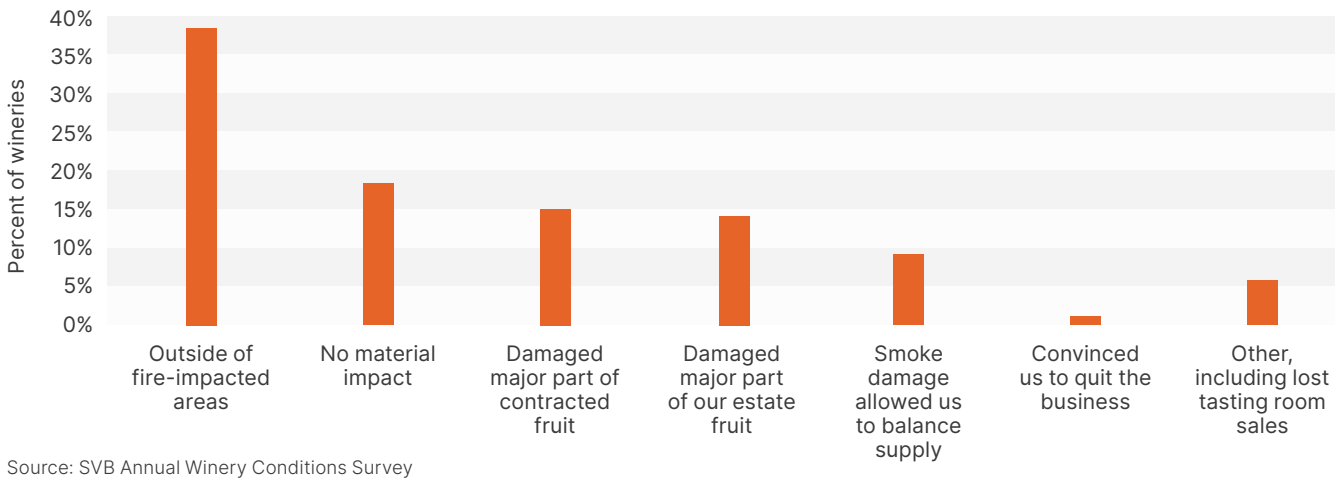
Source: SVB PGA Database

While larger producers were having better years on average due to off-premise channel shifting, the premium family wineries on the West Coast were struggling but at least surviving. Still able to offer outdoor tasting even if in diminished capacities, they did some necessary cost-cutting and focused on new strategies, including curbside pickup, digital tastings (aka Zoom tastings), club sales and internet offerings.

Through June 30, Silicon Valley Bank's database of premium wineries' financial statements revealed total sales growth was minus 7.1 percent. For comparison, through June 30, 2019, sales growth for the same database was positive 7 percent. Despite the lower sales levels, cost-cutting created enough relief for those wineries to turn a small profit (see figure 35).

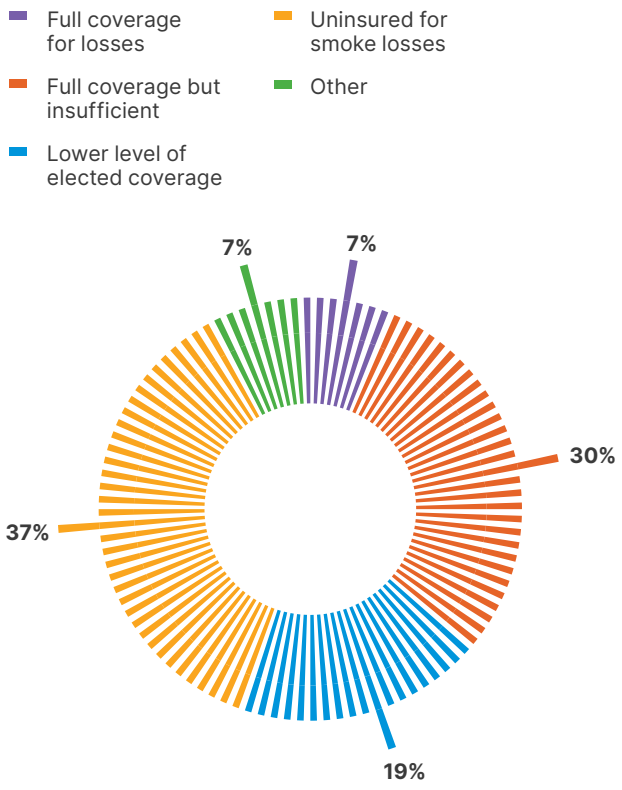
The shock effect of the pandemic was lessening by the end of summer, and while more restrictive business conditions were being implemented, wine demand was holding steady, and coming into the large October/November/December period, there was hope that we'd see a smaller, high-quality harvest and that the worst was behind us. After all, what else could go wrong?

Figure 36: **Impact of smoke and fires**



Source: SVB Annual Winery Conditions Survey

Figure 37: **Insurance coverage for significantly impacted vintners**



Source: SVB Annual Winery Conditions Survey

The four seasons — winter, spring, summer and fire

On August 16, an extremely rare dry lightning storm from the remnants of Tropical Storm Fausto spinning off the coast of Baja California made its way into Central California and as far north as Southern Oregon, sparking hundreds of fires and leaving cities in the West under unhealthy air conditions for weeks on end.

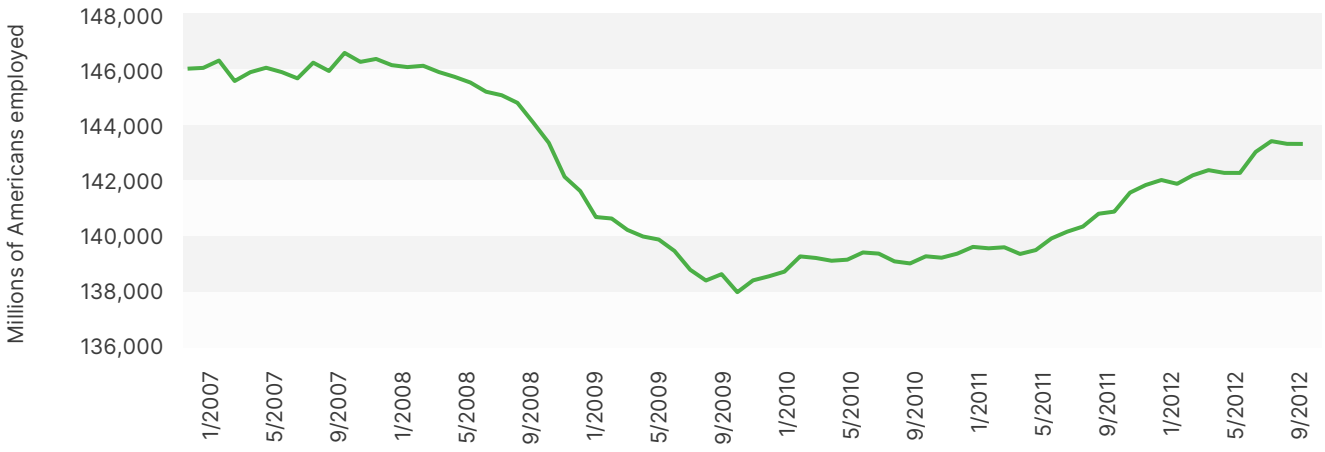
Additional fires cropped up through September and October. The early start to fire season didn't mean the season would end early. The Glass Fire, the second major fire for Napa in 2020, started on September 27, cutting through the heart of the Napa Valley and damaging or destroying dozens of wineries and luxury hotels.[85]

While many tasting rooms tried to remain open during the summer and fall, smoke made tasting difficult at best for much of the West Coast. Tourism was impacted by the national news, by reinstated COVID restrictions and by hotel and restaurant closures.

Abnormal fires are becoming a new normal for western states dealing with drought and diseased forests, and the term "fire season" may have permanently entered the industry's vocabulary.

Even with several rain and snow events, by the time of this writing in late November 2020, several fires are still not fully contained in California, including the Creek Fire and the SQF Complex fire.

Figure 38: **Employment 2007–2012**



Source: US Bureau of Labor Statistics

In was easily a record year for fire damage. More than 4 million acres in California have burned, more than in the prior four years combined, along with close to 2 million acres in Oregon and Washington.[86] Exhausted winery owners surely had experienced their share of once-in-a-lifetime events for one year, but there was one more large issue to contend with.

Almost 45 percent of the wine industry suffered some level of significant impact from fires and smoke (see figure 36). Without a doubt, the smoke and fire damage in 2020 will be remembered as the largest viticultural disaster since Prohibition. That's not hyperbole. We've suffered regional issues from pests, mold, weather, smoke and fire before, but not since the passage of the 18th Amendment to the Constitution has the viticulture industry in the US suffered such destruction over such a wide region from a single event.

While 37 percent of the industry was entirely uninsured for crop loss from smoke, only 7 percent had insurance that was sufficient to cover their claims (see figure 37). Insurance companies in California have been increasingly denying property insurance to wineries in wooded areas and those at the interface between woodlands and urban areas. There is every reason to expect that to be a growing issue for property owners, insurance companies and lenders.

Surely these smoke and fire issues have answered definitively the rhetorical question, what else can go wrong?

With a month to go in the year as we write this report, I am going out on a limb and declaring that there's nothing else that can go wrong…at least for 2020.

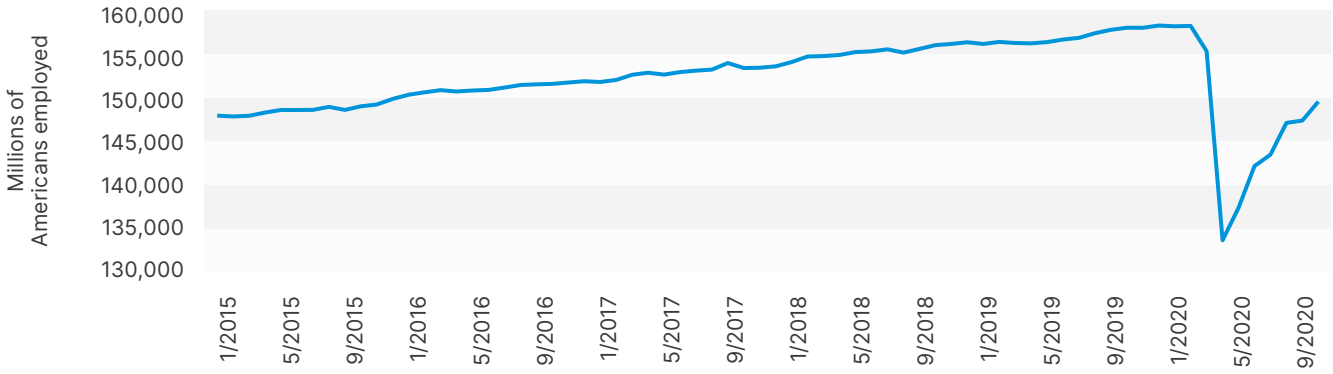
Abnormal economic impacts of this recession

Are wine sales behaving like they did in the last recession, and can we use that previous time as a gauge to determine what happens next? It's a complex topic, but consumers have been impacted quite differently this time and are displaying different wine-buying patterns.

The pandemic created a historic economic shock and recession unlike any other recent economic stress. We saw a much larger and rapid loss of jobs — over 22 million in 2020 compared to 8.7 million jobs lost during the Great Recession of 2007 (see figures 38 and 39). But even so, the impact to the wine business from the pandemic has arguably been less severe than that from Great Recession.

The recession of 2007–2009 was more typical of an asset bubble bursting, which most impacted sectors such as housing and autos (with their sensitivity to interest rates), as well as discretionary purchases like furniture, RVs and boat sales. There was a large impact on equity values, with the S&P 500 losing approximately 50 percent of its value from October 2007 to March 2009. Employment during that recession fell consistently for a period of two years before beginning a recovery in 2010 (see figure 38).

Figure 39: **US employment, 2015–2020**

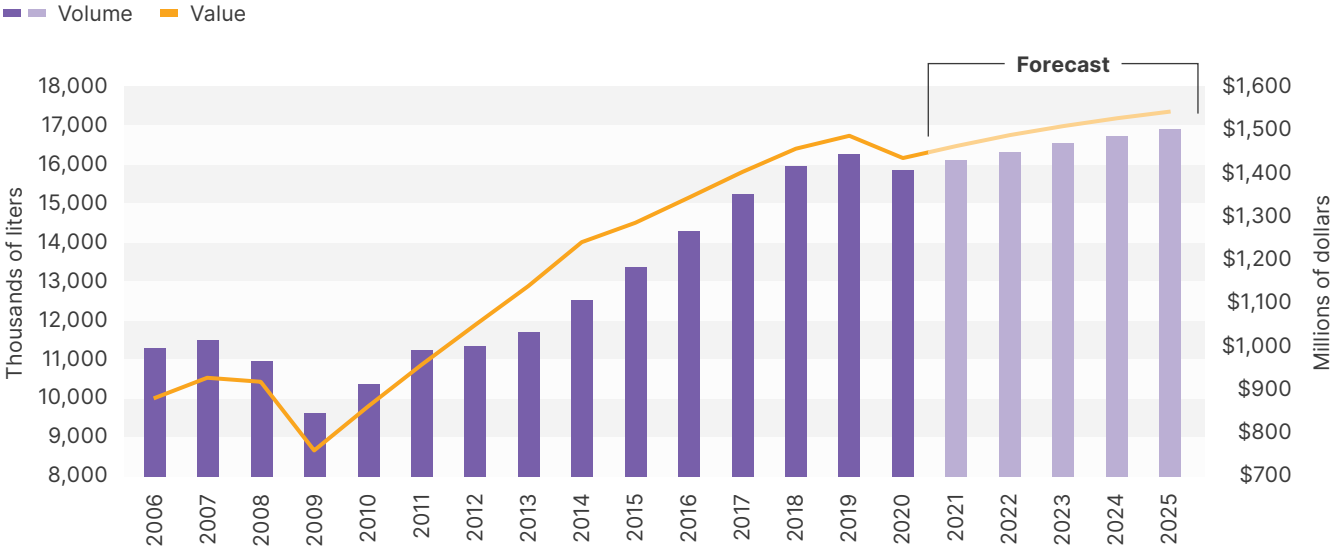


Source: US Bureau of Labor Statistics

Wine has long been known to heavily skew toward consumers who own their homes and have incomes above $100,000.[87] During the Great Recession, nearly all consumers were financially injured, but losses particularly affected those who were heavily invested in the stock market and who purchased homes with high levels of debt in regions that had seen large speculative runups. Many of those losing their homes, their stock market wealth and their jobs matched the typical profile of wine consumers, which was reflected in lower wine sales for a short time period (see figure 40).

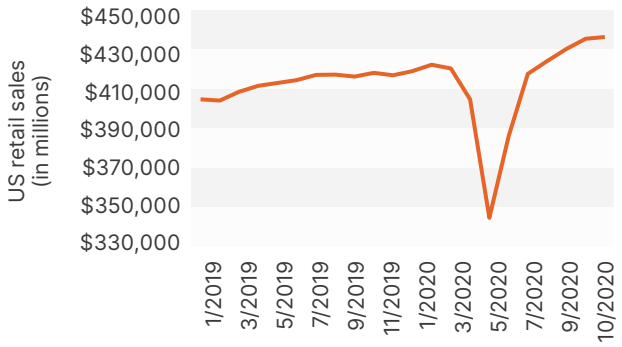
For about two years, thrifty shoppers in all price points sought discounts and bargains. Wine supply was more balanced going into that recession, so the financial meltdown didn't exacerbate an already-oversupplied state. Wine sales by value returned to more stable prices rapidly with strong year-over-year growth in sales volume, value and price point thereafter (see figure 35, 2009–2011).

Figure 40: **US luxury wine sales**



Source: Euromonitor International

Figure 41: **Core retail sales except auto, seasonally adjusted**



Source: US Census Bureau

In the case of this pandemic-induced recession, the immediate shock to the economy had a disproportionate impact on any service business that required employees to be close to customers. While there was an immediate impact for stock values, the Federal Reserve and Congress acted rapidly, and the market and retail sales quickly found their footing (see figure 41).

This time more low-wage employees in service industries (such as barbers, waiters, priests, retail workers and obviously all employees tied to travel and tourism) were economically injured, while higher-paid employees able to work from home saw less impact. Total wine demand and luxury wine demand, therefore, were less affected by this recession (see figure 42). This is not to say that there was little financial impact on wineries — only that the consumer didn't vanish. The problem for many wineries was finding the consumer.

This time around, the stock market, RVs, boating and house values increased. The housing increase has happened because of record low mortgage rates, low inventory and work-from-home changes that led buyers to prefer a larger home with an office instead of a home near work with a shorter commute. Homes in what are typically thought of as vacation areas have also seen growth thanks to work-from-home trends. Autos were hurt early in the pandemic, but used auto sales have since soared as people seek options other than public transit. That same heavy demand extends to boats and RVs as some work-from-home employees took the further step to become work-from-forest or work-from-lake employees.[88]

Wine purchases have also taken a different course with this recession. As noted, wine consumption has long been linked to middle- and higher-income consumers. Since this recession has damaged the incomes of those groups less than the income of lower-wage employees, we witnessed an extraordinary event with off-premise growth in value and volume, with the best growth rates in higher-priced wine (see figure 42).

Figure 42: **Nielsen-covered outlets, grocery and drug — 13 weeks ended 11/28/2020**

	Total sales value	Change in value vs. prior year ($)	Change in value vs. prior year (%)	9-liter equivalent units	Change in 9-liter equivalent units vs. prior year	Change in 9-liter equivalent units vs. prior year (%)
Total table wine	**$4,267,153,227**	**$478,926,791**	**12.6%**	**43,927,994**	**2,870,420**	**7.0%**
$0–2.99	$176,809,115	$5,157,028	3.0%	5,916,738	31,303	0.5%
$3–$5.99	$890,150,165	$37,018,845	4.3%	15,555,366	471,996	3.1%
$6–$8.99	$607,404,882	$10,990,580	1.8%	6,814,796	66,298	1.0%
$9–$11.99	$1,030,592,318	$128,617,445	14.3%	8,233,375	949,484	13.0%
$12–$14.99	$589,446,281	$88,070,457	17.6%	3,665,343	549,609	17.6%
$15–$19.99	$475,978,021	$89,461,862	23.1%	2,330,130	442,977	23.5%
$20–$29.99	$266,503,627	$62,704,425	30.8%	962,472	224,809	30.5%
$30–$49.99	$131,144,465	$30,132,707	29.8%	283,066	64,973	29.8%
$50–$99.99	$71,391,257	$18,252,761	34.3%	91,367	22,954	33.6%
$100+	$20,656,943	$3,297,399	19.0%	10,818	2,324	27.4%

Source: Nielsen

9 Conclusion

The adage that hindsight is 20/20 has taken on new meaning with the turning of the calendar to 2021. If you are reading this, you got through the year. Congratulations! Take a breath and celebrate because the best thing about 2020 (other than the fact you are still breathing) is that 2020 is hindsight now.

But we aren't done with 2020. Certainly, there is a lot we can still learn from the year, and we owe it to ourselves to do so. The tuition is paid, so let's get value for our sacrifices and efforts. Now that we all have experience with a pandemic, should we do something different to prepare for the possibility of another?

A final prediction and a wish: When this pandemic is under control sometime in 2021, there will be a lot of pent-up demand for social closeness, which means celebratory occasions and wine, to perhaps some occasional excesses even.

I predict a spike in consumption as we find reasons and occasions to celebrate. But it won't be like the uptick at the end of WWII, when a treaty was signed on a defined day, which brings me to my wish. Wouldn't it be great to declare a national holiday that celebrates the sacrifices of our health care professionals and pays tribute to the Americans lost in this battle (whose numbers exceed those lost in all wars since WWII)? What should we name it? Write your representatives in Congress!

Cheers to 2021!

Endnotes

1 This 20th *Annual State of the Wine Industry Report* has been by far the most difficult to write. As of the date of this writing, we are closing in on 300,000 American deaths from COVID-19, far more than the number who perished in all of the wars and conflicts the US has participated in since World War II combined — and we all know we aren't through the worst of this yet. To those touched by the virus, those who have lost a loved one, a business or a job, or who fight stress or mental illness due to this, we share your grief. To those in health care who are at the front lines, putting your own lives in daily peril, we admire you and thank you for your selfless service to others. To those in the medical field creating the vaccines and therapeutics to eradicate this virus, we celebrate your victories. A business report is indeed trivial in the scope of the human tragedy created from this pandemic, but we all have to continue on and do what we can to recover our normal lives and get to the other side. It is with all those thoughts in mind that we present this year's report.

2 Silicon Valley Bank Peer Group Database. See figure 10.

3 Paul Duginski, "Moisture From Tropical Storm Fausto Fuels Northern California Storms," *Los Angeles Times*, August 16, 2020.

4 Esther Mobley, "The List of Napa Valley Wineries That Have Been Damaged or Destroyed in the Glass Fire," *San Francisco Chronicle*, October, 12, 2020.

5 "Taking the experience on the road" is a phrase I've used for many years to describe opportunities and efficiencies that are available away from the tasting room. As far back as 2009, I began talking about "Skype tastings" as one of those opportunities. It appears we've zoomed right by Skype tastings now.

6 Richard Fry, "The Pace of Boomer Retirements Has Accelerated in the Past Year," Pew Research Center, November 9, 2020.

7 Kerana Todorov, "California Crushed About 3.9 Million Tons of Winegrapes in 2019," WineBusiness.com, February 11, 2020.

8 Note that we were using off-premise sales as a proxy for the percentage growth in total sales in the past, as it was the most accurate way to view total industry sales growth, presuming no changes in channel shifting. That's not the case in 2020.

9 Carl Zimmer and Katie Thomas, "Pfizer's Covid Vaccine: 11 Things You Need to Know," *New York Times*, December 8, 2020.

10 Berkeley Lovelace Jr. and Noah Higgins-Dunn, "Moderna Says Preliminary Trial Data Shows Its Coronavirus Vaccine Is More Than 94% Effective, Shares Soar," CNBC, November 16, 2020.

11 For what it's worth, I plan on getting vaccinated as soon as possible and beginning a plan for a vacation in Hawaii.

12 Mitch Frank, "U.S. Dietary Guidelines Panel Takes Aim at Moderate Wine Drinkers," *Wine Spectator*, August 5, 2020.

13 Patrick Gleason, "USDA May Adopt New Drinking Guidelines Unsupported by Science," *Washington Examiner*, November 14, 2020.

14 Rita R. Robinson, "Put a Cancer Warning on Alcohol, Consumer and Public Health Groups Urge," November 7, 2020.

15 Consumer Federation of America, "Consumer, Public Health Groups Petition for Cancer Warning on Alcohol," October 21, 2020.

16 Rob McMillan, "Get Ready for Cancer Warnings on Wine Labels," *SVB on Wine*, September 11, 2019.

17 Charles J. Holahan et al., "Wine Consumption and 20-Year Mortality Among Late-Life Moderate Drinkers," *Journal of Studies on Alcohol and Drugs*, January 2012.

18 2020 was a year when an old joke from the 1990s resurfaced: "Bottle aging? Sure, we bottle age from the moment we put the wine on the truck."

19 There is a question for your next parlor game: What did wine and toilet paper have in common in 2020?

20 Nielsen, "Billions in Consumer Spending Are Shifting as COVID-19 Forces Widespread Retail Disruption," November 20, 2020.

21 Independent Restaurant Coalition, "Food and Beverage Employment Drops for First Time Since April; One in Five Jobs Lost During the Pandemic Come from Restaurant Industry," December 4, 2020.

[22] Wellsley Kesel, "The Saddest Restaurant Closures in Your State," *Eat This, Not That!*, November 10, 2020.

[23] Yelp, "Local Economic Impact Report," September 2020.

[24] Cary Funk and Alec Tyson, "Intent to Get a COVID-19 Vaccine Rises to 60% as Confidence in Research and Development Process Increases," Pew Research Center, December 3, 2020.

[25] Sam Meredith, "Dr. Fauci Says 'Help Is on the Way' With Vaccines, but Doubts Covid Can Ever Be Eradicated," CNBC, November 12, 2020.

[26] Tan Vinh, "Summer Is Gone, but Outdoor Dining Will Stay a While as 150 Seattle Street Patios and Sidewalk Cafes Weather COVID," *Seattle Times*, September 26, 2020.

[27] Andrew Curley et al., "Corporate Travel Has a Long Recovery Ahead," McKinsey & Company, August 13, 2020.

[28] Destination Analysts, "Rules, Regulations and Restrictions....Oh My!," December 16, 2020.

[29] Explore Tock, "Wineries & Tasting Rooms," and OpenTable, "Reserve a Spot at the Bar: OpenTable Welcomes Bars and Wineries to Its Platform," May 14, 2020.

[30] Home deliveries: One of my second-generation wine owners told me that delivering wine was her salvation during the darkest hours of the shutdown. She was able to get in touch with her early days driving with her family, delivering wine to restaurants. And people were shocked to see the owner at their front door! What great customer engagement. Those consumers will be customers and evangelists for a very long time.

[31] To show how long I've been talking about "taking the experience on the road," at least a decade ago I started talking about Skype tastings as one alternative to the tasting room. It's gratifying to see all of the success in Zoom tastings, but I wonder how big that digital approach to selling might be today if we had started trying a decade ago? It would have softened the pain of tasting room shutdowns at a minimum. In 10 years, we will know the answer, and my bet is that digital sales will be a substantial component of all wineries' playbooks.

[32] One owner I spoke with believes that Zoom tastings will gradually lose appeal as wineries reopen. I suspect that will be partially true, particularly for customers within a day trip to the winery. In my view, the purpose of a Zoom tasting has to explicitly evolve to entertainment. If people remote from the winery can gather for a wine tasting and some food at a friend's house, or if there is a tasting that includes fun and games, that will never lose interest from consumers.

[33] Paul Mabray.

[34] Amy Hopkins, "Drizly Enters Partnership With US Trade Body," *The Spirits Business*, May 14, 2015.

[35] "Southern Glazer's Wine & Spirits Launches Business-to-Customer eCommerce Team," *Business Wire*, December 1, 2020.

[36] List of DTC vendors providing digital services for wineries.

[37] If you know someone with seasoned instinct and street-level intelligence in the wine business, please let me know.

[38] This was covered in detail in SVB's *Annual State of the Wine Industry Report 2020*.

[39] Eve Batey, "Glass Incident Fire Burns 31 Wineries, Restaurants, and Lodges, Including California's Oldest Resort," *Eater San Francisco*, October 7, 2020.

[40] USDA crop insurance coverage covers crop loss, no matter if the grapes were in contract to be sold or not.

[41] Two-liter bottle.

[42] A common approach anti-alcohol groups use to prove alcohol abuse is to employ a survey. Yet it's impossible to accurately survey a consumer in arrears about the volumes of alcohol they consume. The expected error makes the findings useless in most cases, unless it's possible to measure the volumes actually consumed. In most cases, consumers don't measure pours. And in a restaurant, servers pour from a bottle while the party is talking so it's impossible to account for volume. If you take a small sample fraught with expected error and extrapolate to a population in the hundreds of millions, you can get a mathematical conclusion. It will just be wrong.

[43] Alyssa Lukpat, "Coronavirus Stress, Isolation and Free Time: People Are Drinking More Amid Pandemic, Study Says," *Raleigh News & Observer*, July 16, 2020.

[44] Forty-two percent of boomers had 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.

[45] I performed a search to determine if Las Vegas posted odds on the chances of receiving full Social Security benefits. Las Vegas will allow you to bet on almost anything. Since they aren't making book on that one bet, I can only presume bookies don't see Social Security as a good bet.

[46] I'm sure I was one of the consumers, as a younger boomer, who just came right out and told the table how much the wine that I brought to the party cost. "Hey, everyone, this wine is incredible. I spent my whole bonus on this $11.00 beauty."

[47] Unlike other products, the use of the term "organic" has mixed consumer responses when it comes to wine. But the natural wine movement is an outflow of the concept. Finding the right tone with the terms "organic" and "natural" isn't black and white but invites exploration. My suggestion is to use your wine club to get answers. Tell them you're thinking of a change and ask them what they think. They will appreciate that you consider their advice useful, and that engagement by itself is positive.

[48] Mothers Against Drunk Driving (MADD) and Students Against Destructive Decisions (SADD).

[49] The Alcoholic Beverage Labeling Act (ABLA) of the Anti-Drug Abuse Act of 1988, H.R. 5210, is a US federal law requiring that (among other provisions) the labels of alcoholic beverages carry a government warning.

[50] President Clinton introduces a call for a nationwide 0.08 maximum standard for drunk driving.

[51] Morley Safer, "The French Paradox" (video), *60 Minutes*, November 17, 1991.

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[58] Justin Scheck and Tripp Mickle, "With Moderate Drinking Under Fire, Alcohol Companies Go on Offensive," *Wall Street Journal*, November 29, 2018.

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