



CIATTI
GLOBAL WINE & GRAPE BROKERS



California Report

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**Ciatti Global Wine
& Grape Brokers**

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- 3 2019: The Year That Was
- 5 2020: Looking Ahead
- 7 Contacts

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to jump through this
document.

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As a new decade gets underway, we at Ciatti would like to thank all our friends, clients and business associates for their support throughout the old one, and wish them all a very happy and prosperous 2020.

The wine world is now moving back into full swing after the holidays and this month's report reviews the past 12 months on California's winegrape and bulk wine markets and considers what the new year may bring. As bulk wine inventories built and bulk wine and grape demand struggled to spark into life throughout, 2019 was not an easy year for many sellers. Bulk wine sellers often had to sell for far less than they would have liked as prices declined to their lowest level in at least five years; many growers left uncontracted grapes on the vine and began assessing what vines could be removed, mothballed, or replaced.

We lack a crystal ball to show us what 2020 will bring, but we can offer some simple steps for grape suppliers and wineries to follow in order to help them mitigate the challenging environment:

- *grape suppliers in all areas of the state should get in touch to inform us – as soon as they can – about what fruit they have for sale, in order to maximise their coverage and the chances of their grapes getting sold.*
- *wineries should update us on what older vintage wines they still have for sale, what 2019 wines they have for sale or expect to have for sale, and supply us with samples. We can then add these wines to our bulk inventory wine lists which maximises their coverage and the chance of them being sold.*

To get your grapes listed, contact Molly at +1 415 630 2416 or molly@ciatti.com. With the information above, it follows that:

- *now is an opportune time for bulk wine buyers to step into the market and secure the wine they need, either on spot or contract. There is the ability to contract out bulk wine for longer periods – three years for example – at highly attractive pricing.*
- *it is also a great time to secure grapes beyond on multi-year, amenably-priced contracts.*

To get your bulk wine listed, contact either Jed at +1 415 630 2548 / jed@ciatti.com or Mark at +1 415 630 2458 / mark@ciatti.com.

Ciatti is here to help you navigate the market in 2020 and beyond. Keep reading our *California* and *Global* reports for market insights, but remember – they provide a snapshot. For the fullest and most up-to-date information, get in touch with us directly.

Robert Selby

Opportunities for Buyers
Bulk Wine
18 Chardonnay Coastal
18 Cabernet Sauvignon Sonoma
18 Cabernet Sauvignon North Coast
17/18 Cabernet Sauvignon Paso

Opportunities for Sellers
Bulk Wine
Non Vintage Red and Whites at \$.50 to 1.50 per gallon
19 Chardonnay, Sauvignon Blanc, Pinot Gris (Send in Samples)
Oregon Pinot Noir

Events

Ciatti brokers will be attending or speaking and will have a booth at these upcoming events:

- **January 16:** Sonoma County Winegrowers Dollars & Sense seminar and trade show Luther Burbank Center for the Arts, Santa Rosa
- **February 4-6:** Unified Wine & Grape Symposium, Sacramento Cal Expo
 - **May:** Sonoma County Grower Seminar, Tradeshow, & Barbeque, Forestville
 - **July 28-29:** International Bulk Wine & Spirits Show, San Francisco
 - **December 3:** Wine Industry Expo Trade Show & Conference, Sonoma County Event Center at the Fairgrounds

2019: The Year That Was

The record-breaking 2018 harvest of 4.28 million tons fed into a large pre-existing inventory – created by a pull-back in demand and 2017's own four-million-ton crop – so that the beginning of 2019 saw the slowest market for Californian winegrapes and bulk wine that Ciatti had seen in nearly ten years. Downward adjustments were being made on most, if not all, prices – albeit from record highs – as suppliers started to realise the new market reality.

The new paradigm was starkly illustrated to the industry by Ciatti's Glenn Proctor at January's Unified Wine & Grape Symposium: the Ciatti barometer of California's bulk wine inventory estimated nearly 7 million gallons of Cabernet,

4 million gallons of Chardonnay, and 2.7 million gallons of Pinot Noir. At the same time, Nielsen data declared growth of 1.2% in the US wine market in 2018, down from 1.5% growth in 2017 and 2.5%+ in 2016 and 2015. Wine continued to take alcohol market share from beer, and all wine categories above \$11 per 750ml bottle saw growth, but – as would become clearer through 2019 – the array of competition from imported wines and alternative alcoholic drinks such as spirits/cocktails and hard seltzers was ever-growing. As well as the health trend – drinkers aged 34 and under told Nielsen they were either already drinking less wine than before or making efforts to reduce their alcohol consumption – another factor was probably price: wine in the US

Please see next page for more.

is priced at \$2.15 per five-ounce glass versus \$1.28 for a bottle of beer and \$0.93 per shot of spirit.

The grape and bulk wine markets gradually picked up through February, March and April but could still be characterised as sluggish, exacerbated by the delay in the traditional February release of the USDA's official preliminary harvest figure due to the 35-day government shutdown. The preliminary harvest figure was in fact never released; the industry had to wait until the full crop report – published April 10 – for hard data. A week before, Gallo announced it had entered into an agreement to purchase more than 30 of Constellation's lower-priced wine brands for \$1.7 billion. The ensuing Federal Trade Commission's investigation into market competition would last for the rest of the year.

Uncertainty thus pervaded the marketplace in the first half of 2019 and the bulk market moved forward sluggishly, with sellers feeling the pinch in terms of cashflow and storage costs. Bulk wine prices were softening to their lowest level in five years, with the biggest falls coming from historic highs on the Coast (Napa and Sonoma's total tonnages in 2018 were around 30% up on the prior year's). This encouraged opportunistic négociants, unencumbered by inventory of their own, to come onto the market seeking to supply retailers, private label programs, short-term labels etc. with Coastal wines at or near California prices. (In the longer-term, this may improve the range and quality of private label wines and put winery brands under even more retail pressure.) As such, there was some activity on the Coast's remaining 2017 Cabernet, Pinot Noir and Chardonnay inventory and a little on its 2018 Sauvignon Blanc and Pinot Noir.

Much of the market activity, however, consisted of buyers renegotiating grape contracts (we estimated that some 70% of grape buyers in selected regions were seeking to adjust down, or cancel, their supply contracts) to better reflect the reduced market prices. While the average price per ton of winegrapes was up 7% in 2018 on the prior year, this was mainly due to price escalators built into grape contracts – contracts now coming to an end, being cancelled,

or revised downward – so that the decline in the state's overall tonnage price would lag behind the declines seen on the spot market. As the new harvest approached, buyers were making growers especially aware of the maximum tonnages and viticultural guidelines written into their contracts – extra fruit was definitely not going to be needed, and buyers could afford to be highly discerning about quality. For the same reasons, we urged growers to think very carefully about custom crushing excess fruit and bringing yet more bulk wine inventory into a marketplace where it was not needed, and to weigh-up whether the storage costs would be worthwhile in light of falling bulk wine prices.

Further activity involved the larger established wineries – still holding plenty of inventory – putting excess wines back onto the market; by May Ciatti's barometer of California's bulk wine inventory had Cabernet past 8 million gallons and Chardonnay exceeding 5 million gallons. We cautioned that this was an approximate snapshot of a moment in time – but could also be “just the tip of the iceberg”. With that in mind, we urged bulk suppliers needing to make tank space head of the imminent 2019 harvest to cast a wide net (i.e. get into dialogue with their broker) and consider the first offers they received very carefully, particularly as it seemed there were few buyers out there to tempt, even with significant price reductions. “There is little demand,” we wrote in August, “making price reductions irrelevant, however significant they may be”. Crossover was reached: some Coastal prices were falling below their California counterparts.

The 2018/19 winter in California was cooler and wetter than average, so that, by April, Sierra Nevada snowpack was at its fourth-highest level in 40 years and no region of the state was under drought watch or warning for the first time in 12 years. Late spring continued wetter and cooler due to an El Niño effect, delaying budbreak so that – as May turned to June – the growing season was running 2-3 weeks behind a ‘normal’ timetable in the Coast and northern Interior. Big canopies and some humidity led to a few mildew hotspots vigorously controlled by growers. July and August finally brought normal to

Please see next page for more.

normal-plus heat levels to the growing areas, with the Coast also experiencing cooler nights – very good conditions for ripening. Higher than normal temperatures in late September helped quicken ripening further – so that the harvest finished only a few days behind a normal schedule – but there did not seem too much ensuing congestion at wineries. The state’s 2019 winegrape yield is believed to have come in close to the average, with an uptick in the southern Central Valley versus the previous year offsetting a decline from 2018’s bumper yields in the North Coast and Central Coast. The final harvest size will depend on how much uncontracted fruit was left on the vine – it could potentially have been the most since the early 2000s, at least in the Coast. Quality was good in all areas.

The Kincade Fire, a wildfire which grew quickly on 28 October to cover over 80,000 acres, led to evacuation orders and sporadic power outages in parts of Sonoma County and other areas of the Coast, but wineries – amid crushing and fermenting at this point – overcame this obstacle with back-up generators and reserve crushing facilities.

With the harvest completed, growers set about the business of assessing how they might help bring about the supply adjustment the market needs. Some set a deadline of January 2020: if certain vineyards had not earned a grape contract by then, they would consider removing, mothballing, or replacing them with new and more efficient vines. The grape market ended the year as it had been throughout – sluggish.

Ciatti’s bulk wine inventory barometer in November, when nearly all the inventory counted consisted of 2018 vintage wines and older, showed over six million gallons of Cabernet, and nearly three million gallons each of Chardonnay and Pinot Noir. With the 2019 wines now beginning to filter through, the inventory will likely build through the first half of 2020. The bulk wine market did, at least, experience an uptick in activity in December, with some of the 2019 whites being purchased and some low-priced 2018 inventory receiving interest.

Gomberg-Fredrikson data for the six months ending June 2019 showed Californian wine shipments down 2%, with domestic shipments flat and exports down 28%. Worryingly, wine was no longer seeing its share of the total alcohol market in the US increase; it contracted by 1.9%. Nielsen data for the year ending November 2 showed the average bottle price falling in all price categories at \$11+, potentially indicative of discounting being carried out to get sales moving.

The 28% slump in exports illustrated how, in 2019, Californian wine had undeniably become collateral damage in the difficult economic climate globally – whether that be the ongoing US-China trade war, Brexit uncertainty, or continued flat consumer demand for wine in traditional markets. And lacking as it does a unified and comprehensive strategy for certified sustainable and/or organic wine, California continued to struggle to meet growing European demand for such wines.

2020: Looking Ahead

Given that many wineries gave notice on grower contracts to balance their inventory from the 2018 harvest, we believe they will need to come back into the market for grapes at some point in order to maintain flat supply needs if nothing else. We also believe that many grape buyers will be seeking to reset their core supply with new short and maybe even longer-term deals in order to lock-in what they perceive as attractive pricing. This is where the market reset could occur: the negotiated price

on these three-year deals may be higher than they would be on one-year deals, but it is unlikely the prices will return to the level they were at in the years before the current dynamic. There also may be buyers that wait to get into the market until the end of the year and look at buying at the spot price. Growers, meanwhile, are working on rightsizing or realigning their vineyards to achieve greater efficiencies and limit oversupply issues.

Please see next page for more.

A lot of the activity we have seen on bulk wine is tied to retailers requiring wine for their private label brands, with wineries and other suppliers vying to capture those deals. There may be an uptick in demand at the start of the new year as assessments are made of October-November-December's sales at the retail end and future sales projections are calculated. There may also be buyers who have decided to avoid buying grapes and will go straight to buying wine on the bulk market. Only Napa and Sonoma wines can command prices that are higher than elsewhere across the state: the rest of the market must operate at or near California price levels.

Effective October 18, the US is levying additional import duties on a range of products from European countries in retaliation for EU subsidies to aircraft maker Airbus. Increased levies apply to Spanish, German, French and UK wines "not over 14% alcohol,

in containers not over 2 liters". Furthermore, a notice issued on December 12 by the Office of the US Trade Representative (USTR) confirmed that further tariff impositions are under consideration, including – in regard to wine – the widening of their scope to include wines from all EU countries, in any packaging format. It is unknown at what rate these further tariffs would be set, should they be implemented, but the USTR in its notice stated that it could be "up to 100%". France is being especially targeted because of its plans to apply a 3% national tax on the revenue of digital services earned in France by US tech giants such as Google, Amazon and Facebook. There may be a chance this could help California capitalize on rosé opportunities, now that French bottled imports are more expensive, but in general we doubt these tariff hikes will move the Californian market much one way or the other.

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