



CIATTI
GLOBAL WINE & GRAPE BROKERS



California Report

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**Ciatti Global Wine
& Grape Brokers**

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Last January's *California Report* stated: "Probably the biggest question mark over the wine industry in 2022 is: How high will inflation go and if/when will it have an impact on consumer confidence?" The fact that, 12 months on, there are still no definitive answers to these questions highlights what a difficult year 2022 was to read, as the upside of a return to some normality post-pandemic clashed with the downsides of the pandemic's considerable economic hangover and the global impact of the Russia-Ukraine conflict.

Messy and sometimes contradictory data injected further wariness into bulk wine and grape markets struggling to gain forward visibility, the former especially. Outside the perennially in-demand appellations, buyers were price-sensitive as input costs rose and preferred to move forward conservatively (wary of ending up with more supply than needed if consumer demand pulled back) while considering the full array of sourcing choices (wary of supply that allowed for insufficient margin should retailers reject increased shelf prices).

By August we were reporting that "each month, we continue to hear of a few more wineries having difficulty in moving some of their case-good products – this is not true of all wineries, but the number finding the present environment challenging is definitely increasing and now outnumbers those performing buoyantly." Although annual inflation in the US is likely to have peaked mid-year – reaching 9.1% in June before falling back for five successive months – final quarter consumption is believed to have been more muted than normal, ensuring wine's total sales volume in 2022 was lower than in 2021. The \$15+/bottle categories continued to outperform the market, ensuring total sales value remained in growth – just – but the main question hanging over 2023 is how long this will last. Only time will tell. In the meantime:

- Wineries should let us know what 2022 bulk wines they have available so that we can help them find a buyer. Likewise, buyers of bulk wine should let us know their requirements so we can fulfil them quickly.
- Grape suppliers should update us on the 2023 grapes they will have for sale. Buyers of grapes should register their interest with us so we can match them up with a supplier.

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We are, as ever, here to help you navigate the twists and turns of the marketplace, so don't hesitate to get in touch. Read on for our review of 2022 and look ahead to 2023 – we at Ciatti would like to wish all our friends, clients and business associates a very Happy New Year.

Robert Selby

2022: The Year That Was

California's bulk wine and grape markets came into 2022 somewhat hesitant due to a disparity in how buyers and sellers viewed the landscape before them. While the state's 2021 crop size, at 3.61 million tons, was the third consecutive crop below the 4.0-million-ton mark after 2020's 3.40 and 2019's 3.91 million tons, and carryover levels largely reflected this, the COVID-inspired off-premise sales boom was steadily disappearing, overall sales volumes were returning to pre-pandemic levels, and inflation by the end of 2021 was rising markedly.

Despite the short crop overall in 2021, Cabernet's harvest volumes – at 590,000 tons – bounced back to easily exceed 2020 (499,000) and 2019 (581,000) levels: We estimated bulk Cabernet inventory at over 3.5 million gallons as of January 2022, higher than in January 2021 and almost twice as high as the next largest inventory, Chardonnay's. While Napa Valley/Sonoma County Cabernet and Russian River Pinot Noir were, as ever, in demand by February, and selling at pricing slightly stronger than 12 months before, the red wine market overall was quiet. In addition, perceptions around smoke exposure continued to cast a shadow over some of the remaining 2020 Coastal red inventory, mainly Cabernet and Pinot Noir.

Buyer interest was mainly focussed on the 2021 Sauvignon Blancs and Chardonnays in the North Coast, and 2021 Sauvignon Blancs, Chardonnays and subsidiary whites (such as Muscat) in the Interior. The early activity on 2022 grapes, meanwhile, mirrored this bulk wine demand. Outside specific Coastal reds and, state-wide, Sauvignon Blanc and Chardonnay, grape and bulk wine prices – reflecting rising input costs – were often too bullish to stimulate many deals.

Indeed, by February, some wineries that were traditionally buyers were placing bulk wines back onto the market, while some sellers were adding more gallons to their availability lists – indicative, perhaps, of lower Q4 2021 sales than projected, and/or expectations of a consumer slowdown through 2022 with inflation rising: annual inflation by March had reached a 40-year high of 8.5%, versus 2.6% in March 2021. SipSource analysts confirmed off-premise sales volumes were down in all categories below \$15/bottle in the December 2021-February 2022 period versus 12 months before, while doubts surrounded the future buoyancy of premium categories priced at \$15+ with inflation rising so sharply.

As rising input costs increased buyer price sensitivity, some buyers who normally source in the Coast switched to cheaper Lodi/Interior alternatives. Likewise, Interior suppliers with robust pricing had to remain cognizant of some relatively competitive pricing on particular Coastal lots. Elevated gas and trucking costs also led to geographical location coming into consideration on some deals, while an increased number of suppliers sought “roadside sale” to remove exposure to elevated logistics costs.

California entered April having experienced a very dry winter – Sierra Nevada snowpack was at just 38% as of the first day of the month – so that some water usage curtailments were already underway by May. The early morning hours of April 12th brought a frost episode to growing areas across the state, most concertedly Northern Interior vineyards; white varietal grapes and Pinot Noir, the more advanced at this stage, were thought to be most affected. This stimulated an uptick in activity on 2021 bulk wines and 2022 grapes as buyers strove to replace what they foresaw as lost tonnages of Chardonnay, Sauvignon Blanc, Pinot Grigio, Chenin Blanc, and Pinot Noir.

By mid-May the bulk wine and grape markets had returned to a steady pace. On the grape side, supply was tightest in Napa, Sonoma, parts of the Interior, and – after two successive short crops in 2020 and 2021 – on Paso Robles Cabernet. Bulk demand was highest on Napa Valley Cabernet, Chardonnay and Sauvignon Blanc, Russian River Pinot Noir and Chardonnay, and Sonoma Cabernet and Chardonnay: “These in-demand wines can be hard to locate and high in price,” we noted in May's report, “while wines from elsewhere can feel as if they are languishing even at competitive prices. Good volumes of Coastal Cabernet outside Napa and Sonoma persist, for example.”

This demand weakness on bulk wine outside specific items was indicative of the vulnerability of the market now that the pandemic pantry-stocking spike had passed; bulk wine buyers no longer felt the need to proceed other than incrementally, while they kept watch on 2022 harvest forecasts and where sales trends were heading, especially as cost increases were beginning to filter through to the retail shelf. NielsenIQ data confirmed that while Q1 2022 retail sales in all categories at or over \$11/bottle remained in growth versus 2019 levels, they were up less so than in Q1 2021.

See next page for more on The Bulk Market.

Later, January to May data showed a 9.5% decline in wine's total sales volume and a 5.7% decline in total value in the US off-premise versus the first five months of 2021 – the smaller value decline versus volume a consequence of the outperformance of premium wines versus the rest of the market. Cabernet was continuing to be a useful barometer: “As consumer sales show, premium wines continue to outperform the rest of the market. Consequently, Cabernet from the high-end appellations is in demand, supply is tight and prices there are high, while Cabernet from outside those areas is selling slowly despite sometimes being considerably lower in price.”

In June we noted that high 2022 grape prices, combined with pushback from retailers against increased shelf prices in an inflationary environment leading to an increase in grape and bulk wine buyers shopping around for sourcing that could preserve margin – the main result of this being Coastal brands switching to California sourcing and, in turn, California's export pricing moving up. Unexpected bulk inventory began to pop up on the market as a result of this shift in sourcing, as well as underperforming retail sales reducing projected needs. “No sense of urgency” was the main takeaway from the bulk market in July, with price-sensitive buyers apparently able to wait to see if prices might soften, potentially because they were still working through supplies they acquired in 2021, during the pandemic spike.

Our estimate of the state's bulk inventory in August, with the new crop getting underway, was significantly larger than in August 2021, most markedly on Cabernet (approximately 5 million gallons versus 3.5 million), but with Pinot Noir also larger (2.5 million gallons versus 1.8 million) and surpassing Chardonnay (2 million gallons) in representing the second-largest inventory by variety. Merlot and Zinfandel availability was also up; Chardonnay and Sauvignon Blanc supplies were more in line. In this regard, California mirrored the dichotomy increasingly in evidence across the world in the past five years: stable or growing white wine demand versus stagnant or contracting red wine demand.

In contrast to the larger bulk inventory, concerns around the coming crop size and two previous short harvests limited 2022 grape availability by early July, state-wide. Again, the reds remained the most plentiful, with pockets of Coastal Cabernet and Pinot Noir available. However, by mid-August, despite expectations of a fourth-consecutive crop below 4 million tons due to drought and some patchy conditions, lots were

becoming available once more on the grape market – mainly in the Central Coast and to a lesser extent in Lake and Mendocino. Extra bulk supply started to appear as well. Activity on both markets was quieter than at the equivalent stage of the previous year, likely indicative of the economic environment.

We noted the continuing disconnect in pricing expectations between buyer and seller, but questioned to what extent price reductions would stimulate fresh buying activity when future consumer demand was so uncertain: “We discern from the current buyer pause a recent change in the sales picture and it has left grape growers and bulk wine sellers who felt the market was going to come to them – understandably so, given the good early activity levels – with limited demand for their remaining unsold supply.”

A week of 105-115°F temperatures in early September brought the picking timetable forward in many parts of California due to the risk of bunch-weight loss, raisining and desiccation. Coming as it did on top of the longstanding drought, the April frosts and a challenging growing season generally (with hail, humidity, coolness and cloudiness also in the mix), we issued a crop estimate of 3.5-3.7 million tons, i.e. in the territory of 2021's 3.61 million tons: “This light crop will help to temporarily keep in supply-demand balance an industry that, structurally, would otherwise err towards oversupply.”

Realization that another short crop was likely stimulated an uptick in demand for remaining unsold 2021 Coastal wines in the second half of September, as well as early sample requests for the new, 2022 whites. After successive short crops, and amid robust demand, buyers started jostling for position on the 2022 Coastal whites early. Pricing on 2022 Coastal grapes, even reds, grew less flexible, as suppliers now perceived potential profitability in making bulk wine themselves, encouraged by the availability – and stable pricing levels – of crush and storage capacity. Grape supply in the Interior was already highly limited, any lots of remaining availability were receiving multiple interest and any overages that started to come in – with the most in-demand grapes, the whites, picking first – readily acquired.

Exemplifying the volatility of conditions through 2022, the heatwave was soon followed by as much as three inches of rainfall in the space of 3-4 days in some areas, mainly in the North Coast and in the lower Central Coast around Santa Barbara; some isolated Interior

areas also received precipitation. This rainfall may have served to reverse the heatwave's sugar increases in some instances, and certainly stretched out the end of harvest to a more normal completion time in many areas. The ongoing scepticism as to the harvest's size in light of these volatile conditions continued to motivate a buying uptick on the bulk market, with October activity levels better versus the equivalent month of recent years.

Again, a semblance of supply-demand balance was being upheld by factors other than actual consumption growth – in this case, the prospect of a fourth consecutive short crop. The large 2021 Cabernet and Pinot Noir inventory in the Coast, outside Napa and Sonoma, received increased interest; activity on the 2022 wines was focused squarely on whites. The disconnect in price expectations on the Coast continued to be a significant drag on deal-making, with Coastal pricing being undermined by supplies at firm but more attractive pricing in the Interior. In turn, the firmness of Interior pricing aroused interest in importing, including Chardonnay and Pinot Grigio from Australia, encouraged by the dollar's strength.

By the final weeks of 2022 it was perceived that the September rainfall had helped size-up some of the later-season red grapes, Cabernet being a particular beneficiary, so that a sub-3.6-million-ton crop was likely averted. In general, it appeared tonnages in the Interior, and in Lake and Mendocino counties, came in closer to the average than in Napa, Sonoma and the Central Coast. In nearly all areas, the later-season reds such as Cabernet performed better than the whites and early reds. Paso Robles appeared to be once exception – the crop there looked to have come in lighter throughout – and also the southern Interior, where Muscat and generic white tonnages appeared to have defied the drought.

Due to the crop's shortness, little if any Coastal fruit became available on the spot market and any overages that did occur were likely either accepted by the pre-existing buyer or taken in-house for custom crushing. Some overages arose in the Interior, likely more indicative of case-good sales projections rather than crop size: Many wineries, projecting reduced future bulk demand, held growers to their contractual tonnage limits for vintage 2022. Some red grapes – namely Cabernet and Zinfandel – lingered on unsold into October, but all were purchased eventually.

The patchy harvest picture, especially in the Coast, was no doubt one of the causes of a high number of

inquiries into Coastal wines in the final quarter of 2022, certainly higher than in the final months of 2021. Inquiries did not always translate to deals: Buyer-seller price expectations continued to be too far apart too often. Interest mainly centred on perennially popular items such as Napa Valley Cabernet, Sonoma/Russian River Chardonnay, and Coastal Sauvignon Blanc. We suspected interest in Sonoma Chardonnay and Paso Robles Cabernet was especially symptomatic of forecasts of a smaller 2022 crop, the latter perhaps also benefiting from being lower-priced than North Coast alternatives. In general, Coastal prices remained stable at the elevated level they reached in 2021.

Final quarter bulk activity in the Interior was largely normal for the time of year, with buying of the remaining 2021 wines getting carried out and normal – perhaps, in some instances, better than normal – early interest levels in 2022 Chardonnay, Sauvignon Blanc and Pinot Grigio. Much of this interest in the 2022 whites was accounted for by high-end California brands finding the Coastal wines they usually supplement their quality with too high in price or unavailable altogether. California varietal white pricing ended the year roughly in line with where it was in December 2021 – attractive enough for those who normally source in the Coast but, among those California brand sensitive to margin in an inflationary environment, high enough to trigger some inquiries into imports.

Muscat yields defied the drought to bounce back after the shorter 2021 crop, ending the need to import. The import focus shifted to Pinot Grigio, perceived to have suffered a short crop in the Interior. We received numerous inquiries into sparkling base wines, likely due to the popularity of imported sparkling wines such as Prosecco and canned wine programs. Four successive years of shorter wine-grape crops have constrained California's grape juice concentrate supplies and, combined with significant input cost rises, GJC prices have risen; current international shipping costs and lead times make importing white GJC prohibitive for many, however.

California's wine industry ended 2022 struggling to read where it stood: Talk of the US being in a "quasi-recessionary environment" was coupled with headline inflation falling for five successive months from a peak of 9.1% in June to 7.1% in November; concerns for December sales ("42% of consumers plan to drink less alcohol this holiday season") were tempered by the knowledge that this would be the first "normal" holiday period since pre-pandemic; consumer belt tightening

“72% intend to seek less expensive alternatives at retail”) could be seen as an opportunity for the sub \$15/bottle categories that had been in decline amid the premiumization trend, but the huge proliferation of rival products such as hard seltzers and canned RTD spirit drinks means plenty of competition at the lower end of the market; the robustness of sales in premium categories ensured wine’s total sales value remained in growth, but for how long would this paper over the return to declining volumes? And the strong dollar

made easier the importing of wines from competitor countries while stunting California’s share of export markets.

Our estimate of California’s bulk inventory ended the year significantly up versus where it stood in the Decembers of 2021 and 2020, the volume of reds especially starting to resemble the levels seen in December 2019, before the pandemic pantry-stocking spike – despite three short harvests in the intervening time.

2023: Looking Ahead

The story of wine’s 2022 retail sales was confirmed in some quarters at the start of the new year – Shanken’s Impact Databank reported a decline in wine sale volumes versus 2021, and a decline in per capita wine consumption for the tenth year in the past eleven, while value growth was “eked out” thanks to the \$15+/bottle categories outperforming less expensive brands. The growth in popularity of wine-based cocktails, as well as sparkling wines – for the 14th consecutive year – helped limit the damage of wine’s over-dependence on older age groups. Until such time as the wine industry can figure out how to carry more appeal among younger demographics, overall volume sales will continue to contract. As no solution will be immediate, it is safe to project another year of slight volume contraction in 2023.

Compounding this long-term structural problem is the current – and hopefully more temporary – economic picture. Programs seeking to preserve margin, already reluctant to move up in retail price due to the ultra-competitiveness of the wine category, are receiving pushback from consumers if they attempt it now, during what remains an inflationary environment, especially on groceries. Adjusting sourcing is seen as a safer bet. In 2023 we are therefore likely to see a shift from Coastal appellations and sub-appellations to Central Coast and California appellations – i.e., akin to what we were seeing in the years before the pandemic. While 2023 is almost certain to see a decline in wine’s overall sales volume – or at best stability with 2022 – only time will tell how dollar sales perform.

Outside of specific, in-demand appellations such as Napa Valley or Paso Robles Cabernet, or Russian River Pinot Noir and Chardonnay, we are likely to see

a continuing relative slowness on the bulk red wine market versus white, something mirrored around the world. Pinpointing the exact causes for the red-white disparity globally are difficult, though at least partly attributable are longer-term consumer shifts in preference from red wine to white, white wine’s wider application in the proliferation of alternative products such as canned RTDs, and particularly short harvests on whites versus reds around the world in the past 2–3 years (compounded by there being a greater area under red grapevines in the first place).

California’s bulk market for 2022 reds is – as is typical for this time of year – slow as many wines have only recently become ready to sample, but the lack of interest in 2021 carryover coming into 2023 has been something of a concern. With scepticism regarding case-good sales pervading the market, and a particular slowness on reds, we may see some buyers not only step back from buying reds but become sellers themselves.

The contrasting fortunes of bulk red versus bulk white around the world, evident for a few years, grew more acute in 2022. It is now clear that rising Chinese demand for imported reds through the 2010s concealed a decline in demand from mature markets; some suppliers – such as Bordeaux and Australia – unwittingly came to over-rely on China. China’s imposition of prohibitive import tariffs on Australian wines has an indirect impact on California, in that Australia is including varietal whites in export package deals with its ultra-competitively-priced reds. This is likely to lead to an increase in imports of Australian reds and whites into the US – potentially at the expense of Chile – while inward Pinot Grigio shipments are likely to increase due to the more limited domestic

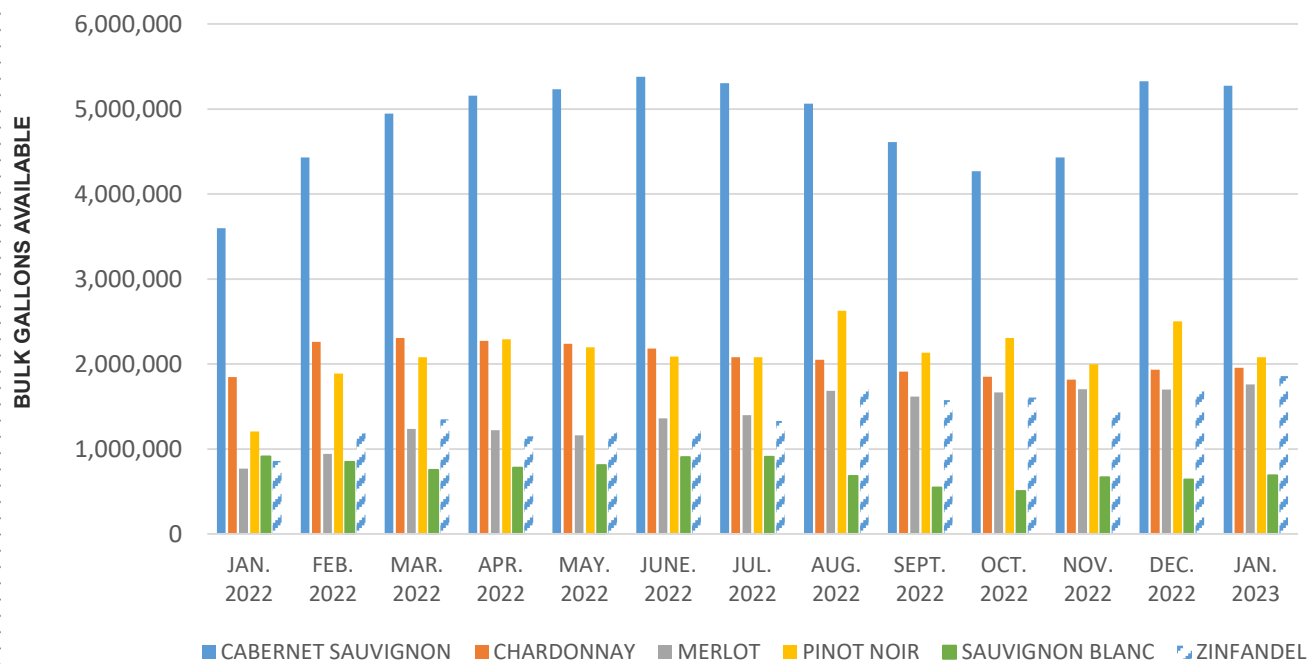
supply. These will supplement the growing imported wine segment in the US, led by Italy with Prosecco.

Looking ahead to the 2023 harvest, there have been a good number of early inquiries into Coastal and Interior grapes, especially on those varieties that came in lighter in 2022, such as Chardonnay, Sauvignon Blanc and Pinot Noir in the Coast. Chardonnay and Petite Sirah lead conversations in the Interior. At this early stage, such inquiries are focused on gaining a feel for potential availability; some planting contracts are being discussed.

Areas of California received considerable precipitation through December into early January, with some

flooding. Despite this, all of California entered 2023 in some level of drought. Viticulture climatologist Gregory V. Jones expects California “to remain in some level of drought through the winter and into spring”, with southern areas of the state forecast to receive below-average rainfall in January-March and northern areas an equal chance of receiving slightly above or below average rainfall. The same storms that caused heavy December and early January rain also brought intense snowfall to the Sierra Nevada mountains, the snowpack there measuring 174% of the average by the turn of the year.

California Bulk Wine Inventory (January 2022 - January 2023)



Events

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

- **January 24 - 26:** Unified Wine & Grape Symposium
- **February 16:** Sonoma County Winegrowers Dollars & Sense Seminar and Trade Show
- **July 25 - 26:** International Bulk Wine and Spirits Show

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