Wine Background and Issues in California

Jim Lapsley

(with thanks to Julian Alston and Dan Sumner)

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Topics

• Production of grapes and wine in California

• Global context

• Structure of the U.S. wine industry
US Wine in Context

• Fourth largest producer—and increasing
• Largest wine market in value
• Second largest wine market in volume (and expected to pass France in 2010)
• Increasing per capita consumption
  – Adding 3 million potential consumers a year
• 30% imported wine by volume
• No subsidies to growers or producers
U.S. Tons of Grapes Crushed
Vintage 2006

California: 3,489,000 tons
90% of all U.S. tonnage

New York: 87,000 tons
(only 5,308 vinifera)

Washington: 316,000
(112,000 tons vinifera)

Oregon: 24,000 tons
## Top 10 California Commodities, 2006

<table>
<thead>
<tr>
<th>Rank</th>
<th>Commodity</th>
<th>Value of Production ($ million)</th>
<th>Share of State Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Milk</td>
<td>4,476</td>
<td>11.7%</td>
</tr>
<tr>
<td>2</td>
<td>Grapes, All</td>
<td>3,707</td>
<td>9.7%</td>
</tr>
<tr>
<td>3</td>
<td>Nursery</td>
<td>3,096</td>
<td>8.1%</td>
</tr>
<tr>
<td>4</td>
<td>Cattle</td>
<td>2,928</td>
<td>7.6%</td>
</tr>
<tr>
<td>5</td>
<td>Almonds</td>
<td>2,523</td>
<td>6.6%</td>
</tr>
<tr>
<td>6</td>
<td>Lettuce</td>
<td>1,813</td>
<td>4.7%</td>
</tr>
<tr>
<td>7</td>
<td>Strawberries</td>
<td>1,340</td>
<td>3.5%</td>
</tr>
<tr>
<td>8</td>
<td>Oranges</td>
<td>1,056</td>
<td>2.8%</td>
</tr>
<tr>
<td>9</td>
<td>Alfafla Hay</td>
<td>1,039</td>
<td>2.7%</td>
</tr>
<tr>
<td>10</td>
<td>Chickens</td>
<td>892</td>
<td>2.3%</td>
</tr>
<tr>
<td></td>
<td><strong>CA Total</strong></td>
<td><strong>38,341</strong></td>
<td></td>
</tr>
</tbody>
</table>
California 2007 Grape Crush
3,674,000 tons

White Wine Grapes (37%)
1,372,000 tons

Raisin Grapes (10%)
364,000 tons

Table Grapes (2%)
63,000 tons

Red Wine Grapes (51%)
1,875,000 tons

About 14% of grape crush was used for concentrate production
Volume versus Value
2007 California Grape Crush

Average Red Wine Grapes: $626/ton, White Wine Grapes: $481

Old rule of thumb: $1 shelf price for every $100 grape price
Percentage 2007 Crush by Tons

- Central Valley: 60%
- Delta: 23%
- North Coast: 8%
- Central Coast: 8%
- Sierra: 1%

Note: Minor districts have not been included
Percentage 2007 Crush by Value

- Central Valley: 25% 
  - Percentage: 25% 
  - Value: $216/ton

- North Coast: 36% 
  - Percentage: 36% 
  - Value: $2360/ton

- Sierra: 1% 
  - Percentage: 1% 
  - Value: $1084/ton

- Delta: 20% 
  - Percentage: 20% 
  - Value: $432/ton

- Central Coast: 18% 
  - Percentage: 18% 
  - Value: $1122/ton
Average Cabernet Prices, 2007 Crush

($/ton)

- Napa: 4143
- Sonoma: 2202
- Mendo: 1246
- SLO: 871
- Delta: 339
- Fresno: 169
2007 Crush by Variety

- Others: 25%
- Chardonnay: 16%
- Cabernet Sauvignon: 12%
- Zinfandel: 11%
- Thompson: 9%
- Colombard: 9%
- Rubired: 4%
- Merlot: 8%
- Syrah: 3%
- S.B.: 3%
Global Context—Broad Trends

• Declining total consumption, especially in Europe
• Increasing consumption by non-producing countries
• Declining production of *Old World* wine
• Increasing production of *New World* wine
• A movement towards higher quality wine
• Increased international trade
• Globalization of taste and production
Per Capita Consumption in Italy and France Has Fallen by 50%!
2006 Wine Production & Consumption

Millions of Hls

- Italy: 52 (Produced), 27 (Consumed)
- France: 52 (Produced), 33 (Consumed)
- Spain: 38 (Produced), 14 (Consumed)
- USA: 19 (Produced), 26 (Consumed)
- Argentina: 15 (Produced), 11 (Consumed)
- Australia: 11 (Produced), 13 (Consumed)
- China: 11 (Produced), 14 (Consumed)
- S Africa: 8 (Produced), 4 (Consumed)
- Germany: 8 (Produced), 7 (Consumed)
- Chile: 2 (Produced), 2 (Consumed)
Production less Consumption in 2006

Millions of Hls

France: 18
Italy: 25
Spain: 23
USA: 1
Argentina: 2
Australia: 8
China: 3
Germany: -5
S. Africa: 2
Chile: 2
How Many U.S. Wineries?

- Approximately 5000 wineries in the U.S.
  - California 2500
  - Other states 2500
- Most are quite small, under 5,000 cases (60,000 bottles)
- Every state in the U.S. has a winery
  - Texas, New York, Virginia, Oregon, Washington all have more than 100 wineries and are growing
The Distribution Problem

- Because of our history with Prohibition, every state has different laws—the U.S. is essentially 50 separate countries.
- Most states require that a producer or importer sell to a distributor, which sells to a retailer.
- As distributors consolidate, they become the choke point in entry into U.S. sales.
Industry Structure—2007 U.S. Sales

- **Total Sales**: 304.0 million cases
  - Gallo: 66 million cases
  - Constellation: 59 million cases
  - Wine Group: 44 million cases
  - Bronco: 20 million cases
  - Fosters: 20 million cases

- **Top 5**: 209.0 million cases (68.7% of total)
  - 6-10: 32.1 million cases
  - 10-20: 12.6 million cases
  - 20-30: 3.7 million cases

- **Total top 30**: 257.4 million cases (84.7% of total)

- **Other 5000**: 46.6 million cases (15.3% of total)
California Wineries in 2003

- >10 million cases: 7
- 1-10 M cases: 27
- 500K-1M cases: 14
- 100K-500K: 71
- 50K-100K: 89
- 25K-50K: 98
- <25K: 743
- Total Physical Wineries: 1,049
- In 2008, about 2500 wineries!
Let’s think about segments

- Luxury >$25
- Ultra premium $15-$25
- Super premium $7-$14
- Premium $3-7
- Jug

More Volume
< $5

~ 50 percent of volume

Distribution: chain supermarkets and drugstores

Non-varietal and “California” appellation

Market declining in share and total volume

Revived with “2 Buck Chuck”
mass distributed varietals
$6-$14
“premium” and “super premium”
significant growth, past 10 years
sold in chain grocery stores
$5-10 ~ “California” Appellation
$10-$14 ~ “Coastal” Appellation
import growth

Brand Varietals
> $14

“ultra premium” and “luxury” rapidly growing market

appellations (e.g., Napa, Burgundy)

“third party” writers validate quality (e.g., Parker; Wine Spectator)

sold in “hand-sell” wine shops and white linen restaurants

>4,000+ producers, 10-12% of market

still growing strong, but many new producers
Price Segments Differ in Performance

2006 CALIFORNIA sales

Gomberg-Frederickson Wine Institute Estimates
Firm strategies to participate in the move to more expensive wines

• Reposition an existing brand
  – Difficult!

• Introduce a new brand at a higher price
  – Several 1000 such introductions in past 5 years
  – Crowds the market

• Acquire brands
  – Constellation and Gallo strategy
Market Trends

• Growth in sales of wine above $14 retail

• Consolidation and stagnation in wines under $7 retail (demanding economies of scale in production and distribution)

• Growth in sales of imported wines
  — 30% by volume in 2007

• Growth in wineries (small) outside of California—5000+ wineries in the U.S.
Summary

- The proliferation of small wineries outside of California will help to make wine an integral part of U. S. culture.
- Young consumers are adopting wine and have been raised with global products.
- There is strong interest in differentiated and artisanal products—but market entry is difficult.
Thank you for your attention!