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# Vintage Economics

## Washington Wine Industry Update August 2020

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The Washington wine industry is facing its greatest challenge in decades due to Covid-19 and a bulk wine and grape glut that has been several years in the making. Wine shipments plunged by nearly 20% in the second quarter on a year-over-year basis, with big and small wineries alike feeling the pain. Surging grocery and chain store sales have not been enough to offset weakness at restaurants and independent retailers and spiking direct-to-consumer “shipments” have been insufficient to counter a loss in tasting room sales.

The future trajectory of the virus as well as the outlook for the economy and wine market remain extraordinarily uncertain.

The U.S. economy recorded its largest quarterly decline in modern history despite federal government stimulus that is unprecedented in both size and scope. The stimulus boosted household incomes and allayed a potentially devastating collapse in consumer spending. Employment has begun to recover at a modest pace, though 16 million Americans remain unemployed.

On the other hand, the virus is still raging in many states and the initial round of stimulus is waning. One of the key concerns going forward is what will happen when the stimulus eventually comes to an end? The answer may be revealed sooner than initially anticipated as partisan bickering has already stalled the effort to extend some existing provisions.

Much also depends on the path of the virus itself, and there are still many unknowns here. Prospects for a vaccine by the end of the year look promising. But even if this comes to fruition – and the vaccine is effective – it doesn’t necessarily imply a speedy end to the pandemic as an extended period of time will be required for it to be manufactured and administered on a scale sufficient to snuff out the virus.

Thus, the specter of Covid-19 and associated activity restrictions are likely to be with us for some time. Even after the virus is gone, the wine market and economy will look much different than they did at the beginning of 2020, and many of the changes in consumer behavior wrought by the pandemic are likely to endure. This environment of heightened uncertainty and accelerated change creates both opportunities and risks for the Washington wine industry.

Given this, is more important than ever to take a strategic approach and make decisions informed by data and analysis. Don’t hesitate to reach out if I can help.

Chris Bitter

## Wine Shipment Trends

*Washington Wine Shipments*  
Through June 2020 (000s of cases)  
Source: Vintage Economics / WA LCB

	Last 3 Months		Last 12 Months
This Year	2,550	▼ 19%	11,700
Last Year	3,139		12,925

Covid-19 took a toll on Washington wineries in the second quarter as wine shipments plunged by 19% relative to the same period in 2019. Shipments are down by 15% year-to-date.

These figures are based on my analysis of Washington State Liquor and Cannabis Board data and mainly represent sales to distributors, retailers and consumers (including tasting room), but also include transfers to storage / selling areas in advance of sales in some cases. They provide a more complete view of volume trends than Nielsen’s scan data, which captures only about a 40% slice of the Washington total.

Distribution channel shipments were down sharply in the second quarter, indicating that hefty gains in Nielsen tracked stores have been more than offset by a drop at other shops and on-premise accounts. Small wineries have been particularly hard hit as retailers have reduced SKU counts.

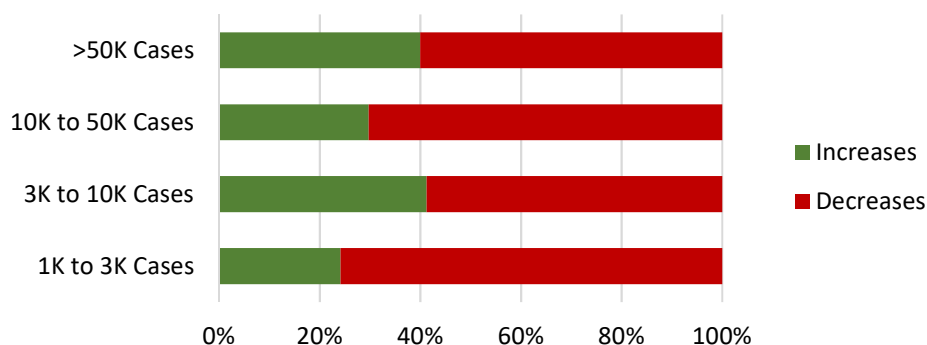
Direct-to-consumer sales/shipments have held up better. Even still, the modest second-quarter decline represents a major reversal from a 10% gain in 2019 and suggests that surging DtC “shipments” have been countered by an even larger decline in tasting room sales.

The damage has been widespread. Two in three Washington wineries (excluding annual filers and those selling < 1,000 cases) shipped less wine in the first half of 2020 than they did a year ago. One in three were down by 25% or more. Most small wineries were in reasonably good health heading into 2020, but many will be in serious trouble if sales don’t pick up soon.

It should also be noted that the pandemic is not solely to blame for the dismal second quarter results as several of the state’s large wineries were already struggling when it took hold. For example, Ste. Michelle’s sales peaked in 2016 and Hogue Cellars’ shipments have been in freefall since the Constellation / Gallo transaction was announced last spring.

Unless there is a major setback, wine demand should gradually improve during the second half of the year as restaurant diners and tasting room visitors return. Even still, Washington’s 2020 shipments are likely to fall below 12 million cases for the first time since 2014.

*Percent of Wineries with year-to-date Increases/Decreases in Shipments by Size Category*



## Ste. Michelle Write-Offs

Ste. Michelle Wine Estates (SMWE) recorded a \$392 million charge to its first quarter income statement, including a \$292 million inventory write-off and \$100 million to offset future losses on noncancelable grape contracts that are no longer needed. The move aims to alleviate a persistent gap between its output and sales that has opened up in recent years.

The inventory write-off will include destroying some excess bulk wine. It represents a major step toward rectifying Washington State's massive bulk wine glut (which I estimated to be about 8 million cases prior to the 2019 harvest) but will not eliminate the problem entirely.

The grape write-down is primarily being handled through contract buydowns, where SWME has asked its growers to reduce crops to below the level specified in the contract. This should result in a substantial reduction in the winery's 2020 vintage wine production.

Though its sales are down from their peak, SMWE is still Washington's largest winery by far, accounting for six in every ten cases of wine sold in 2019. The write-downs provide SMWE's leadership team with an opportunity for a fresh start as they embark upon a "strategic reset."

## Grape Market Update

The 2020 crop is shaping up to be a good one in terms of both quality and quantity, though it will likely fall short in size relative to those in recent years due to Ste. Michelle's buydowns. It has been a warm year in Eastern Washington and the harvest is likely to begin a bit early.

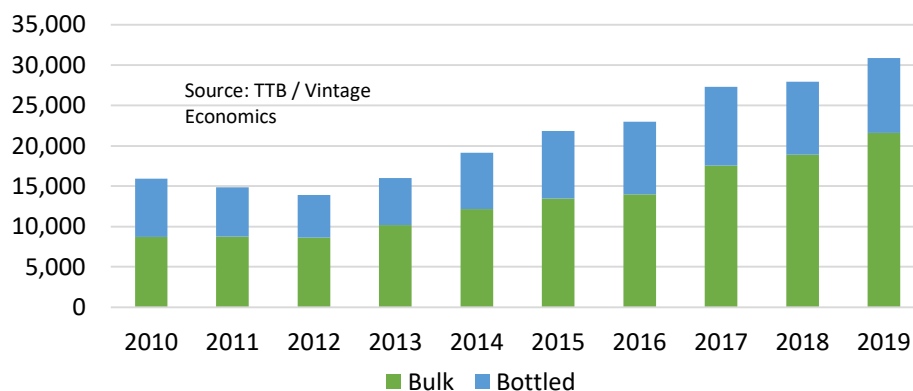
On the economic side, it continues to be a tale of two markets, although the stories have converged somewhat due to Covid-19.

The market for "commodity" grapes continues to be highly challenging. Spot market prices are down, and many growers are still sitting on uncontracted fruit. Virtually no new long-term deals are being signed at this point.

The "boutique" market remains firmer but has been softening due to tumbling wine sales. Small wineries are also hesitating to lock into long-term commitments, and some have terminated contracts. Growers worry that others may not show up for their fruit this fall or will be unable to pay up when bills come due.

Vineyard removals have been modest to this point so even if shipments rebound to their pre-pandemic level the large structural gap between supply & demand that I highlighted in the March newsletter is set to persist into 2021.

WA Bonded Inventory - August 31 (000s of cases)



## About Vintage Economics

Vintage Economics is a Vancouver, BC based market research and consulting firm focused on the wine industry. The firm is dedicated to providing insightful market research and analytics to help clients make better informed and more strategic decisions and position their businesses for success in a rapidly evolving and increasing competitive market environment. Areas of expertise include market analysis and forecasting, strategic research, and business analytics.

Vintage Economics also supplies analytical reports and customized metrics and intelligence on the the Washington wine industry tailored to meet clients' unique needs.

Please see the [Vintage Economics](#) website or contact Chris Bitter for additional information.

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