AGG Winter Report - 2023

Apprehension

According to *Oxford Languages* (Google's on-line dictionary), the definition of the word apprehension is "anxiety or fear that something bad or unpleasant will happen." Interestingly, this word is one we have been using to describe the actions (or lack thereof) of most grape buyers contemplating future grape purchases since the end of the 2022 harvest.

In 2021, it seemed that the second the last grape was delivered, wineries throughout the state were tripping over themselves to procure supply for 2022 and beyond. We negotiated (and renegotiated) hundreds of grape purchase agreements starting in November of 2021, with sales activity remaining strong throughout the winter and into the spring of 2022. The 2022 grape market ended up cleaning up very nicely for almost 100 percent of the varieties and regions, stimulated by the April frost and that horrendous heat wave the week of Labor Day.

Grape buyer attitudes this post-harvest have exhibited much more, well…… apprehension. Why the apprehension all the sudden? What exactly are the buyers anxious about or fearful will happen to them that is bad or unpleasant? Given the state of the economy, there's likely a number of things that are on their minds when it comes to market stability. We know the majors: inflation, recession, interest rates and generally waning consumer confidence over the last year.

On top of that, we have "state of the wine world" issues regarding grape/wine supply and demand. The majors here are the strength of the U.S. dollar, the China/Australia debacle, Europe's ever-declining consumption and South America's current hunger to dump red wine. And then we consider the "state of the consumer." The majors here are no alcohol/low alcohol trends, alternative drinks preferences, dominating spirits categories, and an "indifferent-to-wine" Gen Z and younger Millennial crowd (ages 21 to mid-30s).

Failing to provide any tailwind, 2022 California wine shipments were flat - again. That means the only way to grow in this environment is to steal someone else's share. It's harder to take something from someone than it is to grow along side them. Throw the never-forecasted-to-end war in Ukraine as some icing on the headwind-cake and suddenly the newly developed apprehension posture seems a bit more understandable.

Most of these same challenges (or threats) actually existed a year ago, but somehow today it feels more unstable. The biggest factor contributing to buyer apprehension may be something that wasn't even mentioned in the laundry list of concerns, and that's grape price.

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Apprehension

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Over the last two years, spot market grape prices have rebounded from the beating of 2019. Additionally, farming in California has gotten exponentially more expensive. With the strengthening grape and bulk wine markets over the last two years and the trajectory of production costs, it is perfectly natural for growers to place higher value on their grapes for the future to remain economically viable. The trends justify the thought process.

In many cases, however, we are beginning to see a chasm between buyer and grower expectations for grape price, and that has encouraged some buyers to pause and earnestly evaluate the risk associated with investing in more inventory. After all, the excess inventory conditions of 2019 are not that distant of a memory. In some cases, grape buyers (particularly those with sluggish wine sales) have become grape and bulk wine sellers, and the tolerance for inclining prices has certainly moderated.

Add to this the dynamics of "market mix." The market mix refers to that mix of grapes or wines that are available to buyers on the spot market versus what they already have contracted or have in inventory. In recent years, grape buyers have increased the percentage of grapes they have secured under multi-year contract. This was done because of the tightening supply and the fear of loss if they failed to contract.

This means there are generally less grapes available for sale today than in years like 2019 or 2020. But it also means most buyers are positioned well with regard to contracted supply. Additional purchases, in many cases, are optional for the time being. Without strong market pull or some threat that the supply won't be there, buyers are better-positioned today to take a wait-and-see approach.

This may sound like a blanket statement for the industry, but it really isn't. There are certainly wineries that are experiencing growth and ready to move on the opportunity to buy more product. They will benefit from being able to pick through the available supply for "best fits," even though the options are diminished from a year or two ago.

Demand for certain variety/region combinations remains very strong based on underlying dynamics that supersede those factors which are causing buyer apprehension. We will discuss those a bit more in the market update section, as we talk about what we have been selling and negotiating contracts on since harvest.

So for growers, all this leads us back to the discussion we've had so many times in the past. In the face of margin compression, only the strong will survive. Efficiency, quality and productivity are musts. Additionally, the stakes are high. It costs too much to farm without the assurance you will be compensated for the effort. Uncontracted grapes are a relatively high-risk proposition, and certainly more so today than a year ago.

California Growers Still Resilient

"All progress is change, but not all change is progress." – John Wooden

If there is one constant in the California wine industry, ironically, "change" might just be it. California's winegrape growers have been masters of change; driving the industry forward through drought and wildfires, recession, the proliferation of virus, labor struggles, and a sometimes seemingly intractable battle in the halls of Sacramento. Today feels different though; the challenges suddenly more formidable and more urgent. Today, growers are faced with a group of obstacles that, collectively, demand unity within our industry while simultaneously forcing hard conversations about how much all this change really represents any degree of "progress" for the grape grower.

One new obstacle, in particular, has many growers asking themselves a perplexing question: What do you do when your buyers become your largest competitors in the grape market? A whiplash return to the pre-COVID malaise in popular and commercial-premium wine sales, in the wake of the COVID retail surge, has left many large wineries scrambling to balance their supply ledgers. One solution they have adopted is hardly foreign to the California wine industry but, in the interior, has emerged at a scale that is proving to be as disruptive a market force as we have seen.

The rapid rise in winery-to-winery transactions of both "estate" fruit and the "flipping" of existing contracts to competitors (sometimes in arbitrage) can effectively turn what is a very active grape market on its head. In 2022, deals in which growers were in deep negotiation evaporated instantaneously as fruit previously considered to be "sunk" supply entered the market as available by competitors.

To be clear, wine grape growers of all stripes have a right to sell their product to willing buyers. This is, after all, a bedrock principle of our economic system, and businesses should not be villainized for taking action to protect themselves through free market activity. It does, though, raise a series of challenging questions that we need to tackle as an industry. Not the least of those is how grapes are to be priced in an extremely consolidated market (like the interior) where major buyers now inherently share pricing information via their own arms-length exchange of goods.

ALLIED GRAPE GROWERS

The good news is that California growers are still the same resilient bunch that they have always been, and an organization like AGG exists to be a market hedge in this precise scenario. Growers across the state can, and should, utilize any disruption in the market to reorient themselves as the vanguards of the industry; the stories of sustainability, of regenerative farming, and the realities of organic viticulture should come from the vineyard, not as a reflexive response to wine market demands.

AGG strives to be at the front of that movement, through the collective voice that we bring to the table in winery negotiations, the new winery clients cultivated to diversify regional buyer pools, and the practical in-field advise offered to growers in-season. AGG members are well positioned to succeed in the future of California wine, and we're always peaking forward to see what will be next in our constant state of change.

As always, we would encourage those interested in engaging further with industry-wide issues to reach out to their local industry groups as well as statewide organizations such as the California Association of Winegrape Growers and the Farm Bureau.

by Kyle Collins
North Valley Manager

2022 Vineyard Removal Activity "Normal"

We often discuss vineyard removal trends alongside planting trends at AGG. It's done in an effort to provide the whole picture with regard to net bearing vineyard acres.

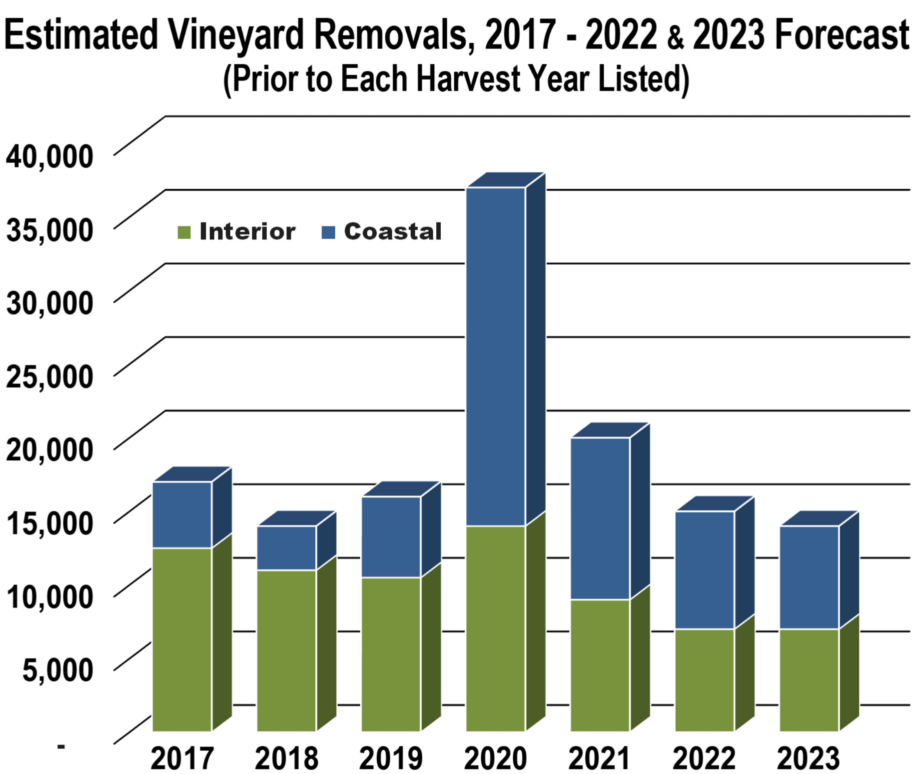
One observation that we have made over the years is that growers are generally hesitant to make rash decisions regarding vineyard removals. Sometimes, growers will tolerate years of marginal returns prior to making the decision to remove a vineyard, even if that vineyard does not lean toward the "productive" side. If the grape market is balanced and contracts can be had, growers very seldom exit the business, even if they aren't making money.

We've seen a bit of this behavior the last couple of years as vineyard removals throughout California have slowed in the wake of an improving grape market. The exception to this has been in the "white areas" (non-irrigation district areas) of the Central Valley and on the west side of the Central Valley, where water limitations and costs have forced the non-negotiable removal of some otherwise healthy vineyards.

Given that growers in most areas of the state have been moderating their desire to remove vineyards the last two years, it's very likely, if we were to experience another grape market "crash" (like that of 2019), it would cause a spike in removals. The reason? When vineyard removal is deferred, it generally takes one really bad year for a slew of growers to react. There becomes a bit of pent-up removal energy when vineyards are retained past their useful prime

The newest data available reveals that removals are generally on par with that which we have observed over time, if not slowing just a bit (see graph). The improved grape market has held back many growers from making that "final" decision on removals the last two years.

We have noted, since 2021, that the impending prohibition on ag burning in the San Joaquin Valley may encourage vineyards at or near the end of their useful life to be removed. So far, that incentive to get them pushed, piled and burned has not been enough to counter the incentive to keep them in while the market is "healthy." We have two more years until the prohibition goes into full effect (January 1, 2025).



Additionally, the "Ag Burn Alternatives Grant Program" has provided a reasonable alternative for San Joaquin Valley growers to remove their vineyards without burning. The ability to have the additional costs of this method of removal offset by state funding has been a positive, but there's no guarantee that money will be available in 2025 or thereafter. This fact may still promote additional removals prior to the prohibition implementation date.

Overall, unless we see a major shift in the grape market, we don't expect any huge spikes in removals. This is specifically true in the coastal regions. Other factors will play into a more definitive decision to remove vineyards in the San Joaquin Valley. These include a continuing weak wine market below $11 per bottle, limited or high-cost water, and the impending burn prohibition.

Grape Market Update – Buyers are Getting 'Ready'

As mentioned in our opening article, the grape market is much more quiet currently than this time last year. This is true in all areas of the state, and we discussed the reasons why. But that doesn't mean there is no activity at all.

Buyers are certainly active, "taking inventory" of what's available and what has come off contract. Importantly, they are also busy evaluating their own contract expirations and indicating which vineyards they wish to re-sign and on which ones they will hold off for now. There is no doubt that their behavior is consistent with the apprehension we discussed, but it also is indicative of another important characteristic – readiness.

Grape buyers throughout the state are preparing themselves to move when the time comes. Part of that is prioritizing vineyards based on perceived quality. So, there's plenty to do currently. Our sales staff is busy showing vineyards and discussing options and opportunities with buyers. Buyers are generally not long on inventory, so if there are opportunities to increase program sizes and develop new markets, they want to be ready to take advantage of them.

What are the bright spots in the grape market today? Quite honestly, the highest end of the market remains the strongest and most active. Many conversations exist around Napa and Sonoma County grapes in general, with specific appellated varieties in high demand. Examples are Napa Valley Cabernet from most AVAs (but specifically hillside/mountain fruit), Sonoma County Chardonnay (especially Russian River), and Sonoma County Pinot Noir from the popular AVAs like Carneros, Russian River, Sonoma Coast and Green Valley.

More broadly in the North Coast, conversations are certainly being had around Zinfandel and, no surprise here, Sauvignon Blanc. One alarming trend that we continue to see is buyers ditching AVA-based programs to move toward "North Coast" or even "California."

Since the highest end of the market has been the strongest segment the last couple of years, grape prices have escalated and supply has diminished.

This encourages buyers to change their labeling in order to source from a broader region, and at lower price points. The competitiveness of the retail wine space continues to drive these decisions, and it does have a tangible impact on the grape market.

We began to experience some softness last harvest with North Coast Cabernet Sauvignon (specifically those vineyards outside of Napa and the highest end Sonoma County appellations). It appears the slower-than-desired Cab market may continue into 2023. Additionally, coastal Pinot Noir outside of those special Sonoma appellations may bring weaker-than-desired responses from buyers this marketing season.

The Central Coast is comparably quieter than the North Coast in terms of activity, with buyers "talking" about reds in general in the Paso Robles area, but movement in the market has been nil since harvest. Grower expectations for pricing is strong though. After two years of strengthening demand and prices, growers do not seem ready or willing to allow that to roll back just yet.

Of course, outside of Paso Robles, whites are generally in demand, namely Sauvignon Blanc. But Chardonnay will likely experience a very price-sensitive market. Since Chardonnay continues to show market strength statewide, it really does come down to a matter of pricing and destination wine program.

The Central Coast Pinot Noir market remains quiet. Pinot has been widely recognized as the variety in the longest position on the Central Coast in recent years, even though the wildfire smoke of 2020 and the pursuant short crops have masked the degree to which that variety is overplanted.

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Grape Market Update
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Within the interior regions, the dynamics in Lodi and the Delta are much different than down valley. Essentially, south of Lodi, there are no grapes available. So, it feels "slow," but that's because there's simply not much to transact. Most central and south valley grapes are under multi-year contracts, so the only vineyards popping up as available are those that had contracts expire after 2022 harvest. These are very few, based on recent years' contracting cycles, where many contracts were extended prior to expiration.

If there is one Central Valley variety that continues to be requested by buyers and still provides active planting contract opportunities, it is Rubired. The Rubired market improved substantially in 2022, and we expect it to continue to strengthen into the future. The lion's share of Rubired in production is aging, and production has been falling. But at the same time, demand remains very strong, and convincing growers to put more in the ground has been a challenge. The result: the market remains tight and escalating.

In the North Valley, Chardonnay remains the variety of discussion, with most other major varieties much less talked about. While buyers are taking inventory of all available grapes, Chardonnay is the one variety that we are already able to move on regarding contract activity. Whites, in general, are in a stronger position market-wise than reds, in the interior.

Overall, today's California grape market is in a "ready, set" stage. Experiencing the "go" is probably just a matter of time. However, that "go" may not come very convincingly if we get to April/May and start to see larger than average crop potential. With our market continuing to hang perilously in balance after three short crops, and no sign of pent-up consumer demand manifesting itself anywhere, a larger than average crop would certainly cause some brake lights in the marketplace.

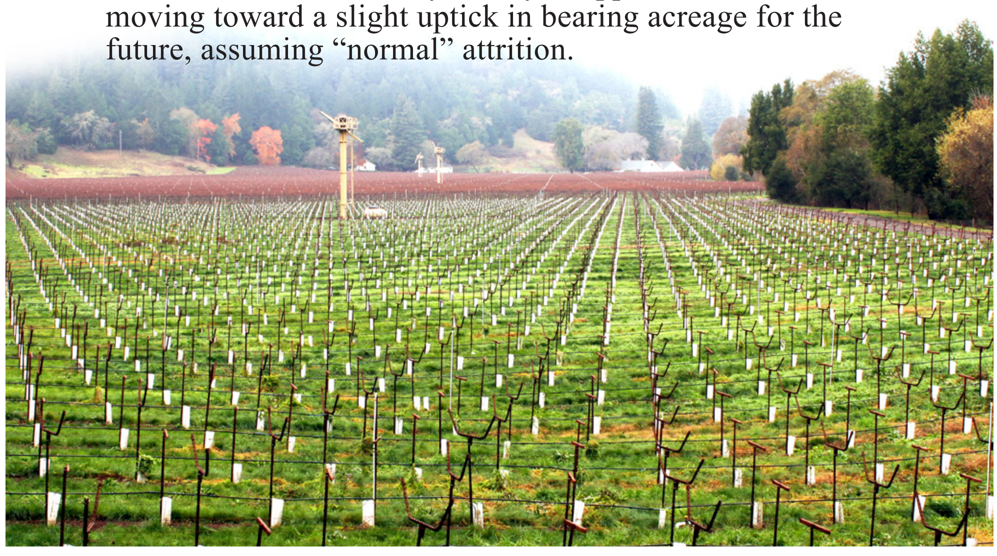
Plantings Continue at Moderate Pace

The most recent grapevine nursery survey performed by Allied Grape Growers indicates that, once again, California growers planted somewhere between 16,000 to 18,000 new acres in 2022. As of writing this newsletter, we are still in the process of collecting and disseminating the last of the data. Our full report on planting trends will be presented at the Unified Wine & Grape Symposium in late January.

Initial indications from the survey point to some interesting changes in planting dynamics. What started in 2021 as a noticeable shift away from planting Pinot Noir occurred with even more definition this past year. For the first time in many years, Pinot Noir will not rate with double digits in terms of its percent of all vines planted. In fact, when the final numbers are tallied, it's possible Pinot Noir will no longer be in the "top three" of all varieties planted.

What's gaining in popularity in terms of planting? Basically, Sauvignon Blanc. Sauvignon Blanc made an impressive showing with significantly more vines planted this past year than in any other recent year. Also, we are beginning to see the effects of planting contracts having been offered in the central interior in 2020 and 2021 by the increased amount of planting in the value segments of the industry. These amounts are not substantial, but it does indicate a change in behavior. French Colombard, Chardonnay, florals and Pinot Grigio all experienced increased interior planting activity in 2022.

All in all, the initial indication from the nursery survey is that things are mostly status quo, with previous years' trends continuing to play out. The "mix" of varieties planted is ever-changing, but once you move past the King and Queen (Cabernet Sauvignon and Chardonnay), the remaining varieties are planted in much lower volumes. They have little likelihood of significantly altering supply dynamics in the market. However, based on what we shared earlier regarding vineyard removals, and considering the planting data obtained from the nursery survey, it appears California could be moving toward a slight uptick in bearing acreage for the future, assuming "normal" attrition.



Meet the AGG Staff

***(Standing - left to right)* Michael Haddox, Chad Clark, Kyle Collins, Karl Lehman, Jeff Bitter, Joe Osterman, Tim Mendonca, Kevin Rogers, Ed Nikssarian**
(*Seated - left to right)* Marcia Silva, Irene Ybarra, Alesia Zion, Pam Bond

AGG is growing something other than grapes; we are growing our business!

Even in the midst of an otherwise flat wine market and pressures resulting from industry consolidation, our association of growers continues to prosper and bring value to those we serve. Over the last four years, we have seen our annual sales increase by a compounded growth of 12 percent. The number of grape contracts we negotiate, administer and enforce has grown in that same time from 578 to almost 800 – a 34 percent increase!

In response, we have staffed up! Our most recent addition in June of 2022 was grower relations representative Tim Mendonca (pictured third from the right). We currently have 13 year-round employees and are looking to hire another. Our sales team and field staff is outstanding in their performance, so our operations and administration team is swamped with work.

We are currently looking for an operations administrator to help keep our team as efficient and productive as possible. It’s time to focus more on the intangibles, like media and communications, processes and programming, and database management, in order to support and enhance the growth in business generated by our sales team. This person would be part of our Fresno, California, staff and working from our main office.

If you know of anyone who might be qualified and interested, please send them our way!

Operations Administrator

Under the direction of the President, this person would be responsible for a number of operational and communications functions including, but not limited to, data processing and dissemination; social media/website development & maintenance; systems maintenance; database management and contract administration.

Primary Duties & Responsibilities:

- Liaise with management to execute business operations and procedures within the company
- Facilitate industry and member communications via web and written marketing materials
- Support the Manager of Accounting and Administration with data processing and entry
- Develop and maintain internet presence including social media and company website
- Create, review and administer grape purchase agreements and related business documents
- Automate and evolve internal business systems for efficiency and accuracy

For Required Qualifications & Abilities, contact: Jeff Oliver, Oliver Search Consulting
(559) 434-8500 jeff@oliversc.com

Winter Report - 2023

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ALLIED GRAPE GROWERS

Written for the growers and customers of
Allied Grape Growers

Allied Grape Growers (AGG) is a 500-member grower-owned winegrape marketing association. We exist for the purpose of effectively selling our members' winegrapes to grape buyers of all kinds throughout California. AGG is the leader in understanding supply-side dynamics in the California winegrape sector and uses that expertise to maximize results for its member-growers as well as to work with our buyers to properly plan for their growing supply needs. AGG has been in existence since 1951, with decades of proven leadership and value in the California wine industry.

Quality Integrity Stability

Inside This Issue

Allied Grape Growers