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Final Thoughts on Bordeaux 2015

Executive Summary

What's going on with En Primeur?

When Liv-ex published its "Price Guide for Members" ahead of the UGC tastings in April, it seemed that the 2015 vintage represented an opportunity for Bordeaux to reengage with its overseas markets. To this end, some progress has been made. A tentative recovery is underway. Sales in 2015 were sharply above levels achieved in 2014, which in turn were up on 2013, but in the context of history this is a low bar. Sales in 2015 amounted to less than 25% of 2009 levels. So what's going on?

The new normal

It seems likely that making comparisons to 2009 and 2010, two great vintages launched at the end of a particularly buoyant period for the Bordeaux market, is both part of the problem and unrealistic. If we have learnt anything during the 2015 campaign, it is that those halcyon days are unlikely to return any time soon. Despite this there is still a sense that the latest Bordeaux vintage didn't fulfil its potential in the international market. There are some vintage specific reasons for this, but also some pretty fundamental structural reasons that will take longer to work through.

Pricing, quality and expectations

The variability of the vintage between communes didn't help, nor did the clear gap between what Bordeaux thinks its wines are worth and what consumers are prepared to pay. This was exacerbated by volatility in the currency markets and the weakness of Sterling ahead of Brexit in particular. Indeed, while many exceptional wines were made in Margaux, for example, the wines of the all-important northern Medoc were less good in relative terms. In many cases this fact was not reflected in prices. Equally when Liv-ex surveyed its members ahead of the campaign, the consensus expected a 17.8% price increase in Euro terms on 2014. The reality was nearly three times as high. There is little to suggest that these additional price increases were led by consumer demand.

Hit and Miss

As a rule, successes fell into two camps. Those properties that made better wines than they have ever made (like Canon and Giscours) or that offered attractive discounts relative to comparable vintages (like Pape Clement and Lafleur). The basis of frustration around the vintage is that too few producers priced their wines to sell through to the final consumer. Many wines in the northern Medoc, in particular, made wines that didn't match up to the heights achieved elsewhere, a fact not taken into account in release prices. The process of price discovery wasn't helped by the marked differences in critic scores. Was 2015 a 97 point vintage as Suckling suggests or 94 points as advanced by the Wine Spectator. The implications for price are substantial. The absence of Parker as an anchor around which to make a market has certainly added complexity to the process.

Low interest rates and perverse incentives

The prevailing gap in pricing between Bordeaux and its customers partially reflects the fact that exceptionally low interest rates have shifted incentives away from generating cash flow to hoarding stocks. For the chateau, this has involved selling less grand vin to match falling demand in order to keep prices at inflated levels. Maintaining high property values is much more important than making profits. Low interest rates have also incentivised the negoce to build stocks as the potential for margin far outweighs the holding cost in the current environment. Competition for allocations and an obligation to buy to stay in the game adds fuel to the fire. This may turn out to be a good strategy if prices rise, but the obvious paradox is that values will only go up if wines become scarce. This is not going to happen until the wine sells through to the consumer.

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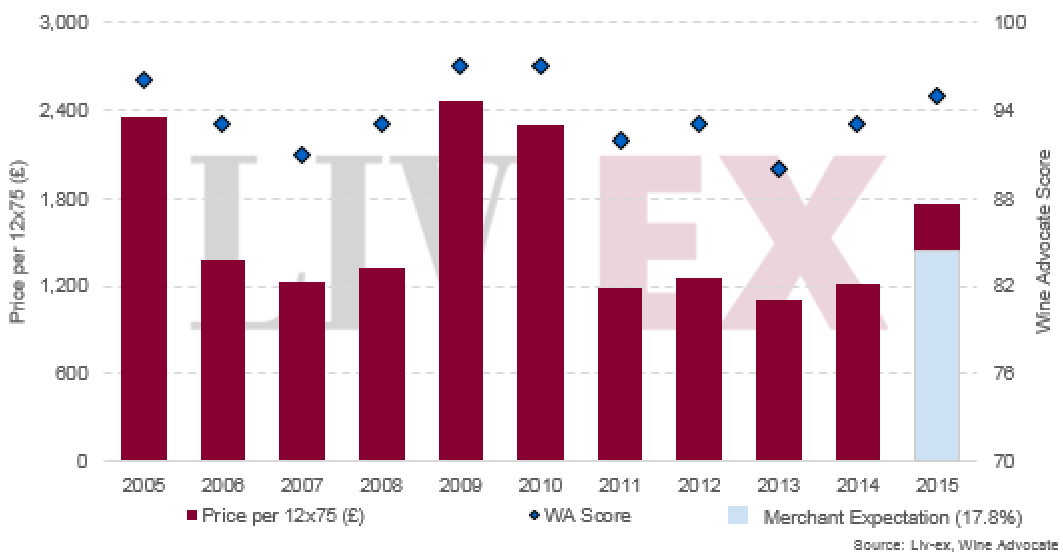
Introduction
In the foreword to the "price guide for Liv-ex members" published just before the UGC tastings in April, it was suggested that while it was "too early to make a definitive call on the new vintage", the prevailing consensus was that 2015 "sits somewhere between the good vintages such as the 2006, 2008, 1012 and 2014 and the exceptional ones like 2005, 2009 and 2010."

The report went on to argue that given the substantial price gap between the two groups of wines, there would be "plenty of room to price the campaign in such a way as to make it attractive to all participants". This, it was suggested, represented "an opportunity for the Bordelais to rebuild damaged sentiment around En Primeur". So how did these hopes compare to the reality?

Bordeaux 2015: prices and scores in context
At an average level this proved to be remarkably prescient. The chart below compares the current average market price of the last 10 vintages with the average UK release price for the 2015 of the wines in the Liv-ex Bordeaux 500 Index. Overall the vintage scored 95 points (according to Neal Martin of the Wine Advocate) and the average release price in the UK was £1,763, in between a good and a great vintage in terms of both score and price.

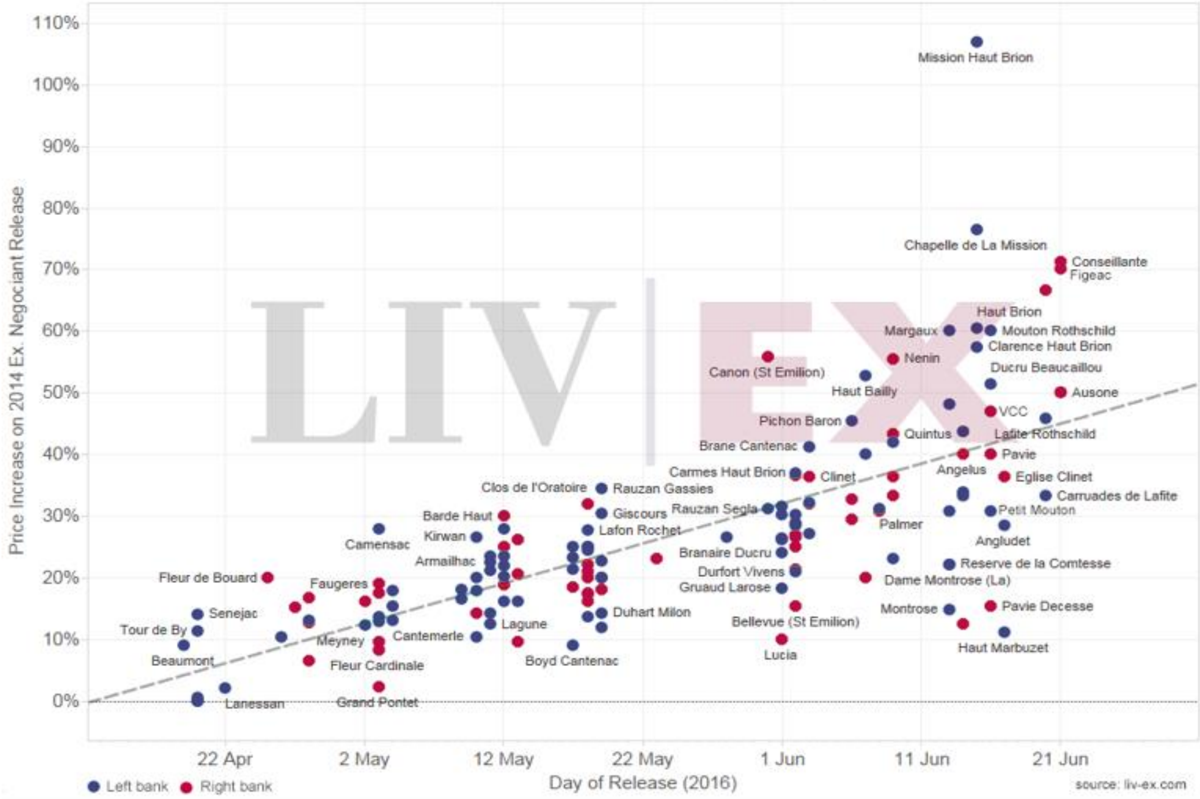
Average 2015 merchant release price and score vs the previous 10 vintages



Averages, however, always hide a multitude of sins and in hindsight there were two important factors that the analysis in April didn't account for. First, as the chart above shows, release prices were in general substantially higher than the market was expecting. Second, the vintage was much more variable between appellations than had been appreciated.

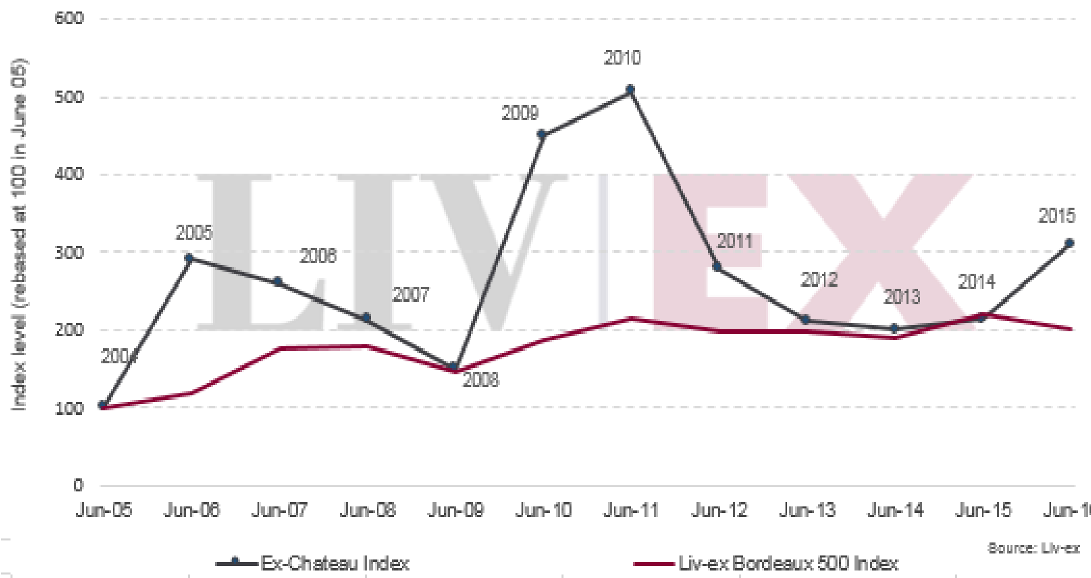
Prices exceed expectations
A survey of Liv-ex members' expectations after the UGC tastings predicted an 17.8% increase in prices on the 2014 release. The actual outcome was 46% - nearly three times as high. Moreover, as the chart below shows, prices tended to increase as the campaign progressed. To some extent this could be justified by increased quality, higher scoring wines released later, but in many cases there was scarce evidence that higher prices were led by higher demand. Not by the consumer at any rate.

The development of release prices during the 2015 campaign: % change on 2014 in Euros



Viewed in the context of the last 10 years, ex-chateau prices recovered to the highest levels since 2010 on average and were just ahead of 2005 levels, the third highest of all time. Against 2014, the ex-chateaux Index was up 45% on 2014. Over the same period, Bordeaux secondary market prices as represented by the Liv-ex Bordeaux 500 Index were down 9% in Euros. Relative to price inflation for stocks already in circulation, therefore, the increases were substantial.

Ex-chateaux price index relative to the Liv-ex Bordeaux 500 index (in Euros)

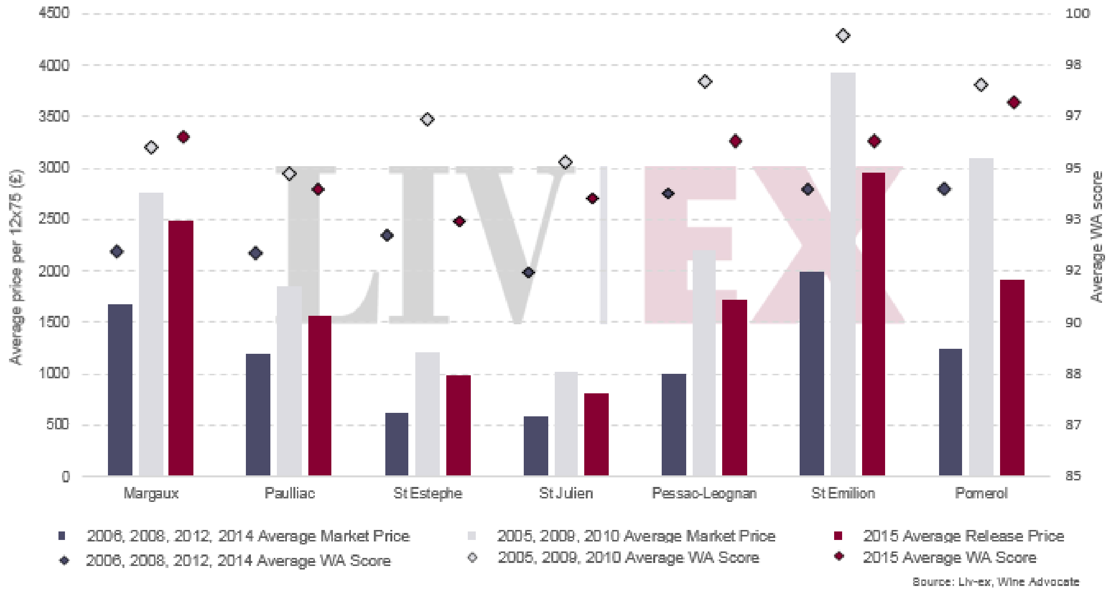


Vintage variation was not reflected in prices

Moreover, the variability of the 2015 vintage wasn't always reflected in prices. This is apparent when looking at the regional averages. Some wines in Margaux, for example, are thought to have made their best ever wines. Indeed, Margaux properties included in the Bordeaux 500 Index enjoyed a higher score on average from Neal Martin than they achieved in the excellent vintages of 2005, 09 and 10.

In contrast, St Estephe – where growing conditions were more challenging – didn't manage to scale the heights achieved in the great vintages. Cos d' Estournel (£1,272) and Montrose 2015 (£1,140), for example, were released at substantial premiums (of 64% and 80% respectively) to the price of a good vintage (ie 2006, 2008, 2012 and 2014), despite attaining a lower score in 2015 on average.

Average prices and WA scores by commune - 2015 relative to good and great vintages*



Region	2006, 2008, 2012, 2014 WA Average	2005, 2009, 2010 WA Average	2015 WA Average	2006, 2008, 2012, 2014 Average Market Price	2005, 2009, 2010 Average Market Price	2015 Average Release Price
Margaux	92.4	95.7	96.0	£1,681	£2,764	£2,497
Paulliac	92.3	94.8	94.3	£1,203	£1,848	£1,559
St Estephe	92.8	96.6	93.0	£624	£1,213	£994
St Julien	92.0	95.2	93.8	£586	£1,015	£819
Pessac-Leognan	94.1	97.8	96.2	£1,005	£2,200	£1,720
St Emilion	94.3	99.3	96.0	£1,991	£3,932	£2,959
Pomerol	94.1	97.7	97.2	£1,248	£3,104	£1,912

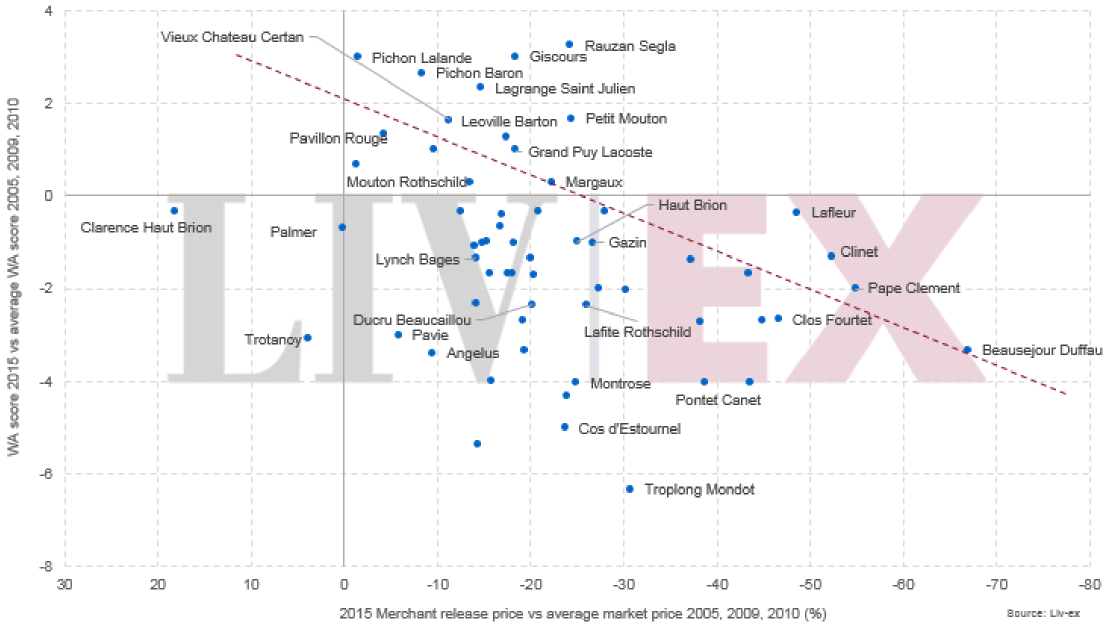
*Liv-ex Bordeaux 500 Index wines only

These regional disparities proved particularly challenging for the First Growths. Chateau Margaux (WA 98-100) was elected wine of the vintage by Liv-ex members and is a strong candidate to receive 100 points in 2015. In contrast, Lafite Rothschild (WA 94-96) made a less good wine in relative terms, achieving a lower score than its "good" vintage average. Despite this, it was released at a premium to Margaux in the UK market (£4,350 versus £4,150). In St Emilion, both Angelus 2015 (WA 95-97) and Pavie 2015 (WA 96-98) released wines at similar levels to the near perfect 2009 and 2010 vintages. Neither price provided any incentive to buy the wine En Primeur.

Winners and losers

For the most part, the wines that sold well in 2015 either made their best ever wines or offered attractive discounts to comparable wines already in circulation. Canon 2015, which is a candidate for 100 points, is an obvious example. Neal Martin awarded it 98-100. Its previous best score in the last decade was 94. Equally Lafleur, which made a comparable wine to those in the exceptional vintages, offered a discount on release of nearly 50% to the current market price of the 2005, 09 and 10. These wines were much sought after.

2015 release price and score relative to the average in 2005, 2009 and 2010

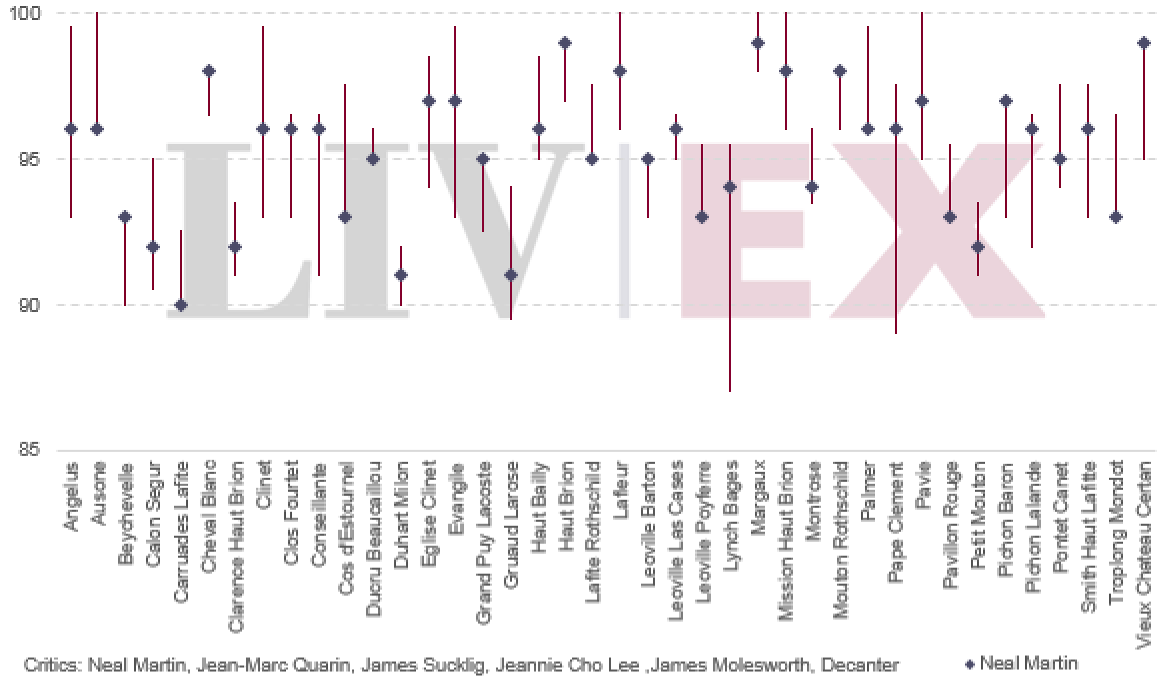


The chart above shows how the release price and score of the 70 wines in the 2015 "Price guide for Liv-ex members" compare with the average of the exceptional vintages (i.e. 2005, 09 and 10). For buyers, the trade-off between price and score is broadly represented by the dotted red line. The wines above the line which either made better wines than they made in the great vintages or offered deep discounts (or both) were successful in the market. Those below less so, with Clarence Haut Brion, Palmer and Trotanoy all releasing wines at higher prices, despite achieving lower ratings. The basis of frustration around 2015 was that too few wines were released at attractive prices.

In search of a new benchmark

While variability between regions posed one challenge in 2015, variability amongst critics posed another. The analysis here is based around scores from the Wine Advocate, but choosing a different critic would give very different results. On average, for example, James Suckling awarded the vintage 97 points, while James Molesworth at Wine Spectator gives 94 points to 2015 on average. Neal Martin, with 95 points, lies somewhere between the two. In pricing terms, this divergence is enormous. A score of 97 points puts 2015 in the same bracket as 2009 and 10, while 94 points is closer to a 2006 or 2014. The market values the former at twice the price of the latter.

The range between highest and lowest critic score in 2015



These differences of opinion were particularly marked at the wine level. The chart above takes the mid-point of the in barrel score range from six of the leading critics and plots the highest and lowest point for each wine. Lynch Bages, for example, scores 95-96 with James Suckling, while Jean-Marc Quarin gives it 87 points. Pape Clement is 89 points with Jennie Cho Lee and 97-98 with Suckling. Differences of opinion aren't unique to 2015, but historically Robert Parker provided an anchor against which the market could fix a price with confidence. In future, the market will need to find a new consensus to guide price discovery.

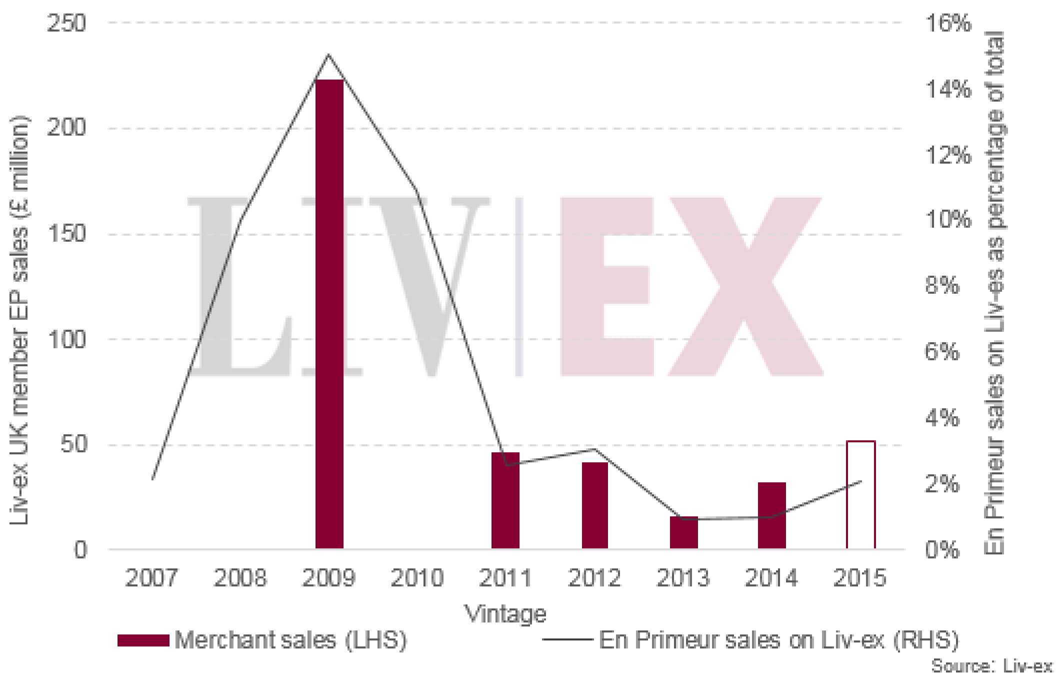
A recovery of sorts

Liv-ex has been polling leading members of the UK trade on their En Primeur sales since the 2011 vintage. The UK trade is a good barometer, because they are selling En Primeur to consumers all over the world. Liv-ex estimates that this group of members has sold £52m of 2015 En Primeur in the last 3 months. This is the best performance since 2010. Sales are up 62% on 2014 and 11% on 2011.

On the face of it, this is good result until one considers that the same merchants sold an estimated £223m of the 2009 vintage En Primeur. Sales this year were less than a quarter of those achieved six years ago. Moreover, due to currency volatility ahead of Brexit, turnover growth is broadly equivalent to the average price increase on 2014 in Pound Sterling terms, suggesting that volumes sold were only marginally ahead of last year.

In this light, it is easier to gauge the sense of frustration amongst the international trade, but making comparisons to 2009 or 2010 may be part of the problem. The backdrop to these campaigns brought together an exceptional set of circumstances. Back to back "vintages of the century" launched into a very buoyant China led boom. Between the sale of the 2008 and 2010 vintages ex-chateau prices increased more than threefold, such irrational exuberance is unlikely to be repeated any time soon.

En Primeur sales analysis*



* Liv-ex En Primeur sales measured from start of campaign to end of March the following year. 2015 campaign measured from April – June 2015.

The impact of low interest rates on the Bordeaux market

There has been a sea change in strategy amongst the owners of top chateaux in the last 10-15 years. Priorities have shifted from making sales and generating cash flow to trying to maximise prices (of the grand vin in particular) and by extension the capital value of their properties. Indeed, with top Bordeaux real estate earning yields of less than 1%, the motivation to generate profits is dwarfed by that of keeping land values high. This has been challenging in the face of falling demand.

Owners have achieved this by releasing smaller quantities onto the market and spreading their production across a second and sometimes a third label. This trend which started with the First Growths, has spread to almost all labels, with Batailley and Clos Marquis being the latest to adopt the idea. A selection of recent public statements from chateaux who have changed their En Primeur sales strategies is listed below.

Many commentators ascribe this trend to deep pockets. It is true that most top chateaux these days are owned by billionaires and insurance companies, but this has always been the case. The main motivation for the strategy is exceptionally low interest rates. Many owners have taken the view that holding onto stocks is likely to generate better returns than they can achieve elsewhere. With costs of production at €15-20 per bottle, leading chateaux do not need to sell much wine to cover their expenses. Punitive tax rates in France are a further incentive for pushing profits into the future.

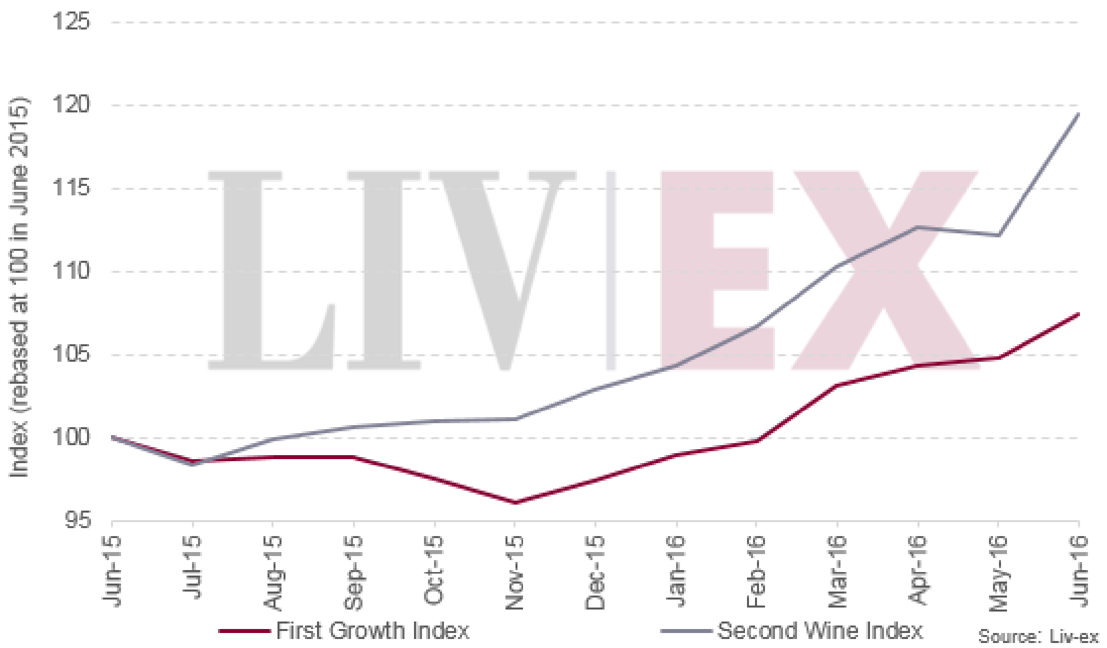
These priorities are understandable and have a certain logic in a world of very low interest rates, but there is an obvious paradox. Wine prices can only appreciate if supply becomes scarce. For this to happen it is essential for wines to sell through to the final consumer and be consumed. This is not happening at the moment.

Chateau En Primeur production and release status

Chateau	Recent strategy statements
Latour	Latour exited En Primeur in 2012 after the release of the 2011 vintage. It now holds back 100% of its stock and only releases wines when 'ready to drink'.
Mouton Rothschild	In February, Mouton Rothschild announced it would be releasing fewer cases En Primeur.
Angelus	Angelus announced it would keep more bottled wine back from the market in 2015. It had previously stated it has held back 20% of stock since 2011.
Palmer	Palmer has held back 50% of stock since the 2010 vintage. The chateau says this is for release after 10 years. In addition to the 50% of the new vintage it releases En Primeur, Palmer releases a seperate allocation of back vintages proportinate to the amount of stock held back. It sells 95% of its second wine Alter Ego de Palmer En Primeur.
Clerc Milon	In line with the new strategy of the Mouton stable, Clerc Milon held back stock in 2015.
Pontet Canet	Pontet Canet released En Primeur in two tranches this year. It originally cut back allocations and offered quantities equivalent to just 60% of last year before releasing a second tranche.
Batailley	Batailley is reported to have offered 30% less stock than it did in 2014 due to the introduction of a second wine, Lions de Batailley.
Clos du Marquis	Clos du Marquis has offfered a second wine this year, La Petite Marquise.

One of the unintended consequences of keeping the price of the Grand Vin at inflated prices is that in many instances the second wines have become more sought after and more difficult to come by than the first wine. Mouton Rothschild is a recent example. In 2015, the First Growth is widely available in the market but buying Petit Mouton is virtually impossible. This is becoming apparent, as the graph illustrates below, in the relative performance of prices. In the last twelve months alone the second wines of the First Growths have outperformed the grand vin by 12% in the secondary market.

First Growths relative to their second wines



The same perverse incentives also encourage negociants to build stock levels. Very low interest rates make the potential profits of owning stock look attractive relative to the costs. This drives competition amongst negociants to build their allocations, which when combined with their obligation to buy every year, only provides succour to the chateaux. This has allowed prices to drift away from levels that are supported by consumer demand.

We showed in our analysis in April that debt to equity amongst Bordeaux negociants has nearly doubled since 2011 and that stocks have increased from just over 200 to 300 days in the last two years. If the market recovery continues and prices appreciate all will be well, but rising stock and debt levels leave the Bordeaux Place vulnerable to an unexpected demand shock or rising interest rates.

Conclusion

Far from representing a major turning point in the fortunes of the En Primeur market as many had hoped, 2015 has only served to reinforce the new normal. It is true that a tentative recovery is underway. Sales in 2015 were sharply above those achieved in 2014, which in turn were up on 2013, but in the context of history this is a low bar.

The absence of Parker as an anchor certainly didn't help the process of price discovery and will result in greater uncertainty around pricing until a new consensus is found. Chateaux that either made the best wines ever or priced their wines at an attractive discount to comparable wines did sell well, but unfortunately there were too few of these to allow the campaign to fulfil its full potential.

The market will need to accept that the halcyon days of the last bull market, which peaked in June 2011 at the end of the 2010 campaign, are not going to return any time soon. Moreover, for as long as the current environment – distorted by exceptionally low interest rates – persists, there will continue to be a standoff between the price that top chateau owners ascribe to their wines and that which the consumer is willing to pay. Until that time merchants will need to adjust both their expectations and the resources that they commit to En Primeur to reflect the new normal.