2018

LIV EX

THE FINE WINE MARKET

Bordeaux 2017 – A risky strategy

JUNE 2018

LIV|EX
THE FINE WINE MARKET

Executive Summary

Sales underwhelm

After a relatively successful 2016 campaign, the UK's leading merchants' En Primeur sales halved to £45 million this year, while the average sterling release price of the 2017s dropped 11.8% from 2016. Volumes sold fell by 60%. The sales balance was focused heavily toward 'winners' such as First Growths and popular brands, while the majority struggled and will weigh heavily on the market for years. On the whole there was a reluctance to pay close to 2015 prices for wines considered to be around or below 2014 in quality.

The discourse of En Primeur

The current reference point for pricing appears to be an arbitrary percentage change from the previous year. Not only is this an ineffective way to establish a price, it is also an ineffective way to sell wine. Buyers of En Primeur have access to a wealth of information that allows them to decide on a case-by-case basis whether or not a purchase is good value. There were a number of success stories for wines priced close to their 'fair value', both this year and last. This suggests that En Primeur sales could easily increase if fair pricing, based on readily available information about price and quality, is properly harnessed.

The squeezed middle

The large reduction in the number of cases sold by the trade implies that an ever-increasing volume of wine is building up earlier in the supply chain. This is a trend Liv-ex has been noticing and commenting on for the last few years. Negociants are caught in the middle between the chateaux, who, protected from market forces, price as they see fit, and their merchant customers who are driving hard bargains. Negociants are thus forced to both carry stock and squeeze their margins. Unfortunately for the 2017 vintage it's likely to get worse for them before it gets better; the comparable examples of the overpriced 2006 and 2011 En Primeur campaigns, both of which are still showing negative returns, should serve as a warning that prices for the 2017s are more likely to go down than up once they trade physically.

Primary & secondary market tension

Greater friction is developing between the primary and secondary markets. While some producers understand the importance of the secondary market, many chateaux owners seem determined to prevent any kind of investment by carefully controlling their supply chain and pricing their wines at a level that leaves little to no value for the trade. This strategy is short-sighted. Without a healthy secondary market for their wines to trade up in value, owners will struggle to raise En Primeur prices in the future.

Introduction

In the Liv-ex report *Navigating Bordeaux 2017 (April 2018),* we highlighted some of the renewed confidence in the En Primeur system and noted that, "the 2017 campaign therefore represents a real opportunity for the chateaux to engage the market this year."[1]

As it transpired, this annual piece of wilful optimism would not be borne out. Feedback from Liv-ex members suggests a campaign marked by frustrations over pricing, combined with a lack of interest from customers for all but the best or most keenly priced wines. Consequently Liv-ex members' sales halved in value from the previous campaign to £45 million and dropped in volume by over 60%.

In this short report Liv-ex concludes En Primeur 2017 by placing the campaign in its historical perspective relative to critic scores, prices and sales. We then identify how the releases fared against Liv-ex's fair value methodology and discuss the consequences of this year's underwhelming campaign.[2]

Scores: 2014 minus
Prior to campaign the expectation was for a heterogeneous vintage, in part due to the spring frosts that had affected various parts of Bordeaux.

Other than Antonio Galloni, who declared that "two thousand and seventeen is very clearly a Right Bank vintage", other critics were reluctant to pick a side. As table one highlights, crudely most critics scores would appear to agree with this suggestion, scoring the Right Bank 100 higher on average than the Left Bank 200. Jane Anson's scores are the exception.

There was more critical divergence between the Right Bank 50 and the Fine Wine 50 (First Growths). Lisa Perotti-Brown MW came down most heavily in favour of the latter, and although 77% of Liv-ex members identified Neal Martin as their preferred critic, it was noticeable how many merchants led their First Growth offers with Perotti-Brown's tasting note.

[1] To access the report, visit: https://www.liv-ex.com/2018/04/bordeaux-2017-report/.

[2] For further information, see: https://www.liv-ex.com/2018/05/liv-exs-fair-value-methodology-note-critic-scores/.

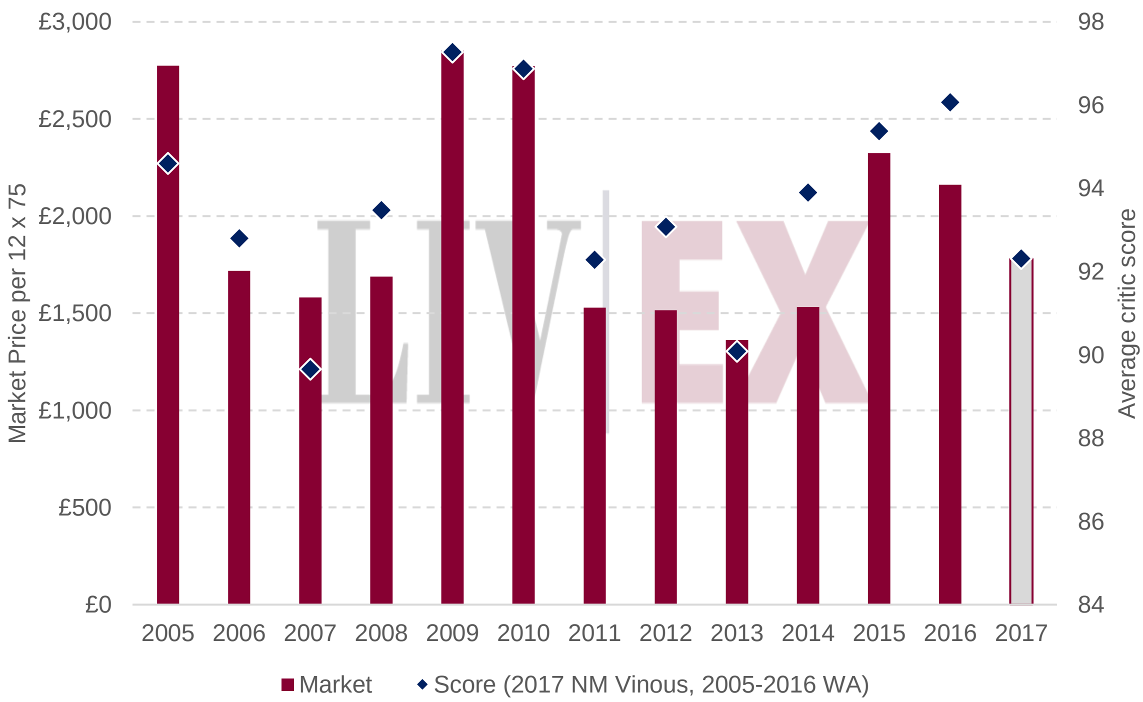
Table 1: Bordeaux 2017, average critic scores by Bordeaux 500 sub-index[3]

Bordeaux 2017 average critic scores							
	JA	JD	AG	NM	LPB	JMQ	JS
Fine Wine 50	96.8	95.6	94.9	95	97.4	95.8	97.3
Left Bank 200	94.4	93.7	93.6	93.1	94.9	94.4	95.1
Right Bank 100	94.3	95.2	94.8	93.6	95.4	95.8	95.5
Right Bank 50	95.6	96	95.5	94.8	95.9	96.8	97.1
Sauternes 50	94.5	95.3	94.8	94.3	95.7	92	96.2
Second Wines 50	91.6	92.3	91.1	90.3	91.2	91.8	93.7
Bordeaux 500	**93.3**	**93**	**92.8**	**92.3**	**93.4**	**93.3**	**94.5**

After En Primeur week many critics, producers and merchants compared the 2017 vintage with 2014. However as chart 1, which shows the average scores and prices of the last twelve vintages suggests, it was actually more of a '2014 minus', scoring lower than 2014 as well as the 2012, 2008 and 2006 vintages.

This did not stop the wines being priced as '2014 plus' and consequently the average ex-London price of the 2017 vintage was £1,780 per 12x75, making it the most expensive 'off-vintage' in the market.

Chart 1: Bordeaux 2017 Price and scores vs 2005-2016



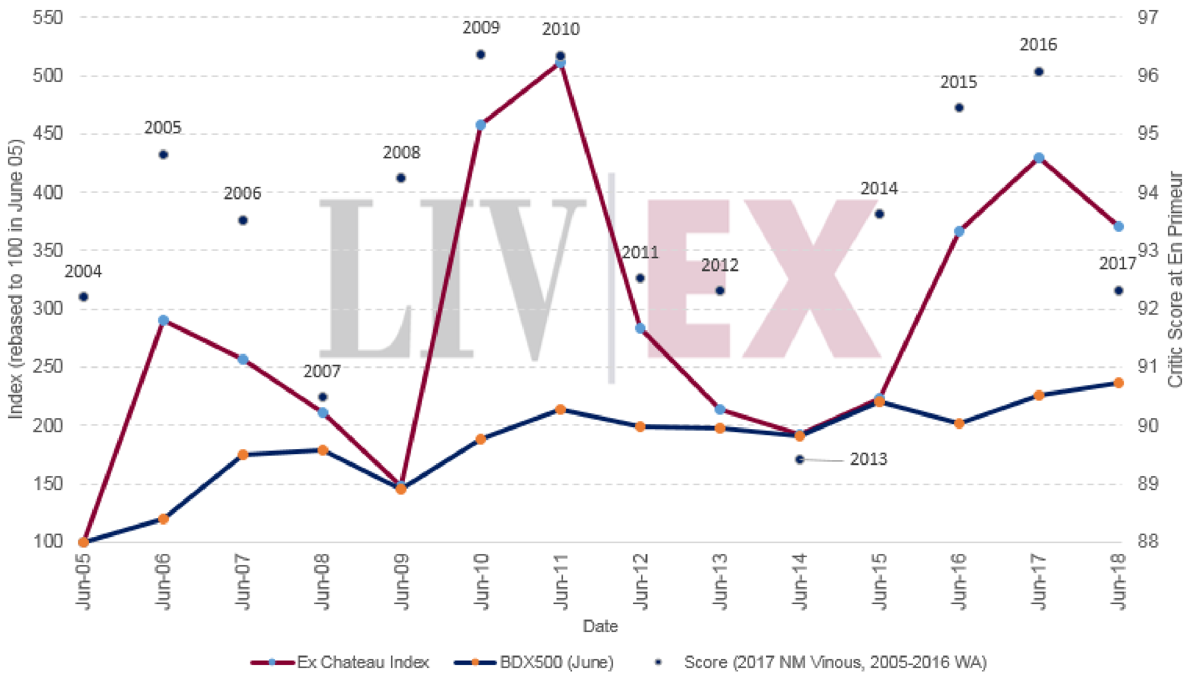
[3] JA = Jane Anson (decanter.com), JD = Jeb Dunnuck (jebdunnuck.com) AG = Antonio Galloni (vinous.com), NM = Neal Martin (vinous.com), LPB = Lisa Perotti-Brown (robertparker.com), JMQ = Jean-Marc Quarin (quarin.com), JS = James Suckling (Jamessuckling.com).

Prices: Just lower than expectations… but still too high

En Primeur prices tend not to move in line with the market, instead they change with the quality of the vintage. Therefore, in spite of the market rising 4.8% in euros since the last campaign, price decreases were expected due to the lower quality of the new vintage. In our annual survey, Liv-ex members anticipated ex-negociant price decreases of 11.4% across a basket of ten wines.[4] The reality was an average decrease of 17.1% for those wines within the basket, although across the wider Bordeaux 500 the average decrease was a lower 11.5%.

It is clear that this did not go far enough. The average ex-chateau price of the Bordeaux 500 was €124, only €2 cheaper than 2015, despite 2015 having an overall vintage critic score over three points higher. This is 20% higher than Liv-ex's suggested average estimate of €104.[5] Consequently the ex-Chateau index displayed in chart 2 is now at the same level as it was in 2015.

Chart 2: ex-Chateaux price index vs Bordeaux 500



Which wines worked?

Throughout the campaign Liv-ex stated that many wines looked unattractive because they were priced with a premium to fair value and above vintages of comparable quality.

'Fair value' is a rigorous way of assessing the price of a newly released wine, because it focuses on quality, rather than simply the year-on-year price change. A wine can go up in price from the previous year and still be undervalued if the quality of the new release justifies the price. Lafleur 2017 is a good example of this.

[4] The same basket is used in the survey every year. There are ten wines including: Cos d'Estournel, Pontet Canet, Montrose, Mouton Rothshild, Pichon Lalande, Leoville Las Cases, Talbot, Cheval Blanc, Pavie and Mission Haut Brion.

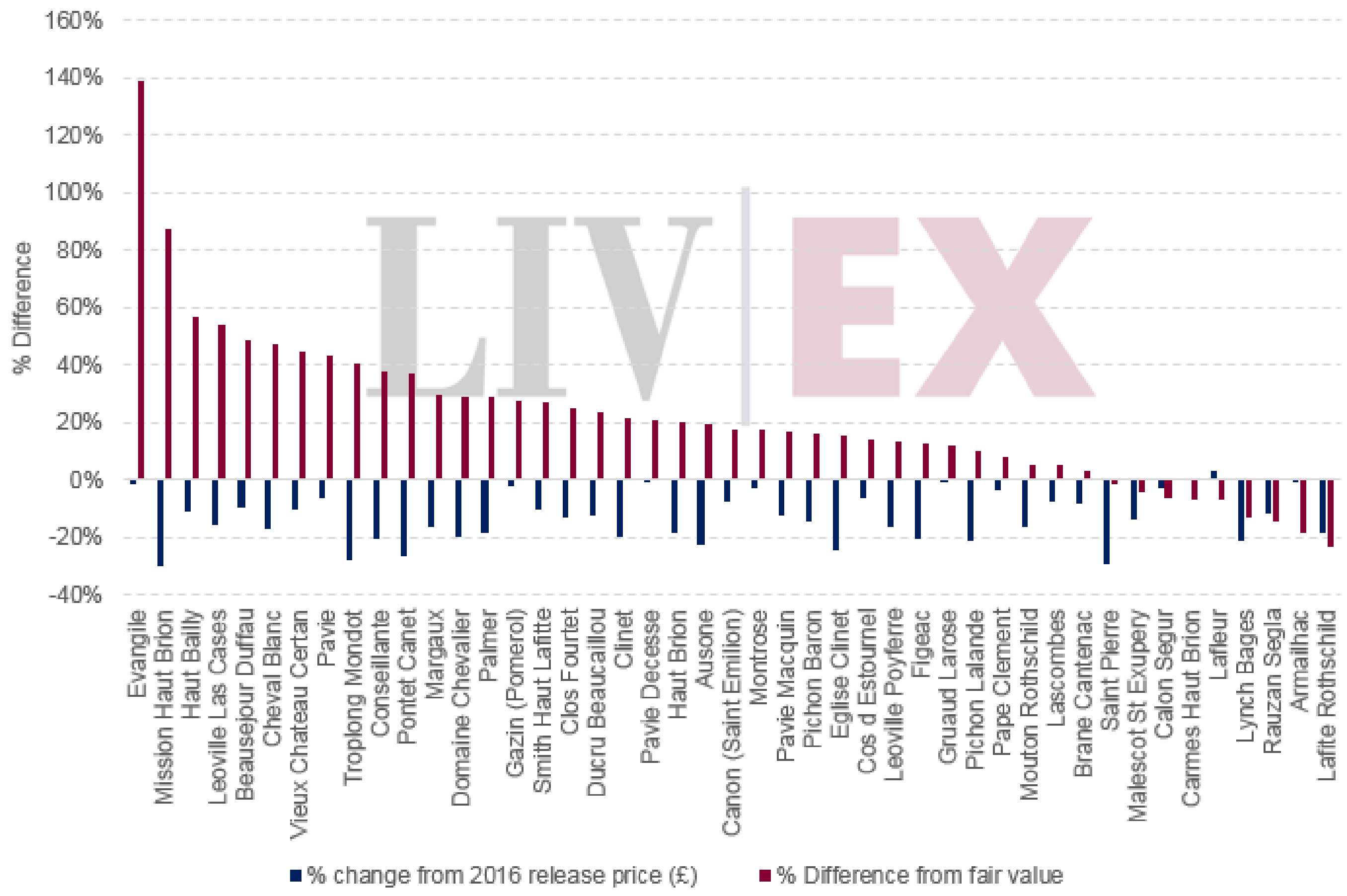
[5] To calculate this estimate Liv-ex assumed the quality was roughly between the 2012 and 2014 vintages. We then applied the amount the market has increased in euros in the intervening time period to an average of the 2012-2014 ex-chateau prices.

Chart 3 shows the percentage difference between 'fair value' and ex-London release price by chateau for 2017 En Primeur. The percentage price change versus 2016 is also shown, to highlight its unsuitability as a reference point for a well-priced release.

Nearly all chateaux reduced their prices on the previous year, yet many were still overvalued according to fair value. Domaines Baron de Rothschild produced the most overvalued wine relative to fair value, Evangile, and the most undervalued, Lafite. On aggregate En Primeur 2017 was priced 20% above fair value.

Our hypothesis is that over time, wines will tend toward their fair value price and thus undervalued wines should be bought at En Primeur and overvalued wines avoided. It's evident that merchants and their customers took a similar view because in a campaign where few wines truly sold through the chain, nearly all those that did, such as Calon Segur, Carmes Haut Brion, Lafleur, Lafite Rothschild, Lynch Bages and Rauzan Segla were released below their fair value price.

Chart 3: Difference of release prices from fair value vs YoY sterling price change (%)



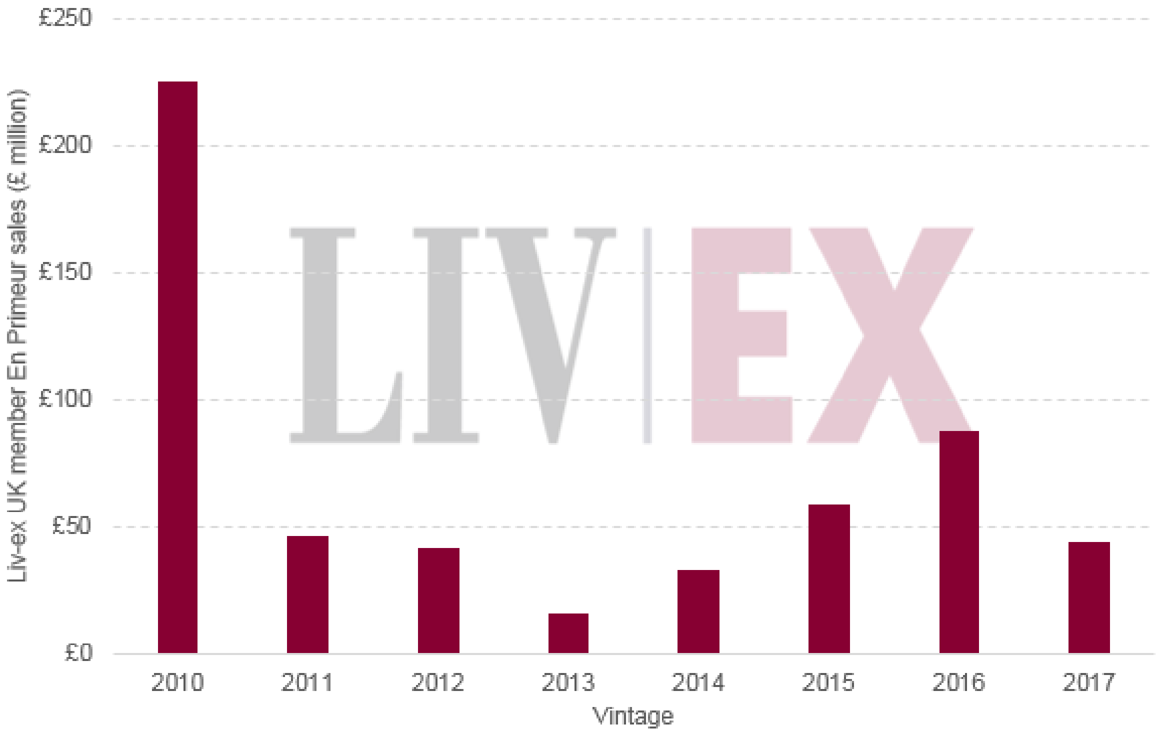
There were three exceptions to this broad rule. Brands such as Canon and Figeac came with a premium to fair value but thanks to the goodwill and momentum they had built up over the last two campaigns, they were still well received. These two chateaux made high-quality wines, priced very fairly for the supply chain in 2015 and 2016. As these wines have appreciated in the secondary market, they have been able to successfully raise En Primeur prices this year without losing sales.

Additionally, the First Growths can defy the logic of fair value by nature of the popularity and exclusivity afforded to the wines at the top of the 1855 classification. However, among this group, Haut Brion struggled and some merchants have reported the other First Growths proving stickier than usual due to the lack of value in their prices.

Another group of wines to succeed were perennial favourites of Asian collectors such as Beychevelle, Clerc Milon and the second wines of First Growths. These wines have no relationship between price and score; price is more closely linked with age. They therefore seem obvious purchases at En Primeur, assuming they are priced below older vintages.

En Primeur sales

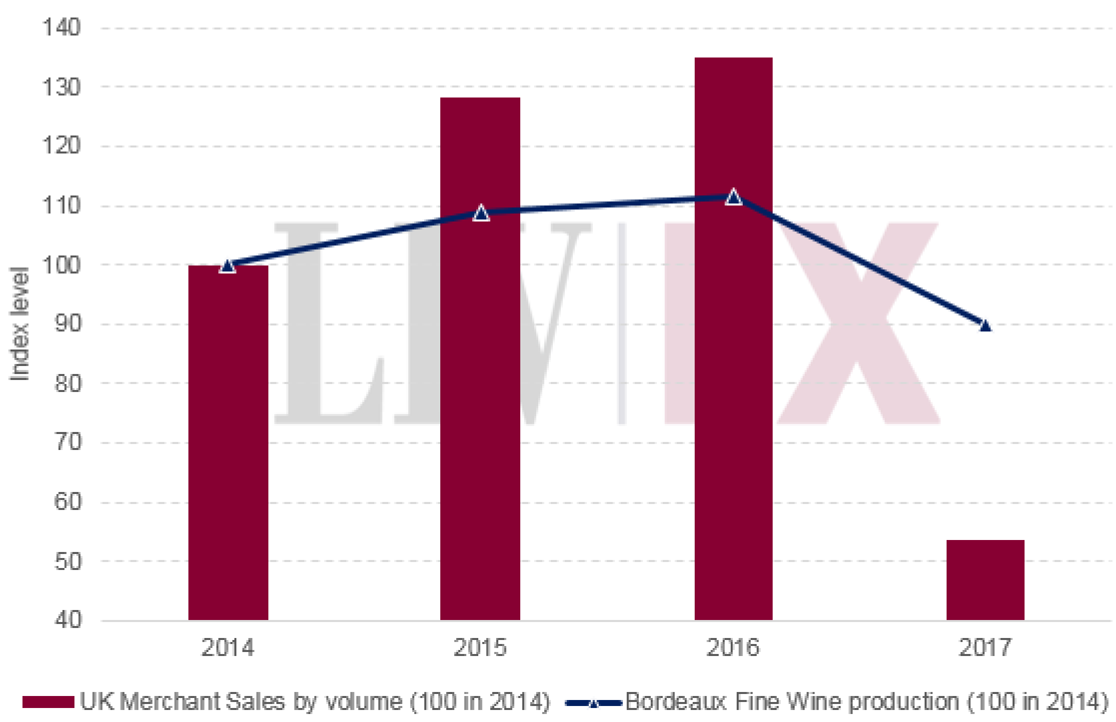
Chart 4: Liv-ex UK merchants' En Primeur sales



Due to the lack of wines that priced attractively, Liv-ex UK members' En Primeur sales declined to £45 million, just over half of last year's total sales. At such a level sales are comparable to the 2011 campaign which totalled £46.5 million. A fall in sales is perhaps no surprise as collectors lost some interest after two exceptional vintages, yet as chart 3 makes clear, a lack of value also contributed to the disappointing total figure. Data from UK members implies that sales have been even more concentrated in the First Growths and the other 'successes' discussed in the previous section than in the past. 2017 has been another En Primeur campaign of winners and losers, with the balance now tipped firmly in favour of the latter.

Of more concern is that sales by volume, which increased between 2014 and 2016, have fallen by 60% from last year. This means that despite the average sterling release price of the 2017s dropping 11.8% from 2016, the average price of a 12x75 case sold by UK merchants has increased 18%; this is a trend that has been developing since the 2014 campaign. It highlights the fact that many lower value wines are failing to sell at En Primeur, both through a lack of interest and through pricing themselves out of the equation.

Chart 5: Liv-ex UK members' sales by volume vs. Bordeaux fine wine production



The squeezed middle

The reduced number of cases sold by the UK trade is further evidence that greater volumes of wine are building up earlier in the supply chain, both at chateaux who are releasing fewer cases onto the market and with negociants who are caught in the middle struggling to sell enough of what they purchase.[6]

Data shared by Liv-ex's negociant members suggests they are being squeezed at both ends. On the one hand a reluctance to abandon allocations means that they are typically carrying 30-40% of stock from this campaign, compared to their usual 20%. On the other hand, they have had their margins squeezed by a combination of the need to trade excess stock on La Place combined with their customers from around the world driving hard bargains.

For the negociants business model of stock holding to continue functioning, they require the prices of the wines they are holding to rise. However, the comparable examples of the overpriced 2006 and 2011 En Primeur campaigns, both of which are still showing negative returns, should serve as a warning that prices for the 2017s are more likely to go down than up once they trade physically.

Table 2 summaries a further complication, which is the tendency of chateaux to withhold stock. The list is by no means comprehensive but indicative of the strategy of many producers. As discussed in our report prior

[6] See *Navigating Bordeaux 2017* pp.19-22.

to the campaign, keeping back production creates an overhang that can exert downward pressure on price. It is not a question of if, but rather when this excess supply will come to exert its force on the market.

Table 2: Volume reductions released onto the market compared to 2016 vintage

Chateau	Volume reduction from 2016
Angelus	60% (production 20% lower due to frost)
Calon Segur	25%
Carmes Haut Brion	15%
Cheval Blanc	65% (production 30% lower due to frost)
Haut Brion	40%
Mission Haut Brion	30%
Mouton Rothschild	15%
Pichon Lalande	15%
Rauzan Segla	15%
VCC	15%

Conclusion

For the each of the last three years Liv-ex has commented that En Primeur has become split into two broad camps of winners and losers. The same was true this year; the popular wines have sold through while the rest remain in Bordeaux.

The success of wines sold near fair value both this year and last year suggests En Primeur sales could easily increase if fair pricing, using information from the secondary market, was properly harnessed. Instead the current reference point seems to be an arbitrary reduction from the previous year.

Reduced UK merchant buying, which accounts for roughly a third of total En Primeur sales, shows that current demand does not support the price level for many of the wines offered. There was a reluctance to pay 2015 prices for a quality that was judged to around or below 2014. Years ago many might have purchased anyway, but now with the advent of price transparency and the lessons of 2009-2011, the myth that En Primeur is always the cheapest time to buy cru classé wine has been confuted.

Chateaux are protected from market forces by the negociants who market and distribute their wines for them. In the short term the negociants are left in the precarious position of holding stock that the market currently believes to be overpriced. In order to sell this they must either look to discount or rely on the market to pick up in the future. Many will hope for the latter, but only those with the deepest pockets can play this game. In the long term chateaux withholding stock will need to acquaint themselves more thoroughly with the secondary market. Without robust and gradual price appreciation, the strategy they are gambling on will not succeed.