LIV EX
THE FINE WINE MARKET

Navigating Bordeaux 2017

APRIL 2018

Executive summary

En Primeur has improved

The general mood around En Primeur has improved from the nadir of 2013. Returns from recent campaigns have been mostly positive, potentially helping to rebuild confidence in the system. However, it has become increasingly important to buy selectively: as we argued last year, En Primeur is for 'the few not the many' even in successful campaigns such as 2015 and 2016. The trade is now primarily interested in the top 30 or so most in-demand wines. These are typically the wines that are highly scored, keenly priced and can be difficult to source in the primary market.

The Bordeaux market is delicately balanced

Bordeaux's market share has been on the decline, reaching a low share of 68% by value last year. Although prices have been steady, the region has not performed as well other areas of the wine market such as Burgundy or Italy. The 2005, 2009 and 2010 vintages of the First Growths in particular have been sluggish over the past twelve months as they move towards their previous peaks. Despite the First Growth slowdown, demand for their second wines continues to be high. Other wines performing well include highly scored wines from the 2015 vintage which have in some instances doubled in price since release.

2017 is heterogeneous vintage in terms of quantity and quality

The main talking point in the build-up to this campaign has been the impact of late spring frosts - the worst since 1991 - that have drastically reduced the overall Bordeaux yield. It appears that much of the damage has occurred to vineyards that supply the lower-priced end of the market, rather than the fine wine segment; certain communes on the Left Bank such as Pauillac, St-Julien, and St-Estephe were hardly touched. Early critical commentary seems to suggest that the combination of frost in certain areas alongside an otherwise relatively good growing season has led to a heterogeneous vintage. With recent movements in the world of wine criticism, there may be some divergence of opinion over which are the wines to buy, quality-wise.

Bordeaux is back…. in Bordeaux

The question of how much wine is being produced versus how much is then coming to market is a crucial one. For the last two years, despite above average production volumes, many of the top chateaux have been holding back more and more of their production for sale beyond En Primeur. The purpose of this strategy, and its long-term impact on the market, is not entirely clear. On the one hand it may simply be part of a normal restocking cycle. On the other, it is possible that the strategy of restricting supply is intended to help maintain price levels.

It's all in the price

The interests of different constituents of the supply chain may diverge on the issue of volume. If wine critics deem the 2017s to be below average, the chateaux will want to sell as much stock now at the highest possible price, which could leave either negociants or international merchants with stock they are unable to sell. On the other hand, if the wine is deemed to be above average, it's likely that merchants might struggle to get their hands on stock that is being withheld to sell in the future for a higher price. Whichever way this goes, as always, the right price will be crucial for the success of the wines in the market.

Bordeaux Market Summary

The fine wine market: Bordeaux in context

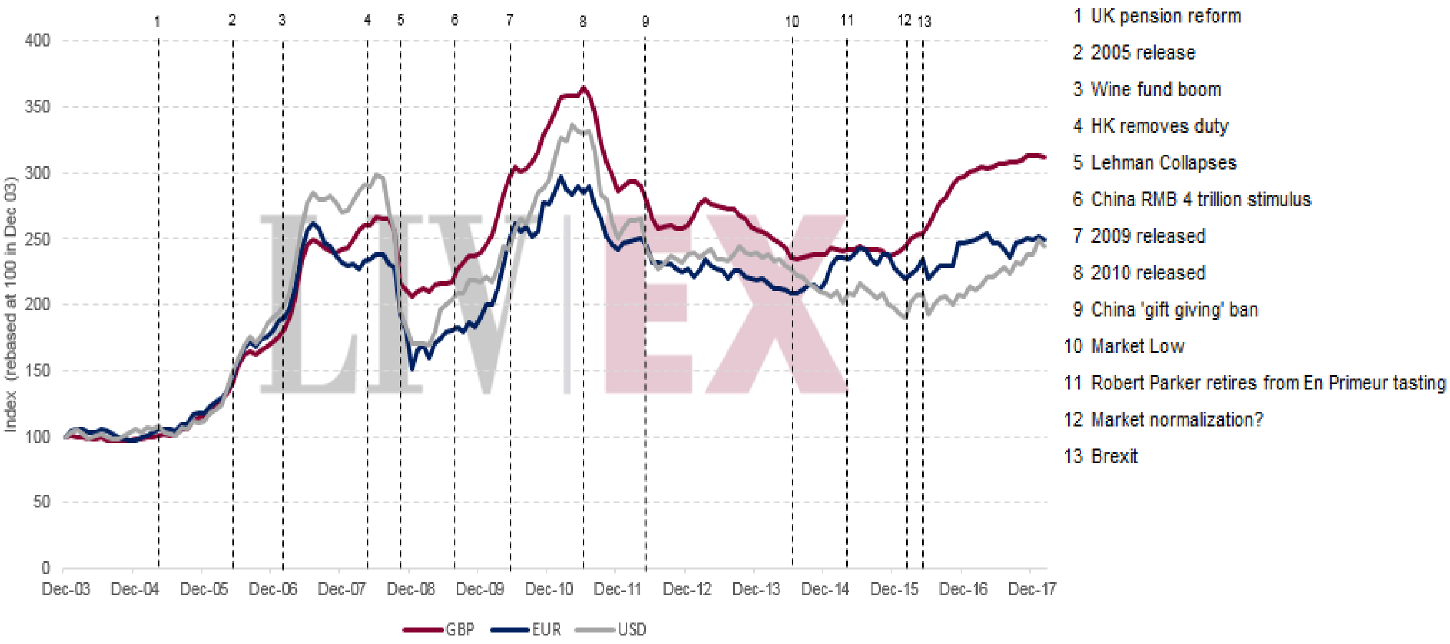
Last year was positive for the fine wine market. All the Liv-ex indices rose in 2017, though at a much more modest pace than in 2016. The Fine Wine 1000 – the broadest measure of the fine wine market – was the best performing index, rising 11.3%. It is currently at an all-time high. Among the sub-indices the Burgundy 150 had its best year in a decade, climbing 23.9%.

By way of comparison, the Bordeaux 500 index rose 7.8% and the Fine Wine 50, which tracks the prices of the First Growths, was up 5.3%.

A fluctuating exchange rate affected the level of demand in the Bordeaux market. The Fine Wine 50 was particularly susceptible to exchange rate movement for the majority of the 2017, largely rising and falling along with sterling's movement against the euro and the dollar.

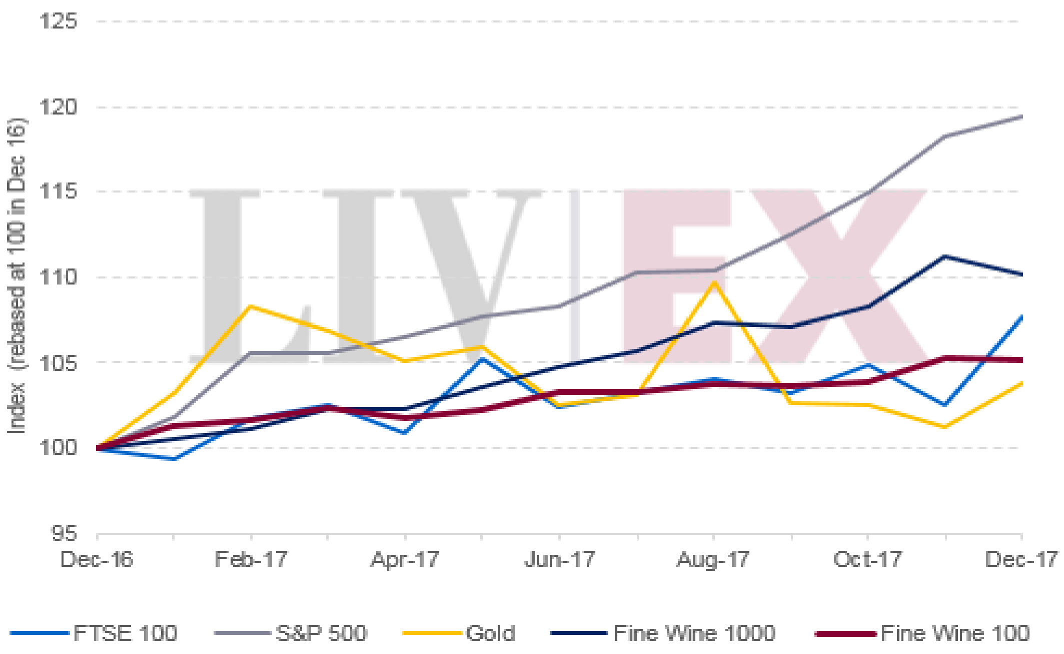
The start of 2018 has largely seen these themes continue: the Fine Wine 50 is up 0.2% year to date while the broader market, represented by the Liv-ex 1000, has gained 1.33%. Currency volatility has subsided, but the weaker dollar has dampened demand from the Far East and the US, undoubtedly contributing to faltering price momentum.

Chart 1: Liv-ex Fine Wine 100 index (in sterling, euros and dollars)



To put the performance of wine in perspective, Chart 2 compares how the Liv-ex 100 and the Liv-ex 1000 fared against Gold and equities. Although neither index was able to keep up with US equities, both outperformed Gold and the Liv-ex 1000 outperformed UK equities in 2017.

Chart 2: Broad market outperforms FTSE and Gold in 2017

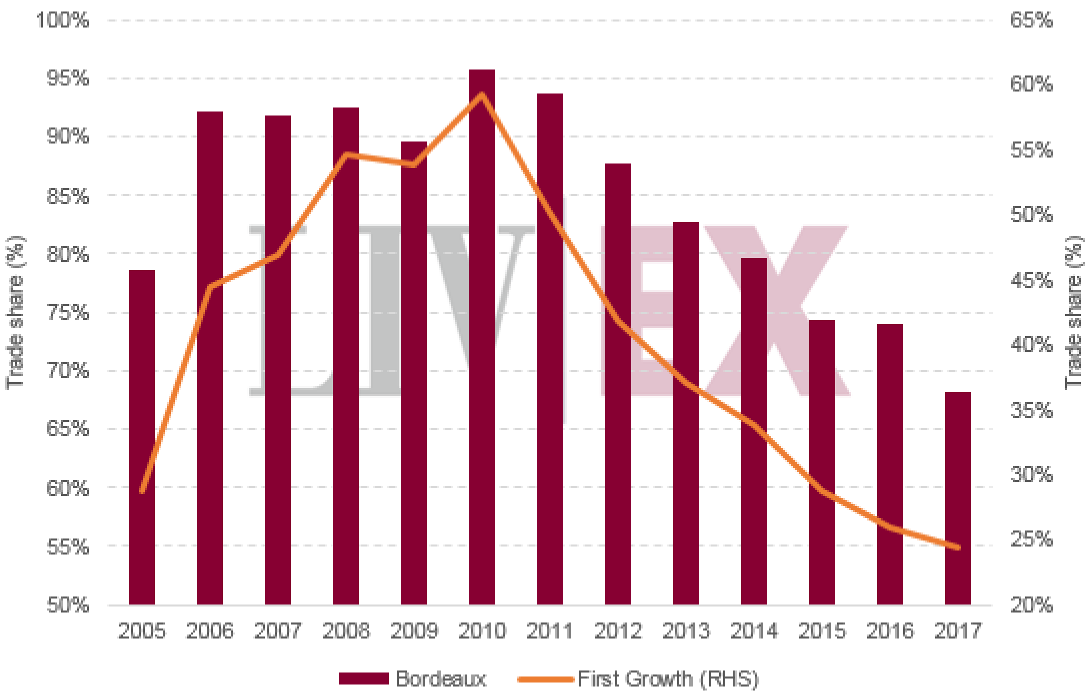


Bordeaux market share at record lows

Bordeaux's market share has been declining since the heady days of 2010/11. Last year, it reached a record annual low, falling to 68% of overall trade by value compared to 96% in 2010. In January 2018, its trade share fell even further to 51.1%, the lowest ever recorded for a month's trade.

Bordeaux's trade share is being led lower by a fall in the value of First Growths trading. As a component of overall trade, activity for these five wines has more than halved from 59% in 2010 to 24% in 2017. Latour's withdrawal from En Primeur in 2011 has contributed to this since there is a reduced overall volume of this wine in the market.

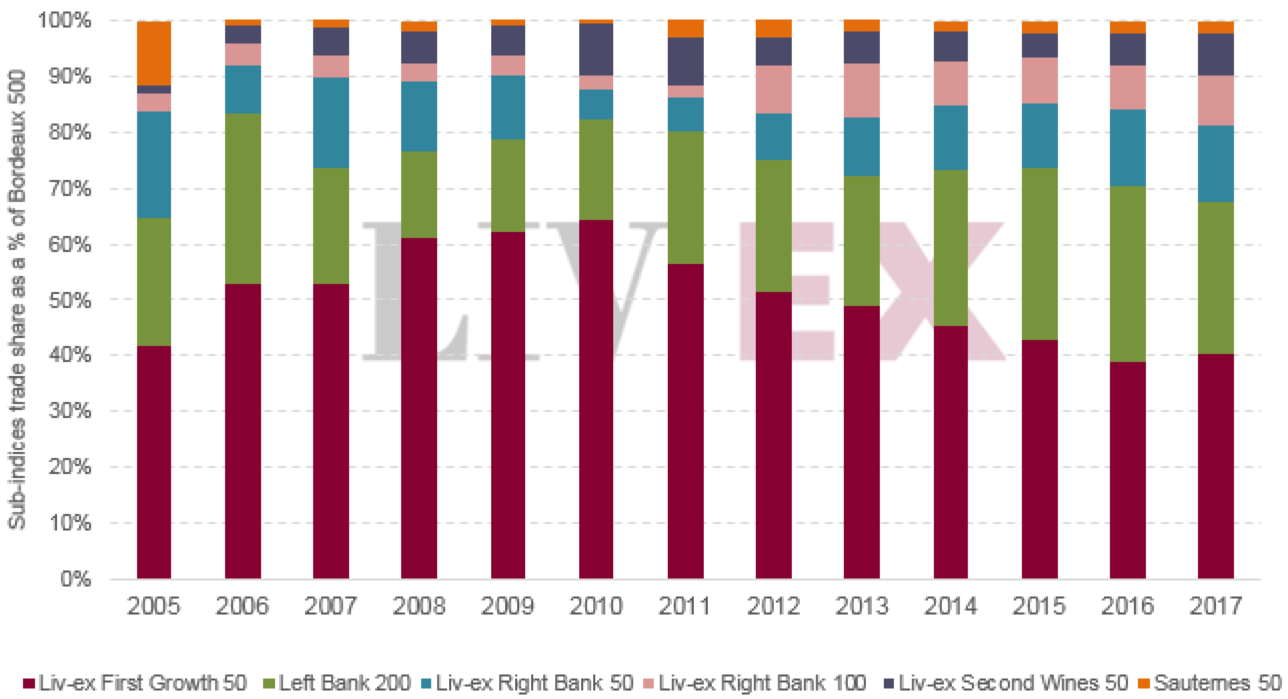
Chart 3: Bordeaux and First Growth market share



The First Growths have also gradually lost share within Bordeaux. From 2010 to 2016 their share of trade within the region fell from 64.5% to 37.7%, with a small rise to 40.1% in 2017.

This has left room for the wines that make up the Left Bank 200, Right Bank 50 and 100 indices to gain Bordeaux market share in this time period. The emergence of the Right Bank 100 is a new theme since 2010. The trade share of the Second Wine 50 continues to wax and wane in line with the First Growths. The Sauternes market, at just 2% of Bordeaux trade, is near non-existent. The region's most important chateau, Yquem, accounts for a large proportion of this.

Chart 4: Bordeaux 500 sub-indices trade share



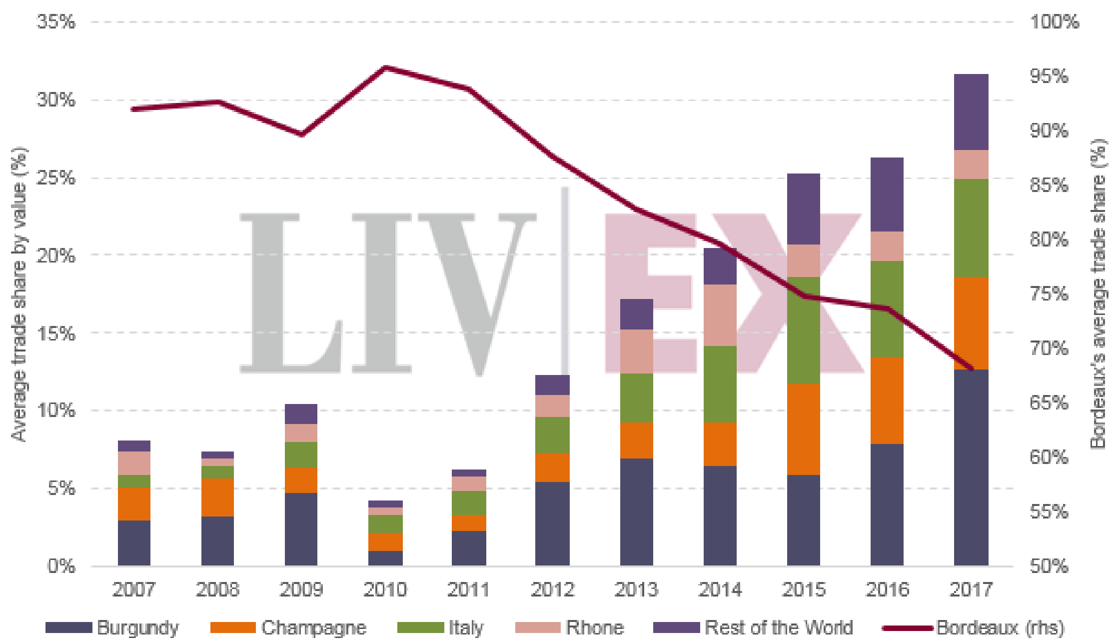
A broadening market

Bordeaux's falling trade share is a consequence of the wine market becoming broader and deeper; over 4,600 different wines from different regions around the world traded last year. This represents an increase of 182% on 2010 when a narrow group of Bordeaux wines dominated the market.

With Bordeaux's market share falling, all other major regions have seen increased activity as chart 5 shows. Burgundy made significant gains in 2017, increasing its share by value to 12.7% from 7.9% in 2016. Italy (6.4%) and Champagne (6%) are in third and fourth places respectively. The USA has maintained a high share of the 'Rest of the World' category and overtook the Rhone in terms of value traded.

Declining trade share for Bordeaux was initially accompanied by falling prices between mid-2011 and mid-2014. Over the past two years, however, it has not been the sign of an unhealthy market price-wise: the Bordeaux 500 has been rising, as chart 6 shows. However with the Bordeaux 500 starting to slow again, it is now becoming clearer that market activity has become very price sensitive once more.

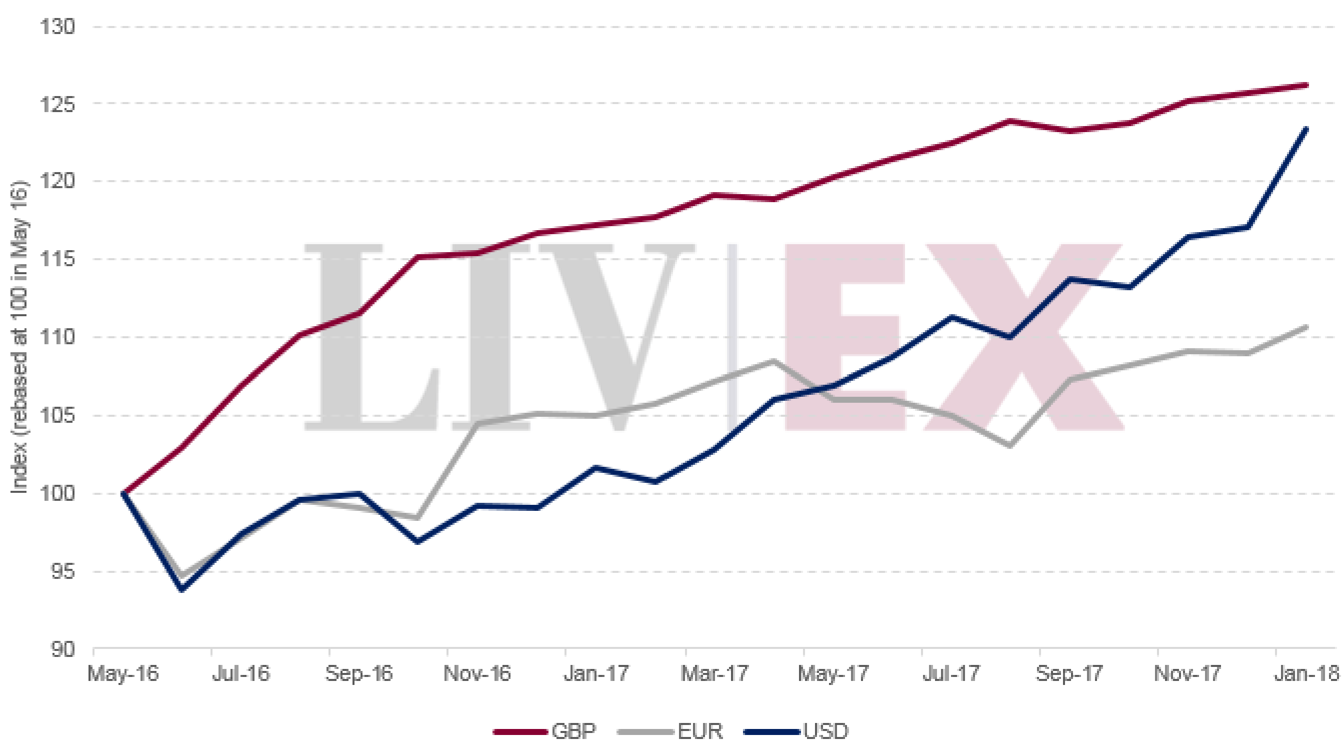
Chart 5: Market share by region



Brexit re-invigorates the market

The most significant event for the Bordeaux market, and in fact the wine market as a whole over the last two years, was the Brexit vote. Sterling's immediate devaluation put euro and dollar-based buyers at an advantage, stimulating trade and providing an instant boost to wine prices and Liv-ex's indices, all of which are denominated in sterling. Consequently while the Bordeaux 500 is up 25% in sterling since Brexit, the increase in euros is just 10%.

Chart 6: Bordeaux 500 since Brexit (GBP, EUR, USD)

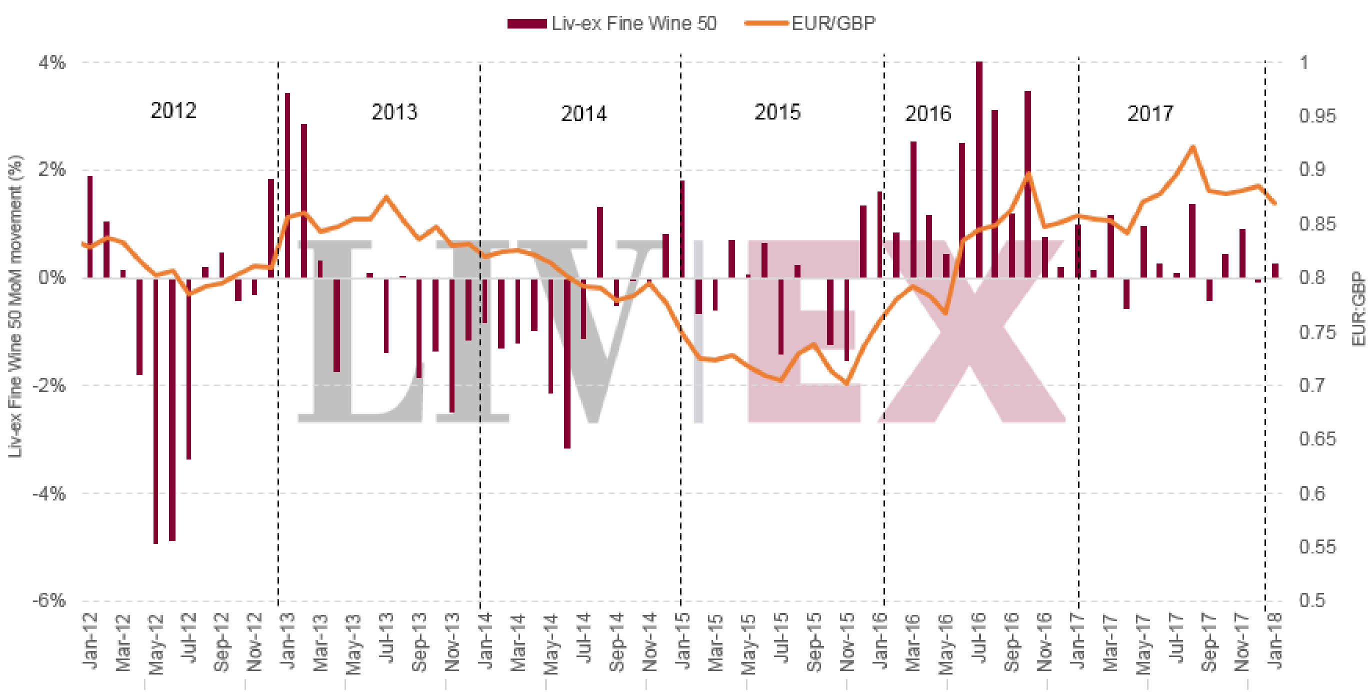


But for how long?

Trade on the fine wine market is international. With merchants trading in multiple currencies, activity can be catalysed by a favourable exchange rate. As Chart 7 shows, wine prices have been particularly sensitive to currency fluctuations for over two years, predating the Brexit vote by around six months. In early 2016, the Fine Wine 50 rallied as the euro appreciated against sterling. This continued in 2017, with the month-on-month movements of the Fine Wine 50 proving very sensitive to the EUR/GBP rate, rising and falling with the euro.

During the latter quarter of 2017 the exchange rate stabilised and month on month price changes became muted. This suggests that if the exchange rate remains stable in 2018 it is likely that prices will continue to be flat, potentially turning negative if sterling appreciates by more than 10%. The current demand for Bordeaux is very price elastic and at times quite weak, compared to say Burgundy.

Chart 7: Liv-ex 50 month on month movements vs. EUR/GBP



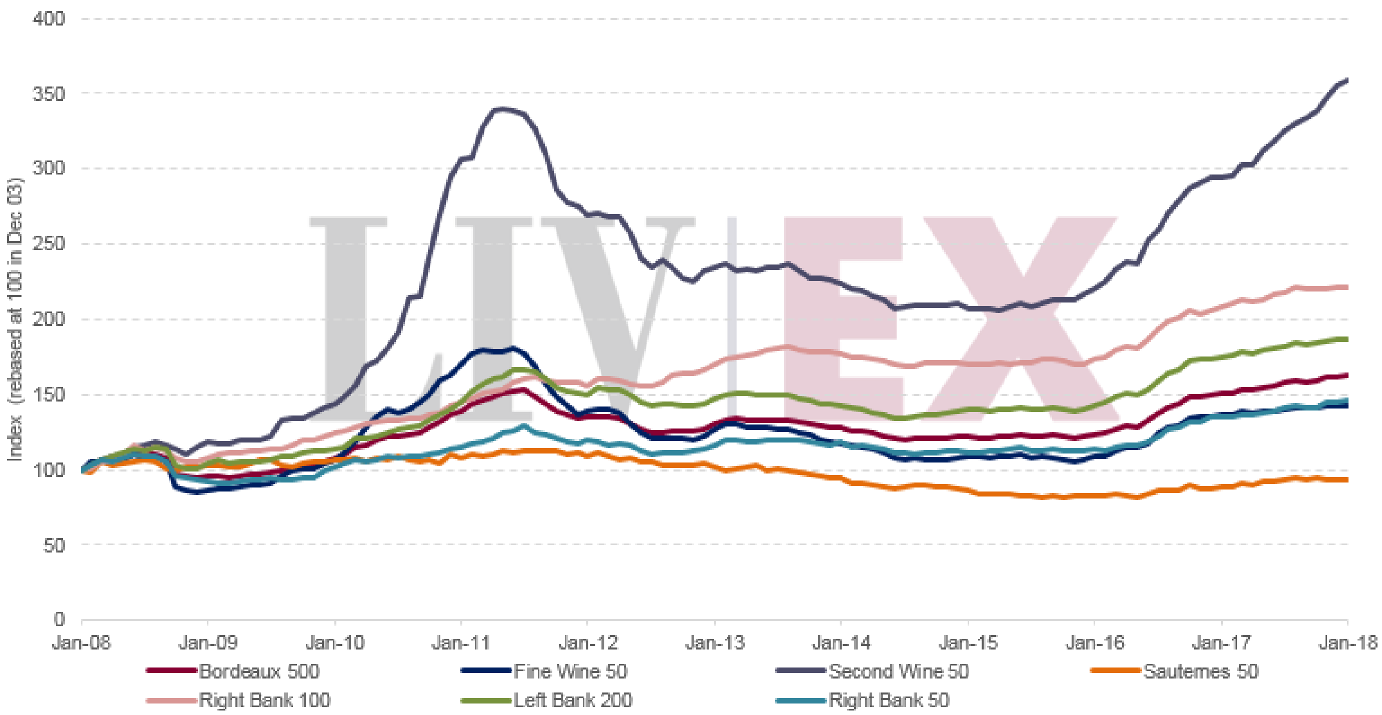
Performance within Bordeaux has not been uniform

As a result of recent price rises, only two sub-indices of the Bordeaux 500 are still below their previous peaks in 2011: the Fine Wine 50 and the Sauternes 50.

The Right Bank 100, the second best performer over ten years, has fared particularly well thanks in part to the 2012 St-Emilion re-classification, which saw Angelus and Pavie promoted to Grand Cru Classe A. However, since Brexit this sub-index has marginally underperformed.

One stand-out trend is the divided performance of the First Growths and their second wines, with prices for the latter rising at a much faster rate than the former. The Fine Wine 50, representing the First Growths, was the worst performer in 2017: First Growth prices have slowed down as they move toward their previous peak.

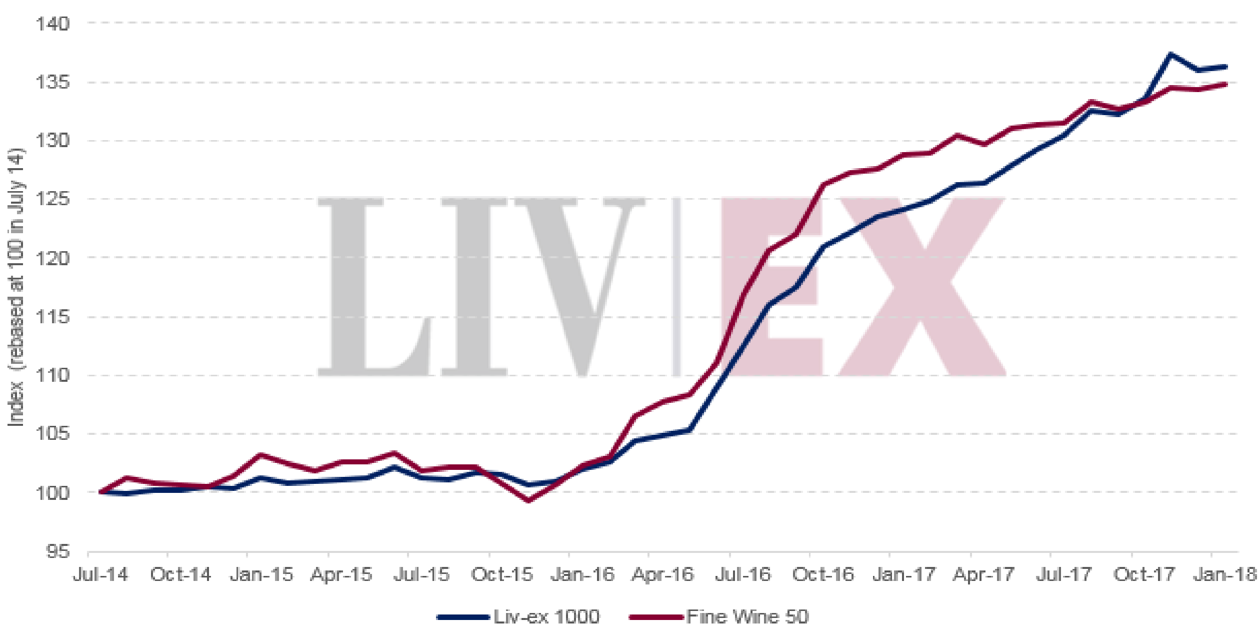
Chart 8: Bordeaux 500 sub-indices ten years



First Growth performance

The Fine Wine 50 index has also underperformed against the broader market, measured by the Liv-ex 1000, since the market low in June 2014. The Liv-ex 1000 overtook the Fine Wine 50 in the second half of 2017, boosted by the strong performance of the Burgundy 150, one of its components. At the same time, the Fine Wine 50 slowed.

Chart 9: Liv-ex 1000 vs. Fine Wine 50 since market low



Over the same period, Mouton Rothschild has been the best-performing First Growth, narrowly pipping Haut Brion to the post.

In 2016, the revived interest of brand conscious buyers from Asia provided a boost for Lafite Rothschild, leading to an increase of 28%. Last year the same index gained 8%. Although this was significantly lower than 2016, it still fared better than Latour and Margaux, which both underperformed against the Bordeaux 500. In Latour's case there appears to be a more severe slowdown. The wine's index only gained around 1% last year, positioning it among the worst-performing chateaux in the whole Bordeaux 500 Index.[4]

Chart 10: First Growth Indices since market low

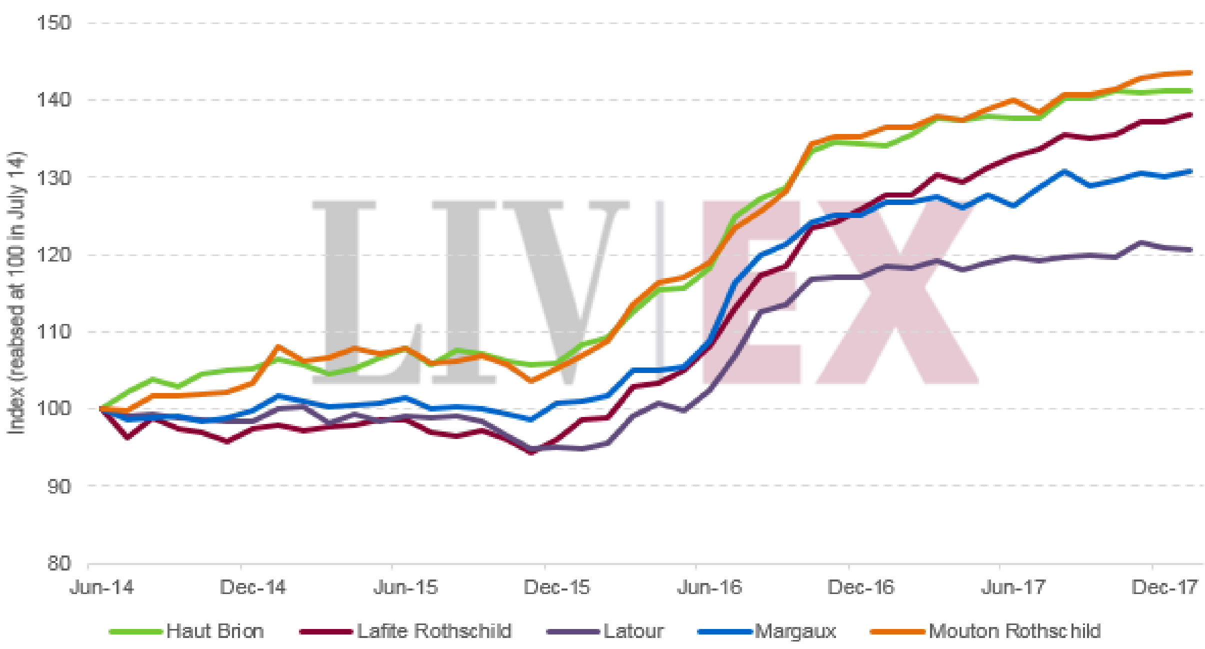
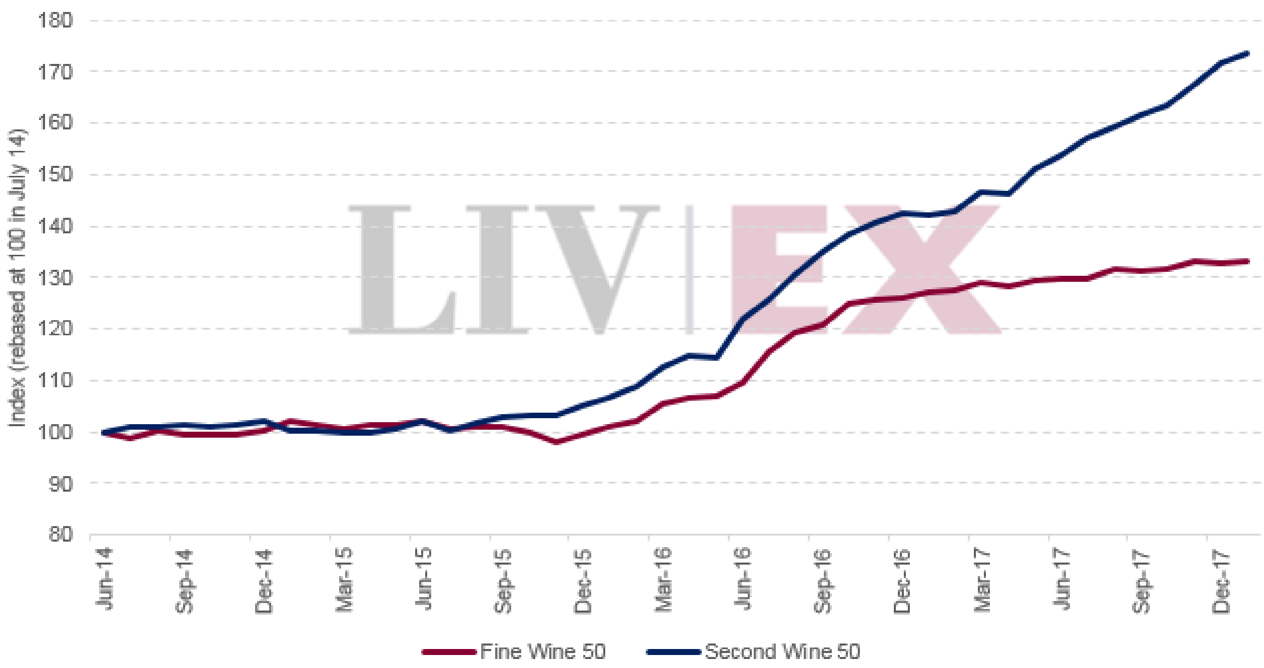


Chart 11: Fine Wine 50 vs. Second Wine 50 since market low



[4] The Latour index includes the vintages from 2002-2011 inclusive, whereas the other indices in the Bordeaux 500 included vintages from 2005-2014 inclusive.

Seconds come first

One area of the Bordeaux market that did not slow in 2017 was the Second Wine 50, which jumped 20%. Prior to 2011, buying in this area of the market was driven by the apparent value of buying into First Growth brands without paying for the Grand Vin. Although this is still the case, there has never been a tighter gap between the two groups of wines, as the chart of the First Growth to second wine ratio shows. In-spite of this the Second Wine 50 continues to climb relentlessly.

Chart 12: First Growths v second wines: price ratio by brand

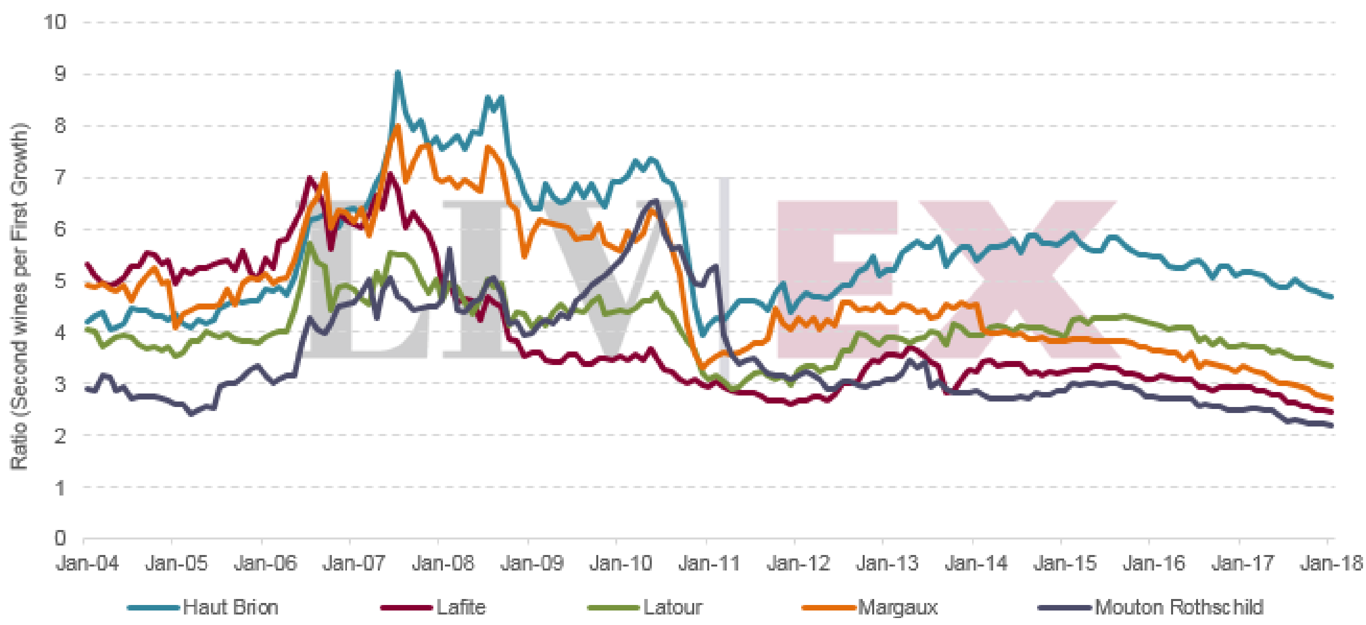


Table 1: Bordeaux 500 sub-indices performance

Performance of Bordeaux 500 Indices					
Index	10 Year	Jul-11	Jun-14	May-16	1 Year
Second Wine 50	258.8%	6.8%	73.4%	51.5%	21.9%
Right Bank 100	121.4%	37.5%	30.6%	22.3%	6.5%
Left Bank 200	86.8%	11.9%	39.3%	25.0%	6.7%
Bordeaux 500	62.4%	5.8%	34.8%	26.2%	7.6%
Right Bank 50	45.9%	12.7%	30.5%	25.7%	8.1%
Fine Wine 50	43.1%	-19.1%	33.2%	24.4%	4.6%
Sauternes 50	-6.4%	-17.2%	6.4%	15.1%	5.8%

The En Primeur Market

Liv-ex UK members' En Primeur sales

After a string of lacklustre campaigns, the higher quality and prices of the 2015 and 2016 vintages lifted the En Primeur sales of Liv-ex's UK members to £58.6 million and £82 million respectively. Although this is a marked improvement on the 2011-2014 campaigns, it is still significantly lower than the £225 million of sales generated by the 2010 campaign. Nor is it likely this number will reach this peak again in the near future.

Farr Vintners, one of the UK's leading En Primeur merchants, have noted in their 2016 and 2017 annual reports "there has been a marked fall in the demand and appetite for buying Bordeaux vintages En Primeur… it is not likely to return the levels of demand seen for the 2009 and 2010 vintages."

Lower sales figures are also a reflection of reduced volumes of wine coming to market, as demonstrated by smaller allocations of several key wines in the recent campaigns. Given that the 2015 and 2016 vintages both yielded more wine than the ten-year average, it must be assumed that there is a large quantity of wine higher up the supply chain, either still with the chateaux or with the negociants in Bordeaux. This question of volume will be discussed later in the report.

Chart 13: Liv-ex's UK members' EP Sales

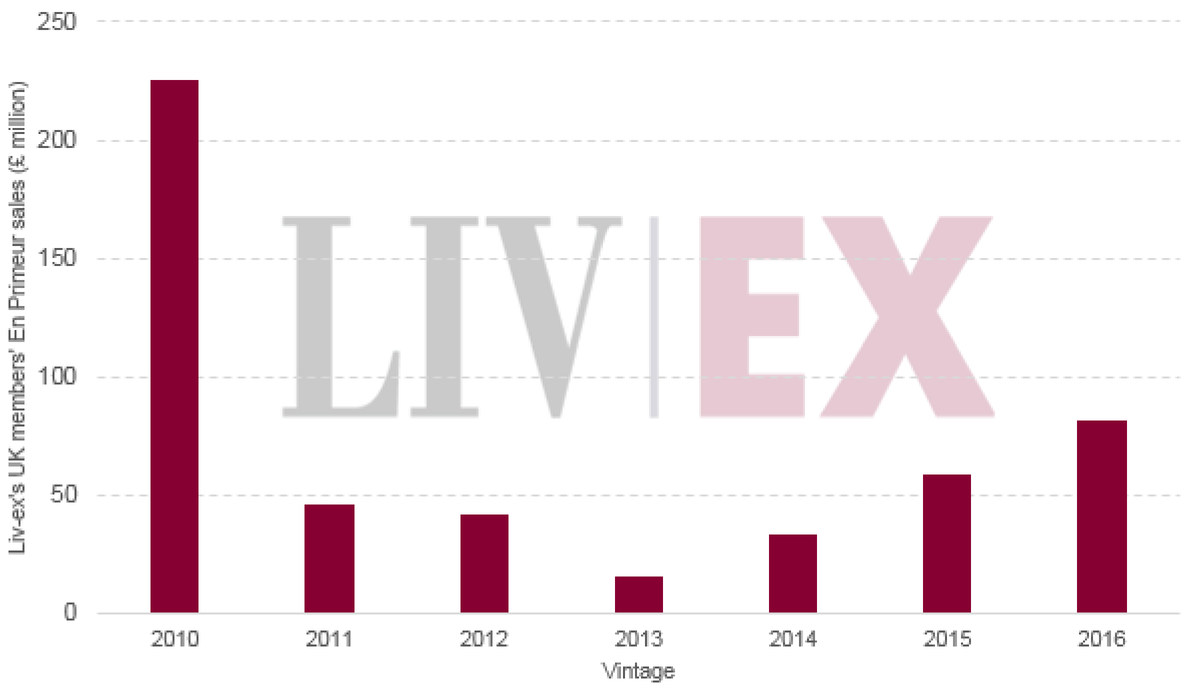


Table 2: Bordeaux 500 En Primeur returns and margin formation

Vintage	Ex chateau	Ex negociant	Merchant Release	Supply Chain	Mid Price at Delivery[1]			Current Mid Price[2]		
	€/btl	€/btl	€/btl	Margin	€/btl	Return[3]	Index Return	€/btl	Return[3]	Index Return
2005	116	143	179	35%	299	67%	49%	243	35%	102%
2006	104	130	153	32%	115	-25%	-17%	152	-1%	41%
2007	85	105	112	24%	105	-6%	5%	142	27%	35%
2008	60	76	93	35%	176	89%	47%	151	62%	67%
2009	180	225	293	39%	257	-12%	6%	260	-11%	31%
2010	202	250	281	28%	233	-17%	-8%	250	-11%	8%
2011	111	138	152	27%	119	-22%	-4%	137	-10%	13%
2012	85	106	111	23%	125	13%	12%	136	23%	19%
2013	80	101	109	27%	103	-6%	5%	120	10%	23%
2014	86	108	118	27%	136	15%	3%	139	17%	9%
2015	132	157	181	27%	-	-	-	201	11%	11%
2016	147	175	202	27%	-	-	-	198	-2%	4%
Average	**116**	**143**	**165**	**29%**	**167**	**10%**	**10%**	**177**	**7%**	**30%**

En Primeur returns and margin formation

Buying En Primeur is an investment, even if many collectors are buying without investment in mind. In return for tying up capital and taking on risk, the buyer is left to hope and assume that he or she has secured the best price for the wine. Yet several years of negative returns in recent memory, including a series of negative returns from 2009 to 2011, when the wines were on average cheaper upon physical release, left many questioning the value in buying En Primeur. As the example of the 2006 campaign shows, buying at too high a price can take over a decade to correct.

Returns from recent campaigns have been mostly positive, potentially helping to rebuild confidence in the system. However, collectors buying purely for investment purposes will note that En Primeur purchases have risen in value at a slower rate than the Bordeaux 500 Index on average in all years except for 2012 and 2014. This indicates that, on the whole, investors see a greater rate of return from wines already in the secondary market than from buying En Primeur.

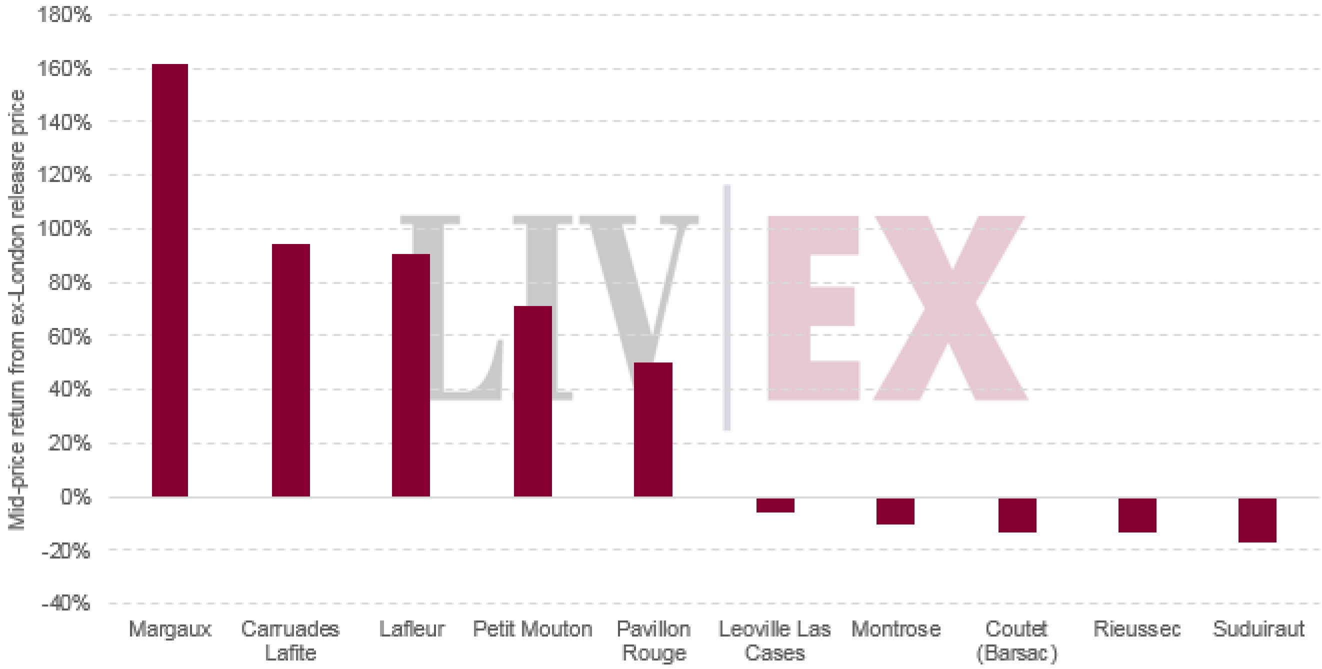
The need to pick winners

Looking at the average return masks the fact that picking 'winners' - wines that have been priced fairly - has become more important than ever over recent campaigns. This is true even for vintages that have outperformed the Bordeaux 500.

Consider the 2015 vintage.[5] Although the average return in euros is 11%, the returns of the individual wines in the Bordeaux 500 range from -17% to 162%.[6] The chart below highlights the best and worst performing Bordeaux 2015s. Margaux, the best performer, has increased in price by over 160% thanks to a combination of the wine's quality and the added value applied by the market to the wine's commemorative bottle.

[1]Liv-ex Mid Price two years after release.
[2]Liv-ex Mid Price as of 31st January 2018.
[3]Return is measured against merchant release.
[5]We are using euros to mitigate the effect that sterling weakness had on lifting the price of assets in sterling, therefore amplifying returns for those already holding the assets. For the same reason table 2 has been calculated in euros.
[6] Other wines such as Canon have performed well but they are not in the Bordeaux 500 and therefore not included in the average return.

Chart 14: Best and worst performing Bordeaux 2015s (%)



Other wines that have performed well include second wines of First Growths: Carruades Lafite, Petit Mouton and Pavillon Rouge are up 94%, 71% and 50% respectively.

As has been the case for a number of vintages, the sweet wines of Sauternes continue to struggle in the secondary market: Suduiraut, Rieussec and Coutet are the worst performers. Montrose 2015, a wine that was deemed to have been poorly priced on release in June 2016 is down 11%.

How to pick winners in 2017?

Last year Liv-ex suggested a more precise way of judging En Primeur releases using 'fair value' methodology. 'Fair value' methodology accounts for the relationship between price and critic score (historically Robert Parker, moving forward Neal Martin) to suggest the price of a wine based on its score.

Where there is a correlation (r-squared) between the scores and prices of over 50%, the trend line made can be used to estimate a wine's 'fair value'. This appears to work for many wines in the Bordeaux 500. Notable exceptions include wines favoured in the Asian market, for instance the second wines, as the importance of brand renders critic score largely irrelevant as an influencer of price.

'Fair value' is a more rigorous way of assessing the price of a newly released wine, rather than the antiquated focus on year-on-year price change. For instance, a wine can go up in price from the previous year and still be undervalued if the quality of the new release is markedly better.

Returning to the example of Montrose 2015, a collector or merchant using 'fair value' methodology during the En Primeur campaign could have identified that the wine was overpriced and not a sensible purchase. This is shown in the chart below with data from June 2016. It should be noted that had the same chart been drawn at the time of the chateau's 2014 release, it would have been identified as a good buy.

We hypothesise 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.

Typically, though not always, the most undervalued wines provide the best returns as the price moves up to fair value in the secondary market whereas overvalued provide the worst return.

As a guide, the chart below shows which chateaux have historically overpriced or underpriced their releases the most over the last ten En Primeur campaigns, relative to other vintages from the same chateau available in the secondary market. For example, it suggests that Troplong Mondot releases have been around 26% above their 'fair value' on average. On the other hand, Lynch Bages has been released at around 17% below 'fair value' on average.

Chart 15: Montrose 2015 regression in June 2016

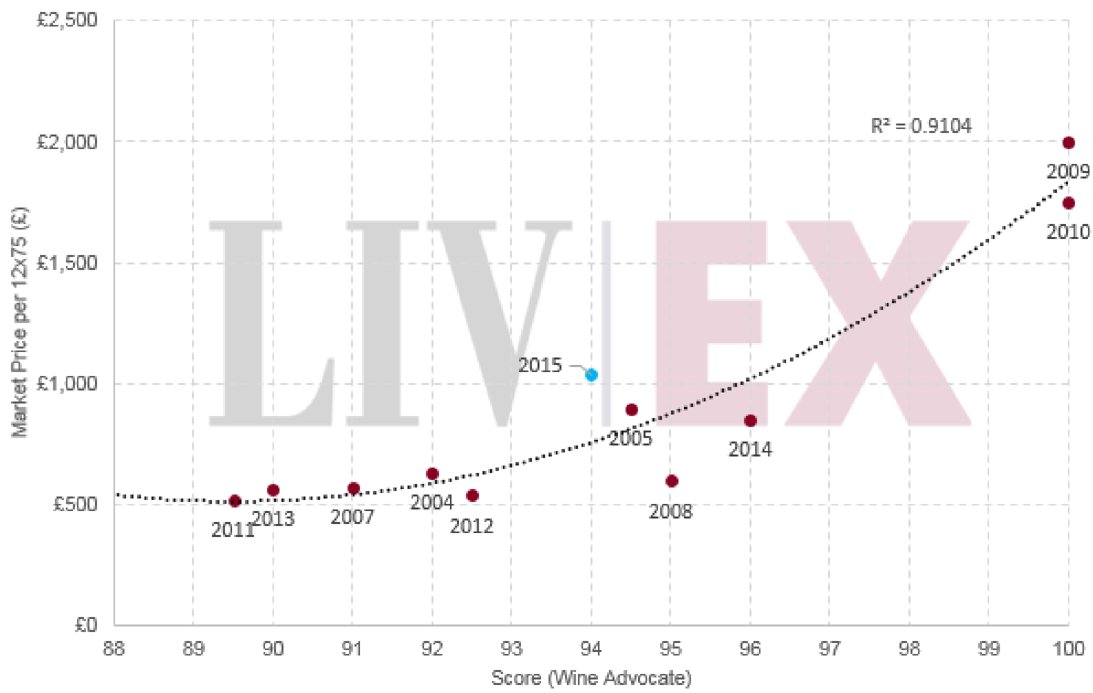


Chart 16: Bordeaux chateaux, most overvalued and undervalued on average on release

Which critics matter?

With Neal Martin leaving the Wine Advocate to join Vinous Media in February 2018, the issues surrounding Robert Parker's succession have re-opened. It was clear enough in the aftermath of Parker's retirement that many were willing to follow Martin, due in part to his association with Parker's publication. Now that Martin has moved on, there seems to be some doubt over whether market prices will continue to be influenced by his scores, or if a number of different voices will become more important.

This is a particularly contentious issue that will continue in the background of this En Primeur campaign. Already the market has been tested with the Bordeaux 2015 in-bottle scores. Several critics released their in-bottle scores at the same time and it was not obvious whether one critic had more impact than another. The curious delivery of Neal Martin's scores by the Wine Advocate may have muted the impact that he was able to have on the market; or perhaps it was the fact that he only awarded two 100-point scores, both of which he had scored as potentially 100 points in-barrel anyway.

Other critics awarded more 100-point scores, including James Suckling who awarded 14. Table 3 shows the top five price changes of Bordeaux 2015s since critics' in-bottle scores were released in February. It would appear that James Suckling's scores have moved the market, as the Market Prices of two wines awarded 100 points by Suckling, Beausejour Duffau and Belair Monange, are the best performers.

Table 3: Bordeaux 2015, price changes since in-bottle scores announced[7]

Wine	100 points	Jan-18	Mar-18	% increase
Beausejour Duffau	JS	£788	£1,309	66%
Belair Monange	JS	£1,219	£1,690	39%
Canon (Saint Emilion)	NM, AG	£1,580	£1,995	26%
Haut Brion	NM, LPB	£4,472	£5,230	17%
Vieux Chateau Certan	JS	£2,300	£2,650	15%

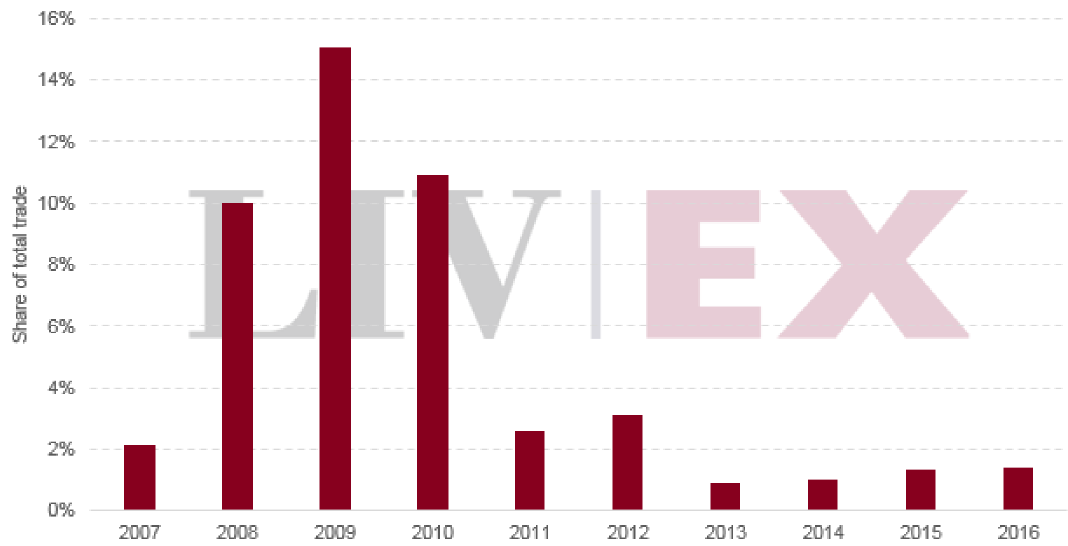
It will be interesting to see if chateaux now start to price their wines by focusing on the highest available critic score, regardless of its author, in the way that some merchants are now using scores selectively to facilitate a sale. Either way it does seems like the trade has a preference for Neal Martin: 77% merchant respondents to a survey by Liv-ex in March 2018 said that Neal Martin will be the critic they follow the closest during Bordeaux 2017. This said, the survey also demonstrated a rapid broadening of the critics that merchants might choose to follow. The days of Robert Parker or bust, are well behind us.

Liv-ex En Primeur sales are low

The need to pick winners is a contributing factor in the decline of En Primeur trade on Liv-ex. As we argued last year, En Primeur is for 'the few not the many' even in successful campaigns such as 2015 and 2016. The trade is now primarily interested in the top 30 or so most in-demand wines. These are typically the wines that are highly scored, keenly priced and difficult to source in the primary market.

[7] JS = James Suckling (Jamessuckling.com), NM = Neal Martin (vinous.com), AG = Antonio Galloni (vinous.com), LPB = Lisa Perotti-Brown (robertparker.com).

Chart 17: En Primeur sales on Liv-ex as a percentage of total sales (by campaign)[8]

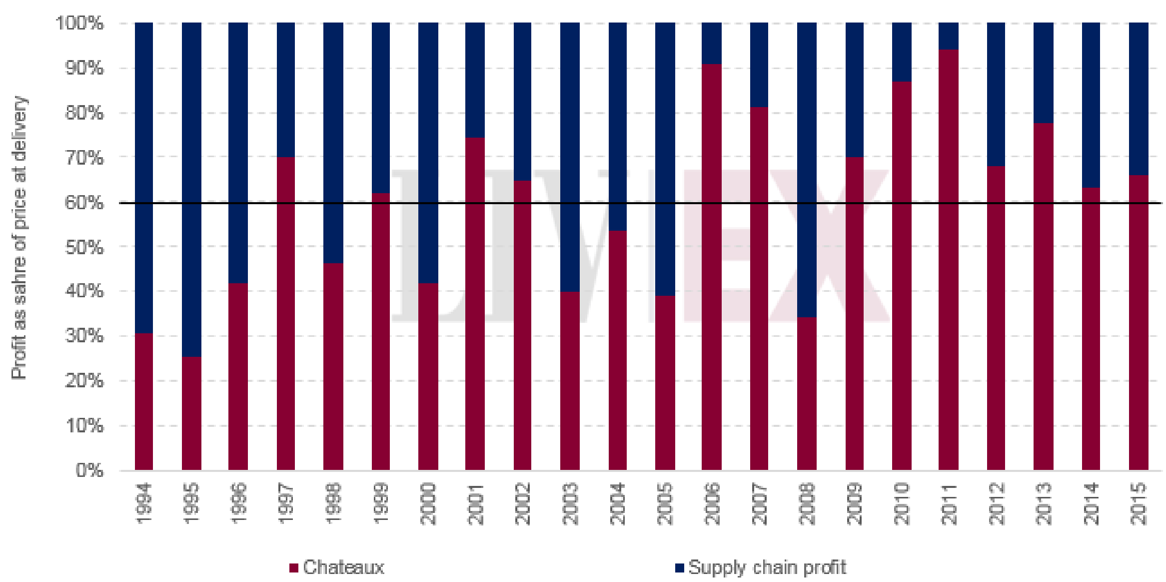


Supply chain margins still lower than historic norm

Not only have En Primeur sales failed to recover to their previous levels, they have also become a less attractive proposition for the trade. The chart above measures the ex-chateau price for the Bordeaux 500 as a percentage of the market price at delivery. This allows us to gauge the division of profits between the chateaux and the rest of the supply chain, including the courtier, the negociant, the international trade and the consumer. As the chart indicates, the chateaux's share of profits have remained above the long-term average since the 2008 vintage. In short, there is less left on the table for the trade now than there was in the past.

The campaigns of 2006, 2010 and 2011 saw the chateaux's share of profits at 85% or more of the total. These are all years following a great vintage. Given that 2017 follows a vintage recognised as one of the best in recent memory, this does not bode well for the coming campaign should this pattern continue.

Chart 18: ex-chateau price as % share of market price at delivery



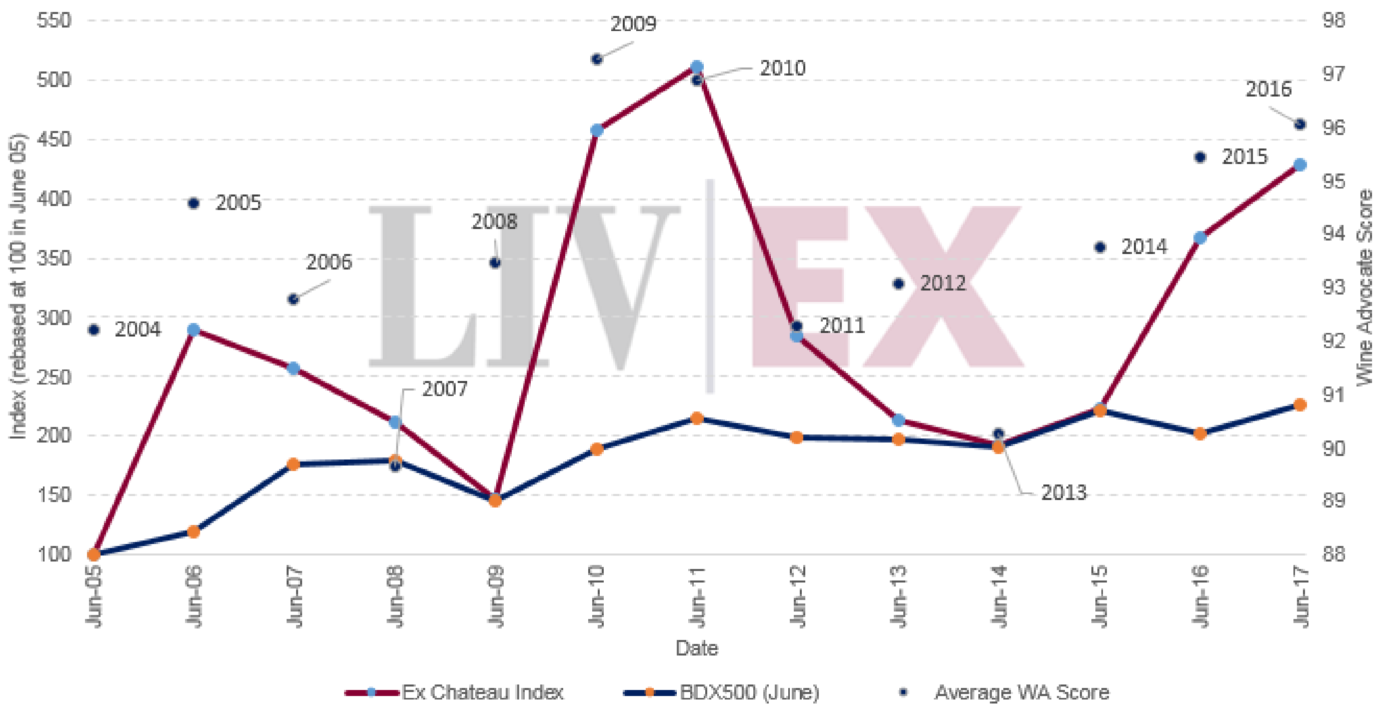
[8] En Primeur sales measured from start of campaign to end of March the following year.

Bordeaux 2017 Outlook

Release Prices

As chart 19 shows, En Primeur prices do not move in line with the market, so while the Bordeaux 500 has increased 3.4% in euros since June 2017, it would be unwise to use this a guide for predicting En Primeur prices this year. Instead prices, as measured by our ex-Chateaux index of the Bordeaux 500, move in line with quality changes.[9] Using the average Wine Advocate score for the Bordeaux 500 as a proxy, there is a marked difference between opening prices of 'on' and 'off' vintages; release prices for 'off' vintages such as 2007 and 2013 were less than half the price of 'on' vintages such as 2009 and 2010.

Chart 19: Bordeaux 500 and ex-Chateaux index vs. WA score



Quantity and Quality

The main talking point in the build-up to this campaign has been the impact of late spring frosts - the worst since 1991 - that have drastically reduced the overall Bordeaux yield. As the data collected by Gavin Quinney shows, overall volumes were down 40% on 2016 and were 33% lower than the ten-year average.

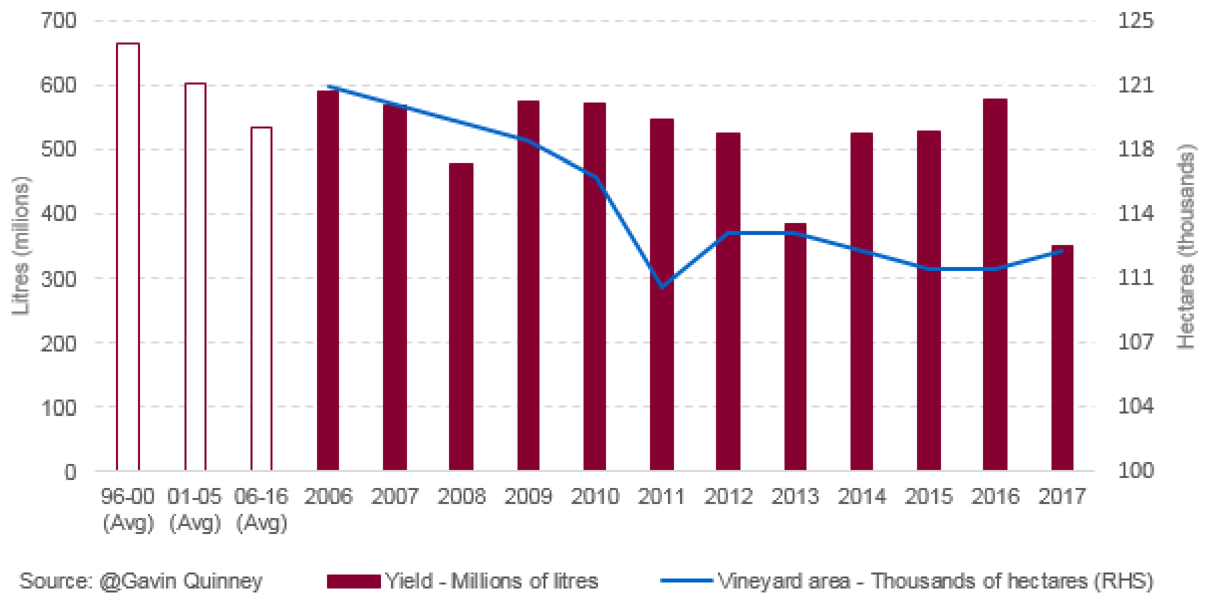
However as chart 22 - a frost map compiled by Quinney - makes clear, the damage caused by the frost was not uniform across the region. Certain communes on the Left Bank such as Pauillac, St-Julien, and St-Estephe were hardly touched. Judging from the map it appears that much of the damage has occurred to vineyards that supply the lower-priced end of the market, rather than the fine wine segment. So far, of the chateaux that Liv-ex covered for En Primeur 2016, only Fieuzal and Climens have declared that they are not making wine.

We cannot yet be certain how much variation there is on a chateau by chateau basis. However, chart 21 confirms that the yields of the Left Bank appellations from which the wines of the 1855 classification come from, other than Margaux, have escaped almost unscathed. A relatively normal volume of these wines should

[9] The Bordeaux 500 ex-chateau index is an index made up of the ex-chateau prices of the Bordeaux 500. It was rebased to 100 for En Primeur 2004.

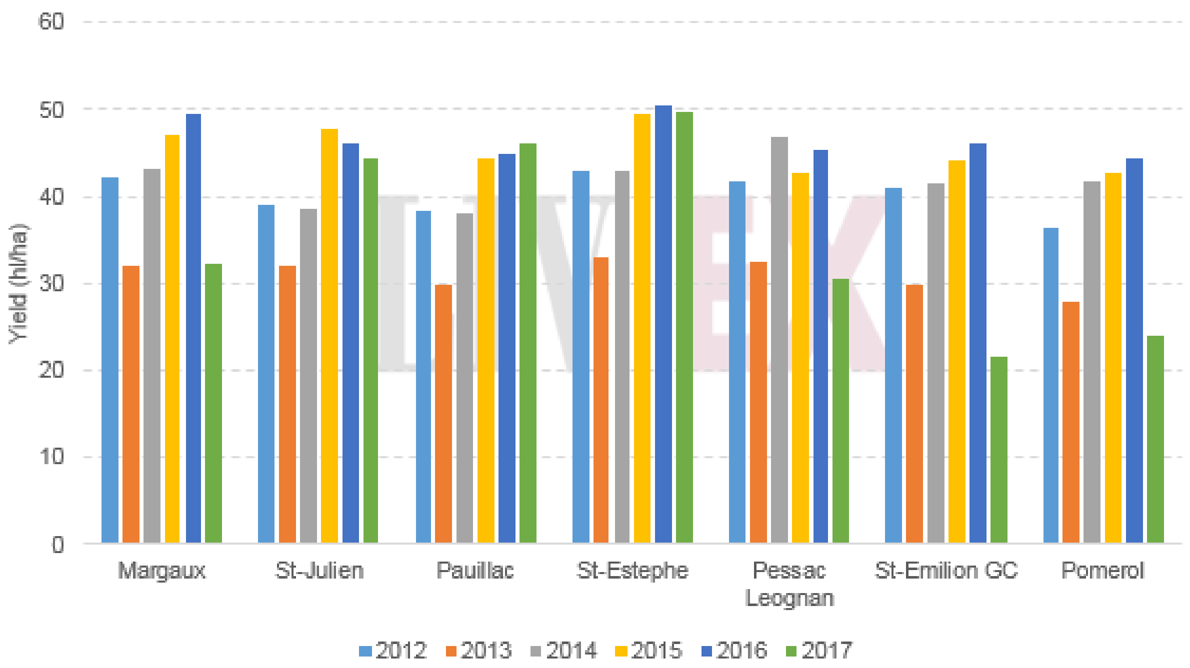
have been produced in 2017. In some cases more wine was produced than on average: the yield of 46.2 hl/ha in Pauillac was in fact higher than 2016's yield. It is possible that chateaux in these communes might decide to make less Grand Vin and more second wine than usual, if the quality is not up to the required standard.

Chart 20: Bordeaux yields 1996-2017



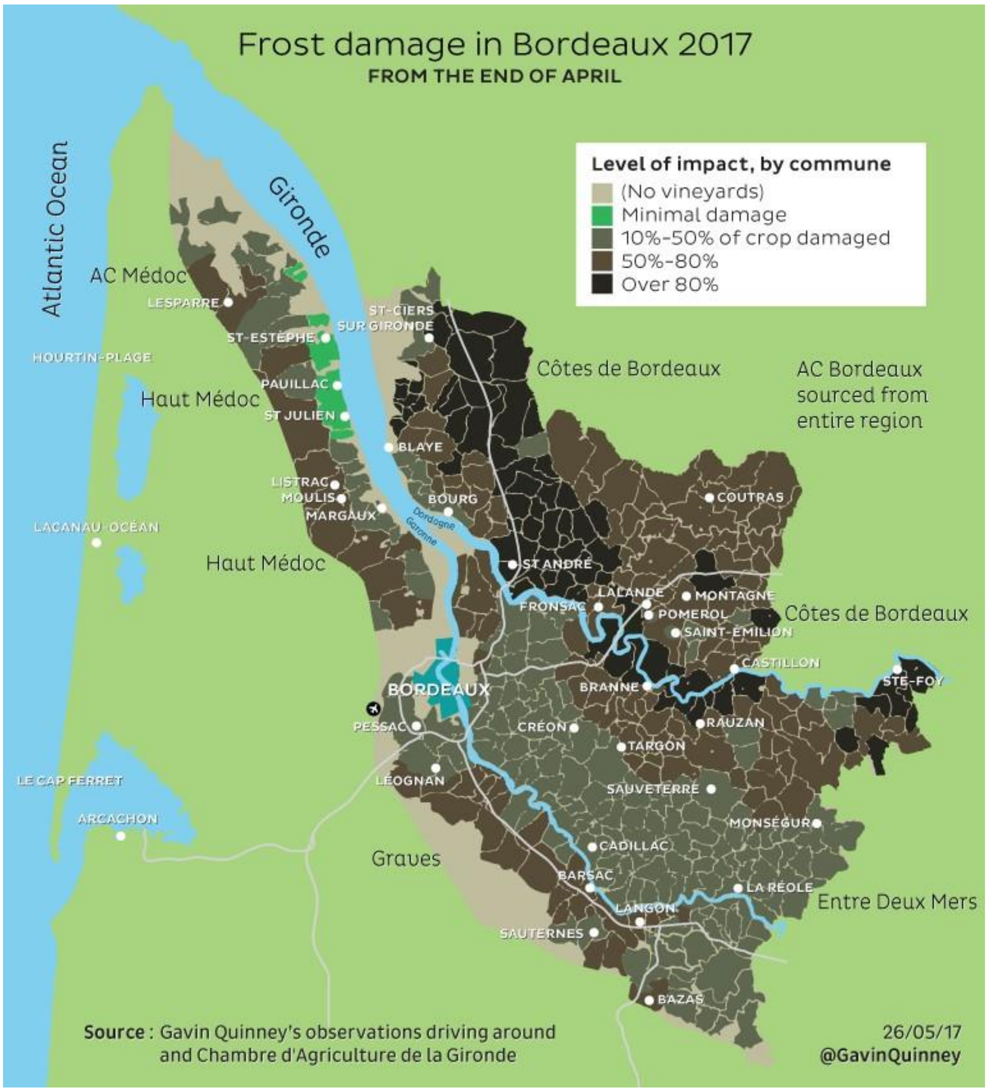
On the Right Bank, damage to vines in Pomerol and St-Emilion is more nuanced than the data for the whole appellation implies. While several Grand Cru Classes in St-Emilion have suffered losses nearing 100%, many of the others were not impacted that badly. In Pomerol many of the famous vineyards higher on the plateau seem to have fared well.

Chart 21: yields by appellation[10]



[10] Data supplied by Gavin Quinney, taken from Douane/CIVB.

Chart 22: Gavin Quinney's frost map of Bordeaux 2017



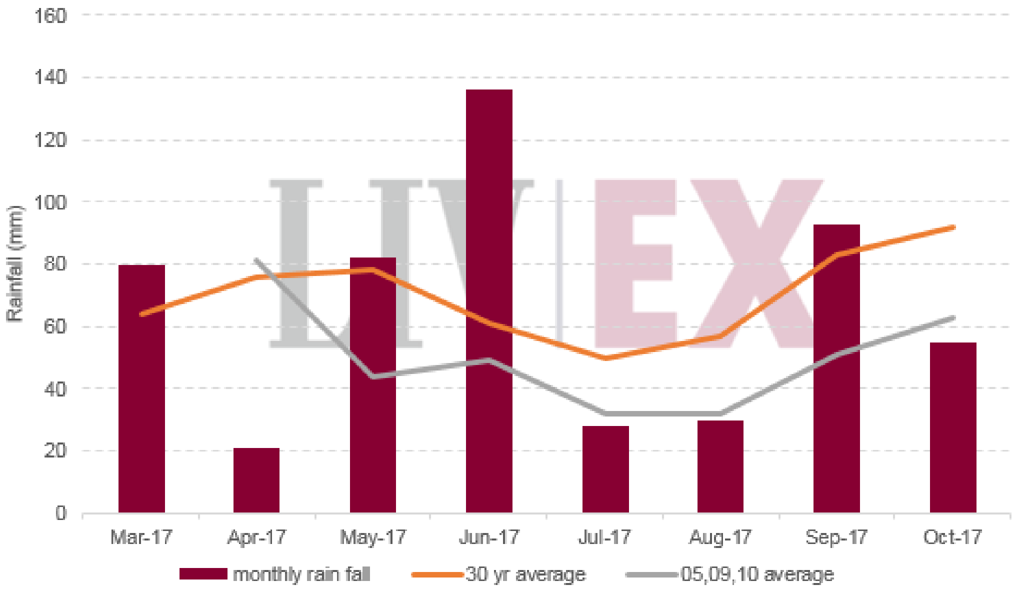
Weather suggests a good vintage

Where winemakers had enough healthy grapes, there is the potential for good results. Typically, the quality of a vintage can be inferred from the weather during the growing season. Although rainfall was higher than average in both May and June, the summer period was both drier than the 30-year average and the average of 'on-vintages' such as 2005, 2009 and 2010.

Rainfall in September was above average, which might seem worrying, but as Jane Anson noted in Decanter recently it was "not such an issue for dilution". Commenting in November 2017, Gavin Quinney reckoned that "it's not a blockbuster year… we should see wines at the same quality level as 2012 or perhaps 2014."

Early critical commentary seems to suggest that the combination of frost in certain areas alongside a relatively good growing season has led to a heterogeneous vintage. Writing in March 2018, Lisa Perotti-Brown noted that she had "tasted some extraordinary surprises… and some very average ones". The fuller picture will emerge in April once the trade and critics have visited Bordeaux to taste En Primeur.

Chart 23: 2017 rainfall vs average[11]



Bordeaux is back…. in Bordeaux

The question of how much wine is being produced versus how much is then coming to market is a crucial one. For the last two years, despite above average production volumes, many of the top chateaux have been holding back more and more of their production for sale beyond En Primeur. The days of chateaux selling 90% of their production are long gone. Table 4 highlights the strategy of some of the biggest players.

Table 4: Chateau strategy

Chateau	Recent Strategy
Angelus	Announced it would keep more bottled wine back from market in 2015. It had previously stated it has held back 20% stock since 2011.
Haut Brion	Released 20% less wine in 2016.
Lafite	Mysterious tranche system obfuscates actual release price and volumes.
Latour	Exited En Primeur in 2012 after the release of the 2011 vintage. Now holds back 100% of stock and only releases wine when 'ready to drink'. Subsequently releases equivalent of a vintage every year with releases in March & September.
Margaux	After reducing volumes in 2015, the chateau was one of the few to increase volumes in 2016.
Mouton Rothschild	In February 2016, Mouton Rothschild announced it would be releasing fewer cases En Primeur. Same number of cases released in 2015 and 2016, but 2016 was a slightly bigger harvest.
Palmer	Palmer has held back 50% stock since 2010. Chateau says it plans to sell equivalent of a vintage every year
Pavie	Release 50%-60% stock at EP. Aim to release a full vintage's worth of stock over the calendar year.
Pontet Canet	Cut allocations in 2015, offering quantities equivalent to 60% of 2014 during first tranche.

Using data provided from the CIVB, table 5 provides information about the stock levels and transaction volumes in Bordeaux. Rather than using numbers for the whole region, Liv-ex has isolated the numbers for fine wine production by amalgamating the data from the communes of St-Julien, St-Estephe, Margaux, Pauillac, Pessac-Leognan, Barsac, Sauternes, St-Emilion Grand Cru and Pomerol.[12]

[11] Rainfall data taken from figures collected and supplied by Gavin Quinney.
[12] Not all the wine made in these communes is classified as fine wine but the majority is.

During the last campaign, more wine left the chateaux in these appellations than in any campaign since 2011. Despite this, stock levels at the start of the 2017/2018 campaign are the highest they have been in seven years both at the chateaux and at negociants.[13]

The ratio of the wine leaving the chateaux to that of the volume of the harvest has been below one since 2014. This means that less wine is entering the market than is being produced, implying that an effort is being made to restrict supply. This numerical data aligns with many of the chateaux statements in table 4; less wine is entering the market causing stock levels at chateaux to rise.

The purpose of this strategy is not entirely clear. On the one hand it may simply be part of a normal restocking cycle, made necessary by overselling between 2005-2010, combined with the impact of the poor 2013 harvest. On the other, perhaps there is a recognition on the part of the chateaux that after the China boom collapsed in 2011 the best way to maintain the price level was through withholding supply. In a low interest rate environment, the opportunity cost of holding stock is diminished and ex-chateau releases later on in a wine's life could command a higher price.

Considering last year's generally reduced En Primeur allocations it is hard to ascertain whether holding back stock was a cautious move in response to the frost or actually aligned with a long term strategy to release less wine during En Primeur.

Table 5: Fine Wine production, stock and sorties figures[14]

Campaign	11/12	12/13	13/14	14/15	15/16	16/17	17/18
Harvest	2011	2012	2013	2014	2015	2016	2017
Harvest (hl)	499,425	489,508	373,568	501,003	547,241	572,375	
Stock at start of campaign (hl)	1,301,522	1,262,124	1,235,188	1,145,569	1,203,729	1,287,812	1,338,104
Available to properties (hl)	1,800,947	1,751,632	1,608,756	1,646,572	1,750,970	1,860,187	
Stock at negoce (hl)	463,265	476,506	510,559	526,954	525,453	559,664	508,789
Sorties (all vintages) (hl)	509,122	472,200	438,647	410,447	431,744	490,111	
Sortie/harvest ratio	1.02	0.96	1.17	0.82	0.79	0.86	

Is the supply chain full?

Table 5 shows that not only are chateaux cellars full of wine, stocks held at negociants are high as well. Further down the supply chain, chart 24 shows that merchants lists are still heavily stocked with wines from the 2014 and 2015 vintages. Between 40-50% of the available wine is made up of the 2014 and 2015 vintages.

Essentially, current stock in the supply chain is heavily weighted to young Bordeaux. There simply is not room for high volumes of wine, and especially not at the wrong price. Curiously, whereas in the last two campaigns there have been complaints about the most in-demand wines being held back from market, this campaign, wine being withheld from market might be exactly what is needed, especially if the price or quality is questionable.

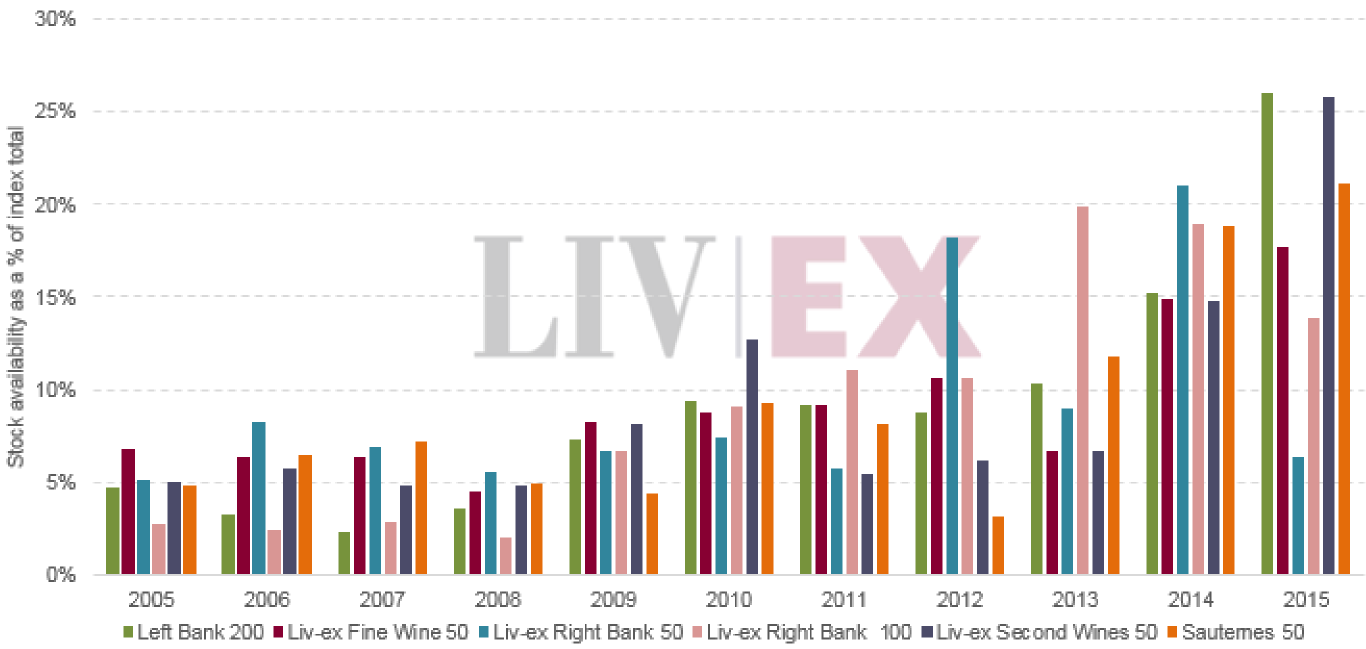
This is where the interests of different constituents of the supply chain may diverge. If wines critics deem the 2017s to be below average, the chateaux will want to sell as much stock now at the highest possible price, which could leave either negociants or the international trade with stocks they are unable to sell. On the other

[13] A campaign in this sense runs from the Start of August to the end of July the following year.
[14] Data taken from CIVB, *Marché des vins de Bordeaux, Bilan par appellation, Campagne 2017-2017,* p.44-47, 51-55 & 78.

hand, if the wine is deemed to be above average, it's likely that merchants might struggle to get their hands on stocks that are being withheld to sell in the future for a higher price.

On the demand side, as the analysis in the earlier section on the Bordeaux market showed, the Bordeaux 500 is currently flat. There is some appetite for certain sections of the Bordeaux 500 in the secondary market, such as the second wines and keenly priced 2014s and 2015, but overall there is lower demand than there was a year ago. If the wine is not priced fairly for the supply chain, this campaign will struggle and could risk taking confidence out of the system at a time when the market is already fairly flat.

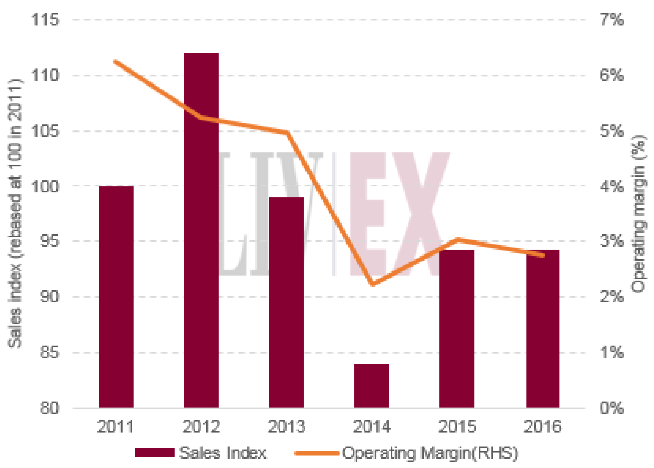
Chart 24: Stock levels as a % of the Bordeaux 500 by vintage[15]



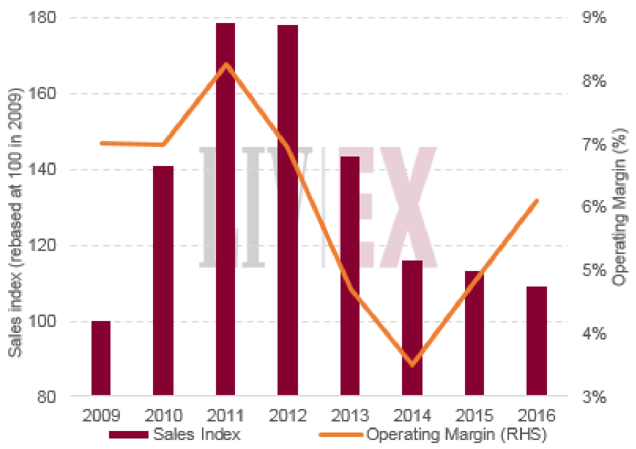
Can the trade bear it?

Sales indices for both the UK and French trade are lower than in 2009 for both countries, although sales will rise in future accounting periods when En Primeur sales of the 2015 and 2016 vintages are recognised.

Bordeaux negociants: sales and profit margins



UK trade: sales and profit margins



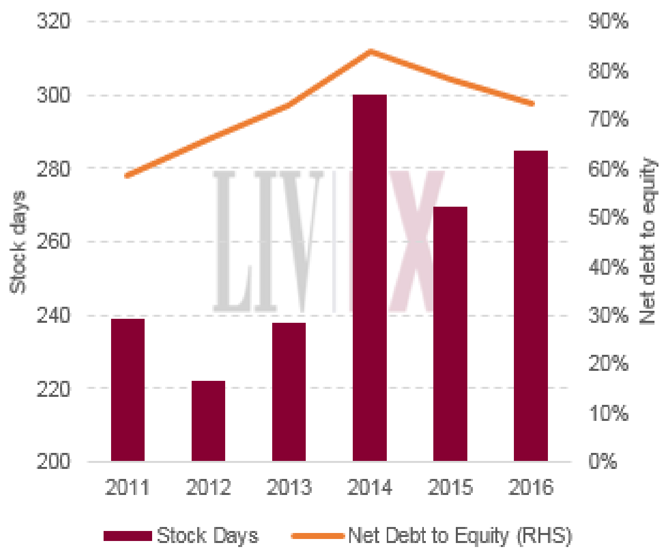
[15] This chart is measuring the stock available by vintage as a % of the index total. The data is taken from the average volume over three months from lists collected by Liv-ex.

A badly priced campaign would do the trade in both France and the UK no favours. In a low interest rate environment there is little pressure on chateaux to sell. This reduces the likelihood of the prices for this year's campaign being compelling, and following two well purchased campaigns, it is unlikely the consumer appetite is there unless the 2017s are better than the previous two vintages.

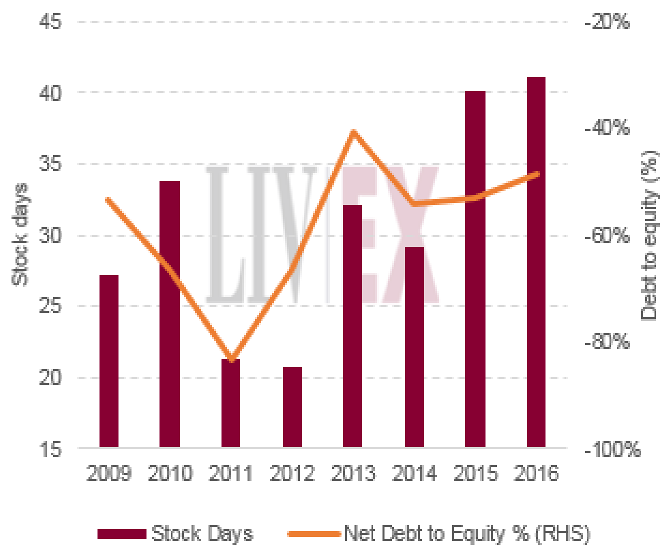
Neither the UK trade nor the negociants can bear to take on large volumes of overpriced stock. The UK trade operate a net cash model with an average of 40 days in stock. This is not a stock holding model. If EP prices are unattractive then the wines will remain unsold in Bordeaux. Rather than choosing to buy and hold stock the UK trade instead chooses to forgo turnover.

Negociants on the other hand have little choice, they are forced to take stock for fear of losing important allocations. Yet as the charts of the financials of Bordeaux top negociants highlights, with operating margins of around 3%, net debt to equity at around 70% and stock days as high as 280 days, there is little margin for error in the business model. At the moment this is fine, but should either the market turn or interest rates rise then one of the most important components of the fine wine supply chain could come under serious pressure.

Bordeaux negociants balance sheets



UK trade balance sheets



Conclusion

Sentiment around En Primeur has improved in recent years. Returns for collectors have mostly been positive, allowing some confidence to be rebuilt in the system. The 2017 campaign therefore presents a real opportunity for the chateaux to engage the market this year. However, a number of developments playing out in the background will likely affect how the vintage is received.

The issue of spring frosts has dominated discussions on the 2017 vintage so far, both in terms of its impact on quantity and quality. There are suggestions that volumes have barely been affected for many great estates of the Left Bank, but the overall quality of the wines remains somewhat of a mystery. Early reports on the vintage suggest that it was a good year, but will not meet the heights of 2009, 2010, 2015 or 2016.

Just how chateaux will price their wines remains unknown. In many cases, high prices for 2015 and 2016 were absorbed thanks to the quality of these wines and strength of the market. Neither are as strong this year, so collectors that have made substantial investments in the past two years will need good reasons to buy. There are now many voices in the market offering a variety of different opinions on quality. It can be tempting for those selling the wines to focus on the highest score(s), but this is likely to be a vintage sold on price.

The En Primeur campaign will define the sentiment of the Bordeaux market for the remainder of 2018. The market has made steady progress in 2017 but is now showing signs of slowing down. An overpriced campaign with suppressed volumes could negatively affect sentiment.

On the other hand, a sensibly priced campaign, with wines released in decent volumes, will boost confidence and satisfy all members of the supply chain. As always, this is surely what the trade will hope for as the campaign begins.