Cover page

Diploma in Wines & Spirits

Unit 7 - Diplomarbeit / WSET Level 5 Honours Diploma

Wine investments – comparison of wine funds and private equity like investments

(Investieren in Wein – Weinfonds & Private Equity Ansatz, ein Vergleich)

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Summary Diploma Unit 7/WSET Level 5

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Introduction

Wine investment funds were booming in the decade between 2000-2010 and attracted significant assets. However, after 2008 the strong price increases in the wine market ended – many funds delivered performance below expectation and several investment funds closed.
Nevertheless, many (Ultra) High Net Worth Individuals ((U)HNWI) are interested in wine investments, not only for pure return objectives, but also for emotional reasons. I this study an analysis on a number of wine investment funds is provided and a Private Equity type investment in several wineries is suggested as alternative. The returns of the two wine related investment options are compared and a number of other aspects discussed.

Performance of wine indices and wine funds

There are number of indices tracking the price development of wines, e.g., the Wine Spectator auction index or the Fie Wine 100 index. Most indices focus on first growth Bordeaux.
In the decade between 2000 and 2010 the indices showed a strong growth, especially between 2003 and 2008, followed by a significant drop after the financial crisis in 2008. After 2008 the market recovered, but lacks the strong price increase seen previously.
In parallel with the booming prices a significant number of wine investment funds were launched, most of them focusing on Bordeaux first growth. Some analysts claimed wine to be “a new alternative asset class” as the correlation with other asset classes was low and the performance was higher during this period. Double digit returns were achieved by the best funds during this time However, after the backdrop returns were significantly lower or even negative. A number of funds were closed and for the remaining ones a return in the range of 5%, similar to the long term average of wine indices seems more realistic.
The wine investment funds are also faced with a number of structural challenges, namely the limited availability of “top” wines due to the trade structure in Bordeaux (selling of a balanced portfolio of wine by Courtier/Négociant/Importer/Distributer), costs for handling, insurance and storage, costs to buy and sell wines at auctions and the fund costs itself.

The case for a Private Equity type investment in wine

Despite the mixed performance of wine investment funds there seems to be a significant interest of (Ultra) High Net Worth Individuals ((U)HNWI) in investing in wine. It is therefore suggested that a Private Equity type of participation opportunity investing in a portfolio of wineries could be a suitable alternative to the wine investment funds.

In order to derive the potential return of such an investment a single winery with 10 ha size was used as a proxy to build a financial model. Based on parameters available in the literature (e.g., costs for establishing a vineyard or to construct a winery) or online resources (e.g., wages or price for vineyards) the model was populated and the sensitivity on the respective parameters was analyzed.
With 6% return the base model reveals a return similar to the wine investment funds. The highest sensitivity is given by the achieved sales price and – indirectly – therefore also by the quality achieved. The variability of the possible returns can be mitigated to a certain extent by investing in a portfolio of several wineries smoothing to returns from “bad” and “good” performers. A portfolio of a minimum of 5 wineries with an investment commitment of EUR 20-30 million is suggested.
From an investment return perspective the investment in several wineries can therefore be an alternative to wine investment funds.
In terms of other factors the investments differ. The holding period of a wine fund is typically 5 years, the investment in wineries is a rather long-term investment spanning at least a plantation cycle of 20 years. Also the liquidity differs – while wine as a product can be sold easily at market price through auctions, wineries are much less liquid and redemptions from the investment nearly excluded the first 10 years. In terms of risks an investment in a wine fund is essentially coupled to the market risk as represented by the wine auction indices, in the case of investing in wineries rather operational risks and the quality of the winemaking are included.

Emotional investment

Many (U)HNWI seem not to invest in wine only because of the potential financial return, but as well for emotional reason. Studies show that investment in, e.g., gold is for most investors based on financial reasons only while investing in art has a much higher emotional component. The pattern of investors in wine funds is more comparable to the later than to the former class. The affinity end emotional binding of such investors in wine investments is also reflected by the acquisition of wineries and “chateaux”, both by UHNWI of emerging markets like China and Mexico as well as by “old world” investors with an established wealth background.

Conclusions

Based on the development of the wine auction market and the closing down of a number of wine investment funds it seems that the boom period of wine investment funds is over.
As for many investors investing in wine has not only a financial but also an emotional component, the opportunity to invest in a Private Equity type form in a portfolio of wineries seems therefore a suitable alternative. For a return perspective returns can be expected to be in a similar range while other investment parameters differ.
Beyond the pure investment components like serving the “own” wine to family & friends, being able to visits the “own” wineries and being part of an exciting development project likely adds to the emotional component of such an investment and the launch of a Private Equity type winery investment funds seems therefore a promising opportunity with good perspectives to succeed.