

Beverages

Risk of tariffs on cognac in China: not a happy new year for spirits

Industry Overview

Chinese government initiates cognac anti-dumping probe

The Chinese government has launched an investigation into imports of French brandy (cognac). The broader context is an ongoing trade dispute between the EU and China, with the EU conducting an investigation on pricing of imported Chinese electric vehicles. The cognac industry association responded saying that *"the investigation is unrelated to our activity"*, but *"cognac producers will fully cooperate with Chinese authorities to address any concerns they may have"*. This seems to be a political situation, the outcome of which is extremely uncertain. In a worst case, but not impossible scenario, where significant tariffs are imposed on cognac in China (as was the case with Australian wine in 2020), any impact on Remy (particularly) and Pernod would be material, but the risk is hard to quantify. The share price moves (RCO -15%, RI -5%) suggest to us a c1/3 chance of RCO/RI losing their entire China profit. The issue is likely to create a further overhang on the stocks until we have more clarity. Valuations in spirits look quite attractive, but visibility and sentiment remain poor.

Australian wine hit very hard by tariffs imposed in 2020

Following a dispute with Australia, China introduced tariffs on a range of products, including Australian wine. A dumping investigation was launched in Aug-20. Australian wine producers completely denied the claims. In Nov-20, China announced temporary tariffs of c100-200% on Australian wine and anti-dumping duties were officially set in Mar-21 at 116-218% for 5 years. Australian wine exports to China fell c90% (IWSR).

Cognac China is c40% of Remy EBIT, 15% for Pernod

The following table shows the spirits companies' exposure to China and to cognac in China. c30% of Remy group sales and 40% of EBIT come from China. For Pernod exposure is c9%/14%. We estimate c13% of MH EBIT comes from China Cognac. Therefore, the impact on LVMH group would be 1-2%. Diageo has some indirect exposure via its Moët Hennessy stake. At the net profit level, we estimate that cognac China represents c2% of group for Diageo. Campari recently announced *Courvoisier* acquisition, which should complete probably around mid-2024. China represents c10% of *Courvoisier* sales, less than 1% for CPR pro-forma.

Exhibit 2: Cognac in China represents c40% of Remy's EBIT

Spirits companies' exposure to China and cognac in China

	RCO	RI	DGE	MH	CPR	CPR (cum Courvoisier)
China as % of group sales	32%	11%	4%	c20%	<1%	1-1.5%
of which cognac	31%	9%	0%	c14%	0%	<1%
China as % of group EBIT	40%	15%	3%	c20%	0%	<1%
of which cognac	39%	14%	0%	c14%	0%	<1%

Source: BofA Global Research estimates

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