

INDEPENDENT RESEARCH

23rd November 2016

Spirits

# Spirits

## Rising to the Generation Y challenge

<b>REMY COINTREAU</b>	<b>BUY</b>	<b>FV EUR84</b>
Bloomberg RCO FP	Reuters RCOP.PA	
Price EUR74.67	High/Low 80.42/58.14	
Market cap. EUR3,711m	Enterprise Val EUR4,145m	
PE (2016e) 30.3x	EV/EBIT (2016e) 20.1x	

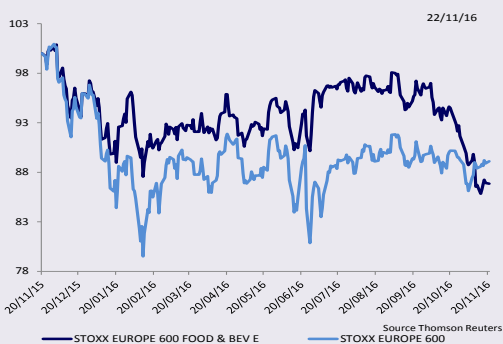
<b>CAMPARI</b>	<b>BUY</b>	<b>FV EUR10.7</b>
Bloomberg CPR IM	Reuters CPR.MI	
Price EUR8.87	High/Low 10.09/6.94	
Market Cap. EUR5,152m	Enterprise Val EUR6,453m	
PE (2016e) 25.0x	EV/EBIT (2016e) 18.2x	

<b>PERNOD RICARD</b>	<b>BUY</b>	<b>FV EUR115</b>
Bloomberg RI FP	Reuters PERP.PA	
Price EUR101.8	High/Low 110.25/91.58	
Market Cap. EUR27,020m	Enterprise Val EUR35,304m	
PE (2016e) 18.2x	EV/EBIT (2016e) 14.8x	

<b>MBWS</b>	<b>NEUTRAL</b>	<b>FV EUR17.1</b>
<b>COVERAGE INITIATION</b>		
Bloomberg MBWS FP	Reuters MBWS.PA	
Price EUR15.69	High/Low 20.27/14.92	
Market Cap. EUR444m	Enterprise Val EUR-23,372m	
PE (2016e) NS	EV/EBIT (2016e) -2.0x	

<b>DIAGEO</b>	<b>NEUTRAL</b>	<b>FV 2200p</b>
Bloomberg DGE LN	Reuters DGE.L	
Price 2005p	High/Low 2268/1745	
Market Cap. GBP50,448m	Enterprise Val GBP58,168m	
PE (2016e) 19.4x	EV/EBIT (2016e) 16.2x	

Price and data as at close of 21<sup>st</sup> November




■ **Millennials: the priority target.** This generation has become the major obsession for the spirits industry which is engaged in a ferocious battle to conquer its heart and wallet. The representatives of this age bracket represent the driving force in consumption, regrouping more than 385m individuals in China (c.28% of the total population), 122m in the EU (c.24%) and 92m in the United States (c.29%). Beyond this demographic influence, in 2020 this generation will represent more than one third of retail sales in the United States and 53% of Chinese domestic consumption (BCG).

■ **Authenticity and experimentation.** While brands are very important to Generation X, Millennials prioritise products which have a story to tell. This is why the notion of authenticity has become key, explaining both the craft trend and the success of certain categories like whisk(e)y, cognac, Latin American spirits (tequila/mezcal) and bitters. Experimentation has also acquired a predominant role. These days we do not just consume a product but all that its universe can offer. The implications are numerous: marketing changes, the emergence of mixology, the importance of new technologies and ethical considerations. The product itself is increasingly specifically designed to create an experience, hence the success of aromatised spirits, the abolition of frontiers between categories, etc.

■ **Rémy Cointreau: the best positioned.** The company generates 64% of its sales in categories in phase with the Millennial generation, i.e. mainly cognac but also, to a lesser extent, single-malt scotch. The Campari portfolio, with its high proportion of bitters and bourbon, is also attractive. We calculate that 39% of the Italian company's sales are generated in products that are popular with Generation Y. In the case of diversified groups like Pernod Ricard and Diageo, this percentage falls to a respective 21% and 11%. Lastly, we estimate that only 3% of MBWS sales are aligned with Generation Y tastes. This analysis reinforces our positive conviction on Rémy Cointreau (Fair Value: EUR84), Campari (Fair Value: EUR10.7) and Pernod Ricard (Fair Value: EUR115). We maintain our Neutral recommendation on Diageo (Fair Value: 2,150p) and we initiate coverage of MBWS with a Neutral opinion and a Fair Value of EUR17.1.



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# 1. Summary of the investment case

## Millennials: the priority target

**This generation has become the major obsession for the spirits industry which is engaged in a ferocious battle to conquer its heart and wallet.** No conference can take place without mentioning Generation Y to explain the launch of a product, a marketing change and the success or, inversely, slowdown of a brand. **The representatives of this age bracket represent the driving force in consumption,** regrouping more than 385m individuals in China (c.28% of the total population), 122m in the EU (c.24%) and 92m in the United States (c.29%). Their number is set to exceed that of the 'baby-boomers'. Beyond this demographic influence, in 2020 this generation will represent more than one third of retail sales in the United States and 53% of Chinese domestic consumption (BCG). But how do the tastes of Generation Y diverge from those of Generation X?

## Authenticity and experimentation

**While brands are very important for Generation X, Millennials prioritise products with a story to tell. This is why the notion of authenticity has become key,** explaining both the craft trend and the success of certain categories like whisk(e)ys, cognac, Latin American spirits (tequila/mezcal) and bitters. **Furthermore, consumption is no longer an end in itself.** The spirits companies cannot afford to restrict themselves to supplying a bottle of alcohol, no matter how unusual. **These days we do not just consume a product but all that its universe can offer,** hence marketing changes, the emergence of mixology, the importance of new technologies and ethical considerations. **This desire for experimentation is also expressed through the products themselves which are increasingly specifically designed to create an emotion or sensation.** The implications are numerous: growth of aromatised spirits, abolition of frontiers between categories, etc.

## Rémy Cointreau: the best positioned.

**Rémy Cointreau generates 64% of its sales in categories in phase with the Millennial generation,** i.e. mainly cognac (62% of sales) but also, to a lesser extent, single-malt scotch (2%). The Campari portfolio, with its high proportion of bitters and bourbon, is also attractive. **We calculate that 39% of the Italian company's sales are generated in products which are popular with Generation Y.** In the case of diversified companies like Pernod Ricard and Diageo, this percentage falls to a respective 21% and 11%. **Lastly, we estimate that only 3% of MBWS sales are aligned with Generation Y tastes,** the company being little present in countries where this population is the most prevalent (China, United States, etc.).

**This analysis reinforces our positive conviction on Rémy Cointreau (Fair Value: EUR84), Campari (Fair Value: EUR10.7) and Pernod Ricard (Fair Value: EUR115). We maintain our Neutral recommendation on Diageo (Fair Value: 2,150p) and we initiate coverage of MBWS with a Neutral opinion and a Fair Value of EUR17.1.**

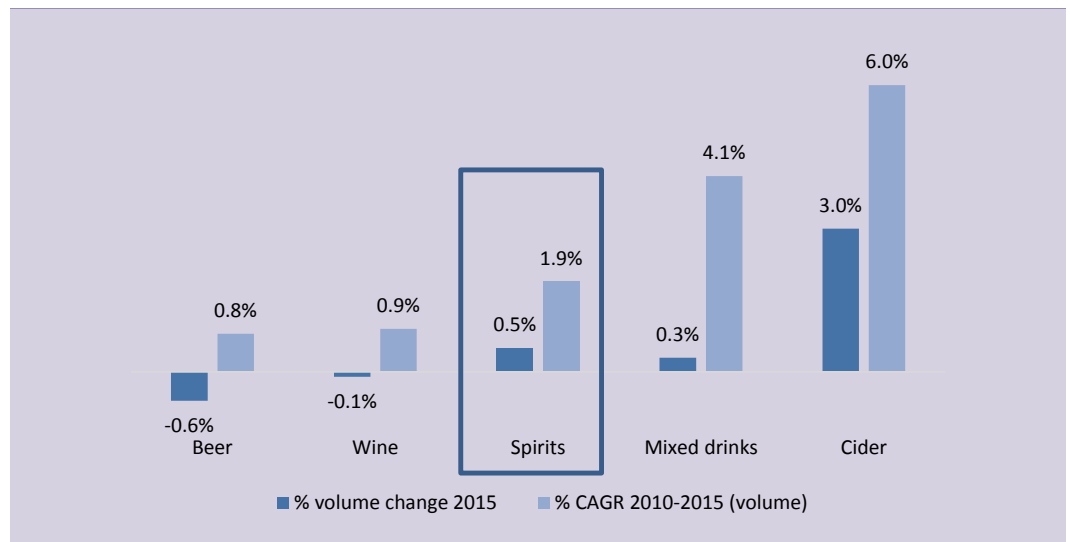
## 2. Millennials: the priority target

Faced with sluggish growth, it becomes all the more important for spirits companies to be able to capture the attention of the Millennial generation. The representatives of this age bracket represent the driving force in consumption.

### 2.1. Sluggish growth

In 2015, the spirits market grew by only 0.5% (in volume) at global level whereas its average annual growth rate for the 2010-15 period had been 1.9%. Excluding national spirits, there was even a fall of 0.5%. The emerging countries and Travel Retail continue to be growth detractors while the trends in the developed countries are more robust.

**Fig. 1: The alcoholic beverages market: volume growth by segment**



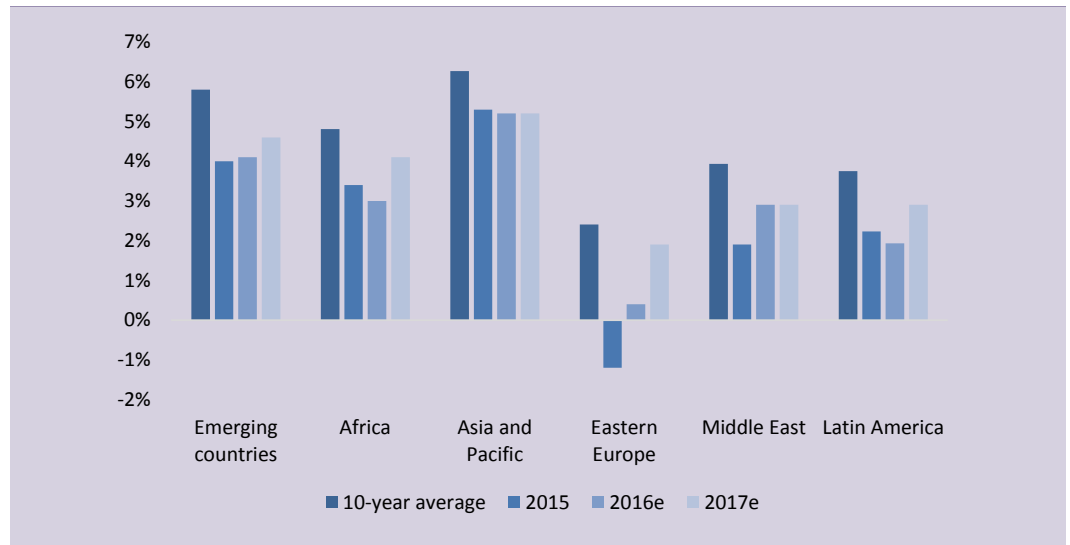
Global spirits volumes grew by only 0.5% in 2015

Source: IWSR

#### 2.1.1. Emerging markets and Travel Retail are struggling

The spirits companies continue to struggle in the emerging countries, whose real economic growth is not expected to exceed 4.2% in 2016. This is broadly in line with 2015 (+4%) but well below the average for the past decade (5.8%), largely due to the CIS and Sub-Saharan Africa, which have been impacted by the fall in commodity prices and currency volatility. In the Middle East, political instability prevails while Brazil, the leading Latin American economy, remains in recession.

**Fig. 2: Real economic growth**



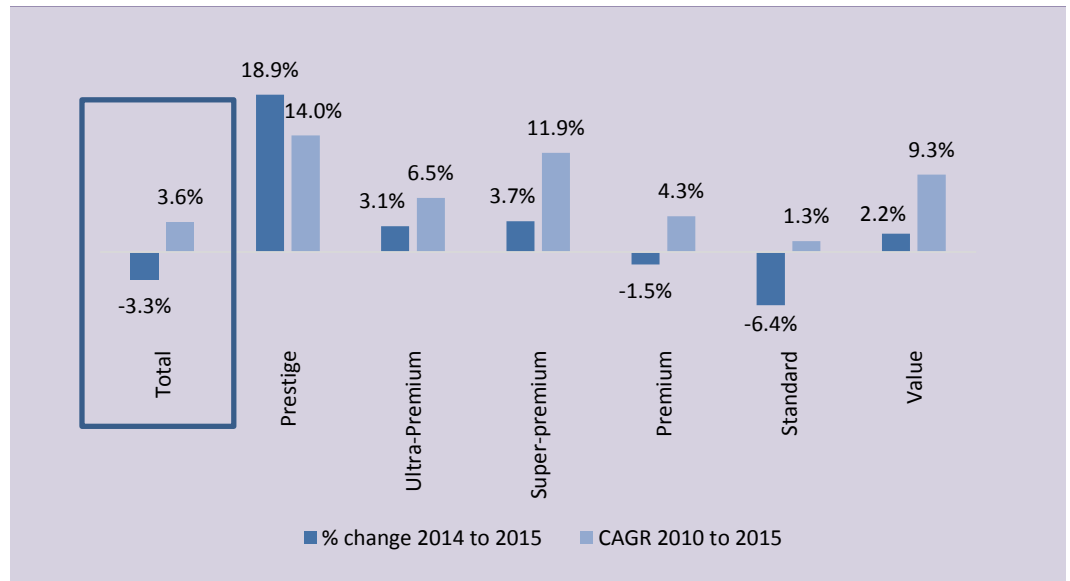
Source: IMF

Regulatory changes in the emerging countries have had a negative impact

**The emerging countries have, however, also been negatively impacted by tighter regulation.** The anti-extravagance policy implemented in China during 2012 is the most striking example of this although the situation in the country now looks set to improve. **In India, there is very heavy fiscal pressure** with taxes amounting to 3/5ths of a bottle's retail price. The GST (Goods and Service Tax) reform in theory excludes spirits but not their inputs, which could lead to margin pressure. **Several States have also banned alcohol:** Gujarat, Mizoram, Nagaland, some parts of Manipur, and the Union Territory of Lakshadweep. Bihar, the third largest State by population, joined this list in April 2016. **The trend towards outright prohibition is also very apparent in Indonesia.** In April 2015, the government banned the sale of alcohol in around 70,000 neighbourhood stores. In July of the same year, it increased by 150% taxes on imported drinks with alcohol content of between 25% and 80%. A law prohibiting the production, distribution and consumption of alcohol across the entire country is currently under review. **In Turkey, the tax increases of early 2016 should continue to disrupt the market.**

**In 2015, spirits sales in Travel Retail declined by 3.3% in volume, according to IWSR. This compares with an average annual growth rate of 3.6% between 2010 and 2015.** The channel is suffering from the decline in the number of Chinese and Russian tourists. However, the premiumization trend under way in this channel is enabling strong growth in the super premium and prestige segments (respectively +3.7% and +18.9% in 2015).

**Fig. 3: Spirits sales (in volume) in Travel Retail**

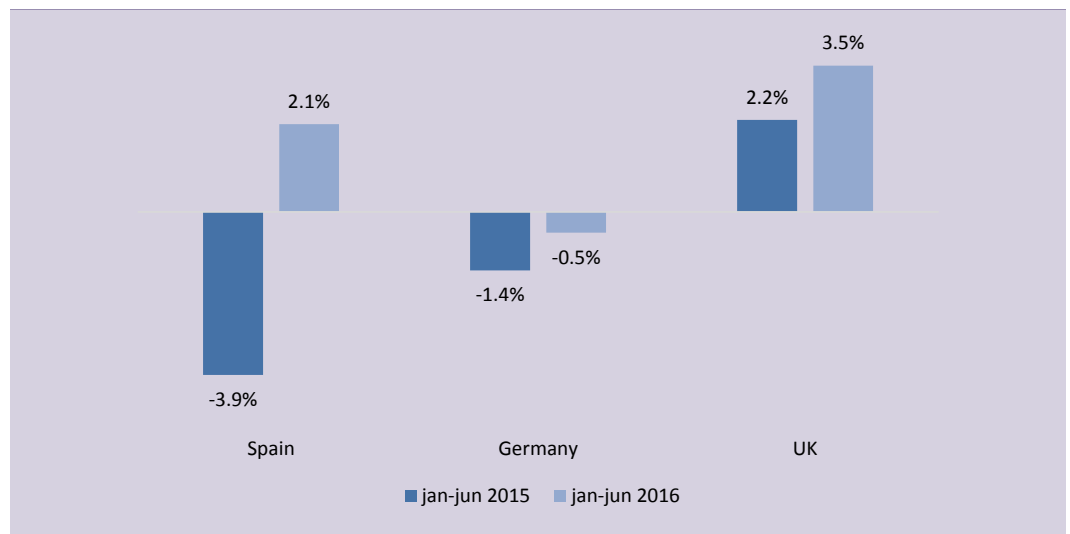


Source: IWSR

### 2.1.2. Developing countries are seeing a more robust trend

Europe is showing clear signs of a pick-up. Sector performance has improved in Western Europe over the past twelve months, and this despite the terrorist attacks and structurally negative demographic trends. This is particularly notable in Spain, the United Kingdom, and Germany. However, the significant pressure on prices from retailers is negatively impacting spirits sales in France. We are forecasting organic sales growth of 2% for the region, broadly in line with the current trends.

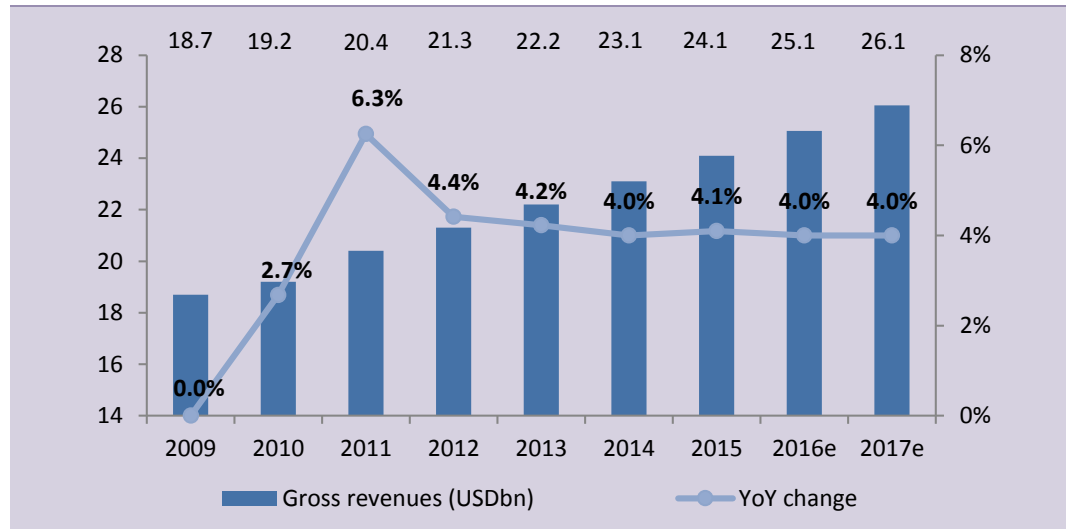
**Fig. 4: Growth of the spirits market (in volume) in the main Western European countries**



Source: Nielsen

However spirits industry growth in the developed countries is being driven, in particular, by the United States. Sales in this country are posting similar growth to the level seen in the past few years. According to data from the Distilled Spirits Council of the United States, sales grew by 4.1% in 2015, globally in line with the 10-year average of 4.2%.

**Fig. 5: Strong momentum in the US market**



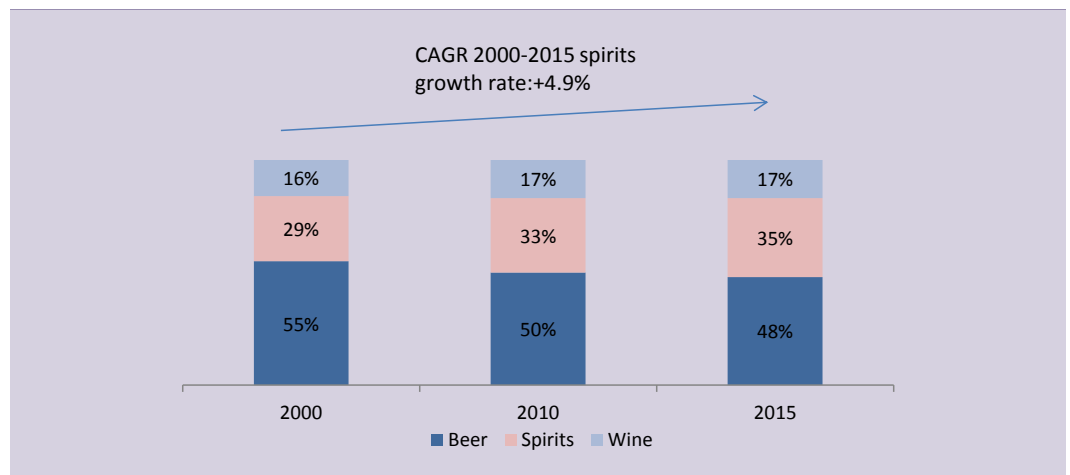
We forecast 4% growth for the US spirits market in 2016 and 2017

Source: DISCUS

A number of structural trends are driving this strong US growth:

- Favourable demographic changes.** Caucasian population growth is weaker than that of the non-Caucasian population (particularly Afro-Americans and Hispanics). While the members of the first category consume more beer, those in the second category tend to prefer spirits. In 2015, spirits thus represented 35% of the sales generated by the US alcoholic beverages market versus 33% in 2010 and 29% in 2000.

**Fig. 6: Market for alcoholic beverages in the United States: breakdown by segment (% of sales)**

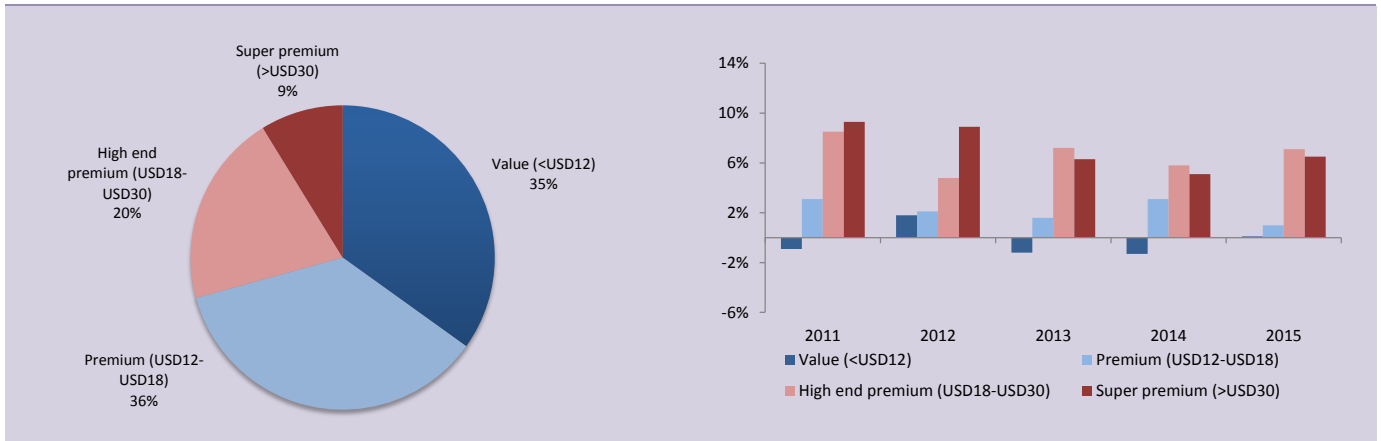


Source: Distilled Spirits Council of the United States

- **A move up market.** The US spirits market tends to be less premium than in many other world regions. It is mainly a volume market in which promotions are of primordial importance. We are, however, witnessing a premiumisation phenomenon.

**Fig. 7: Spirit volume breakdown by price segment**

**Fig. 8: Annual volume growth by price segment**



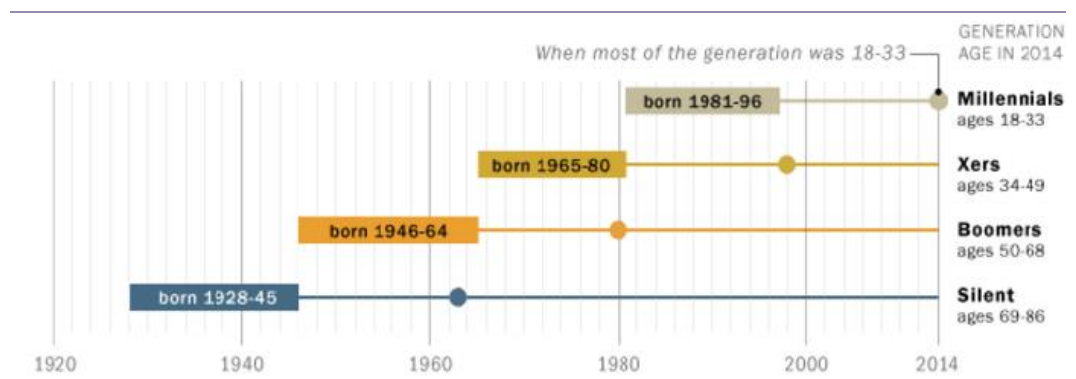
Source: Distilled Spirits Council of the United States

- **A relaxation in legislation.** A growing number of States and regions are authorising the tasting and sale of alcohol in grocery stores/on Sundays. Lobbying by the industry is also preventing any big tax increases. Since 2001, of the 402 draft laws aimed at increasing taxes, 373 ended up not being voted through.

## 2.2. The Millennial generation

The term ‘Millennials’ designates individuals born between 1980 and 2000 although other terms are frequently used like ‘Echo Boomers’ and ‘Generation Y’.

**Fig. 9: The different generations**



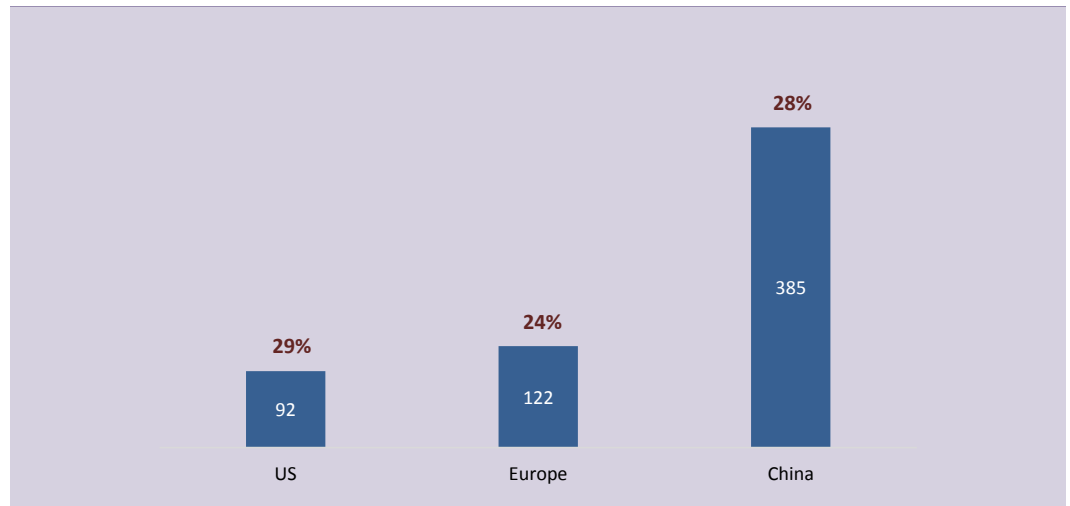
Source: Pew Research Center



The Millennials: the driving force in consumption!

The representatives of this age bracket represent the driving force in consumption, regrouping more than 385m individuals in China (c.28% of the total population), 122m in the EU (c.24%) and 92m in the United States (c.29%). Beyond this demographic influence, in 2020 this generation will represent more than one third of retail sales in the United States and 53% of Chinese domestic consumption (versus c.45% currently) according to BCG.

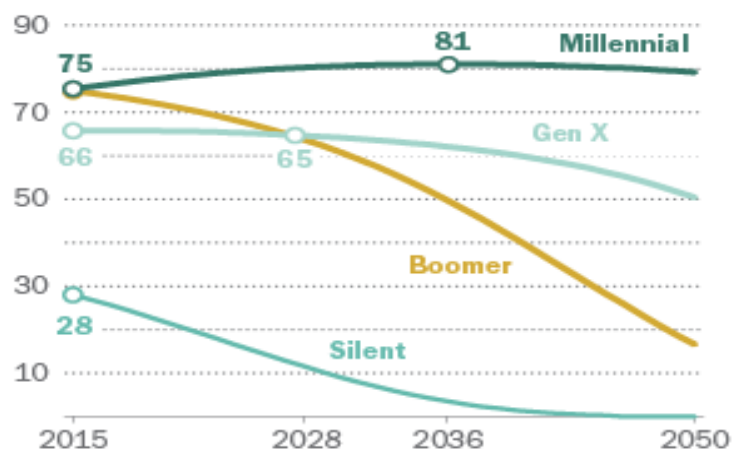
**Fig. 10: The Millennials: their number (in millions) and their percentage of the population**



Source: Pew Research Center

Their number is set to exceed that of the ‘baby-boomers’, something that is already the case in the United States.

**Fig. 11: Population by generation (in millions) in the United States**



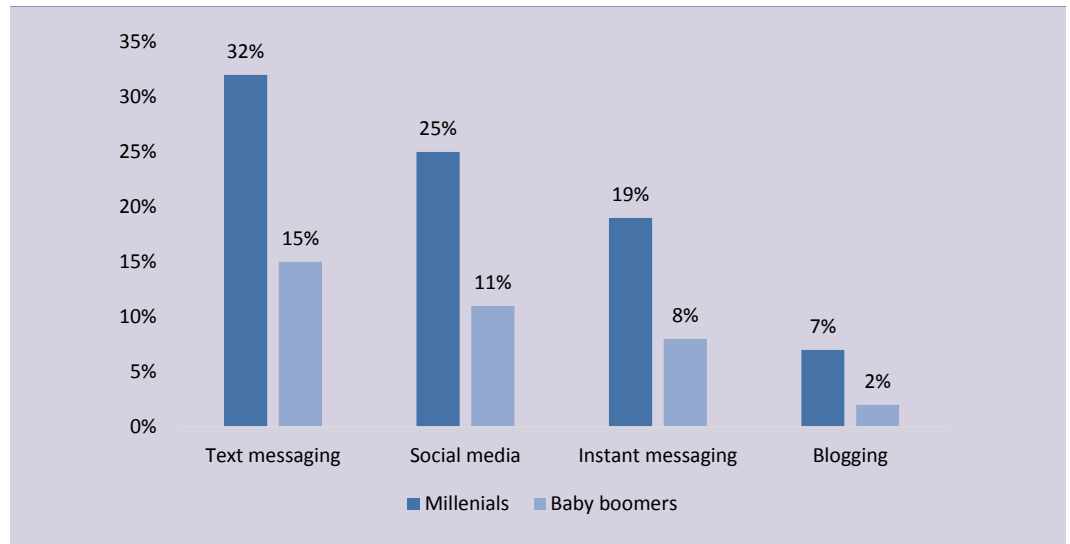
Source: Pew Research Center

It is always dangerous to attribute shared characteristics to all representatives of a single generation but experts generally agree that the members of Generation Y do have a number of points in common:

What is a Millennial?

- **They think ‘collective’.** Contrary to common belief, the members of Generation Y are far less individualistic than their Generation X elders. Millennials are thus not particularly receptive to ‘me against the world’-style advertising and more receptive to campaigns focusing on team spirit, solidarity and the idea of belonging to a community, etc.
- **They relegate work to second place.** Generation Y has never known war or dictatorship but has lived through two major economic recessions: one in the early 2000s and the second in 2008. The result is a profound awareness that work is not synonymous with security. This generation is clear in its demand for a work/life balance, involving flexible working hour, free time, remote working, etc.
- **They are tolerant.** This generation has a deep respect for minority rights. Their Generation X elders believed that they needed to work towards equality for women, homosexuals, etc., while rightly or wrongly, the Millennials see this as having been achieved. They thus lend very broad support to political reforms in this direction.
- **They make intensive use of technology.** They research the characteristics of products, their efficiency, compare their prices and buy and sell online.

**Fig. 12: The connected generation**



Source: Prosper Insight & Analytics

- **They are not very receptive to advertising.** The research shows that this generation does not appreciate advertising with explicitly commercial content but prefers a reliable, relevant supply of information. In any case, they are more sensitive to peer networks (facebook, blogs, etc.) and consult their entourage when it comes to making purchasing decisions.

By 2025 Millennials are expected to represent 50% of the buyers of wines and spirits

**Generation Y has become the major obsession for the spirits industry which is engaged in a ferocious battle to win their hearts and wallets.** No conference can take place without mentioning this generation to explain the launch of a product, a change in marketing and the success or, inversely, slowdown of a brand. **By 2025 Millennials are expected to represent 50% of the buyers of wines and spirits (Advisium Group).** David Trone, the owner of Total Wine & More, has said: *“The millennial market is extremely important. This generation is the future of our business, and they’re shaping the way consumers shop for wine.”*

But how do the tastes of Generation Y differ from those of Generation X? While brands are very important for Generation X, Millennials prioritise products with a story to tell. This is why the **notion of authenticity** has become key. Furthermore, consumption is no longer an end in itself. The spirits companies can’t afford to restrict themselves to supplying a bottle of alcohol, no matter how unusual. These days we don’t just consume a product but all that its universe can offer. **This desire for experimentation** is also expressed via the products themselves which are increasingly specifically designed to create an emotion or sensation.

### 3. Authenticity

While brands are very important for Generation X, Millennials prioritise products which have a story to tell. This is why the notion of authenticity has become key, explaining both the craft trend and the success of certain categories like whisk(e)y, cognac, Latin American spirits (tequila/mezcal) and bitters.

#### 3.1. Craft: “Small is beautiful”

**In the Western world, the global spirits industry has been rocked by the emergence of the craft trend.** The number of spirits presenting themselves as such increased by 265% between 2011 and 2015 (Mintel)! **In the 2016 first half, one in seven launches involved a craft brand whereas this figure was one in twenty in 2011.** These products respond to the demand from Millennials for more authentic products with a real story to tell. **Around three-quarters of the Americans in this generation believe that craft alcohols are higher in quality than the leading brands and are ready to pay more for these products. This percentage falls to 55% when the total population of alcohol consumers is asked the same question.** This also holds true for other countries: craft spirits are deemed to be more attractive than the leading brands by around half the consumers of alcohol in France (55%), Italy (53%), Germany (50%) and Poland (46%).

The number of craft brands increased by 265% between 2011 and 2015!

Whisk(e)y is currently the category the most concerned by this trend. In 2015, it represented 43% of the launches of craft spirits, i.e. 600bps more than in 2011. Gin is just behind (23%) but its growth is much stronger, the number of new products having doubled between 2011 and 2015.

**Fig. 13: Proportion of whisk(e)y and gin in global spirits launches**



Source: Mintel

Tito's

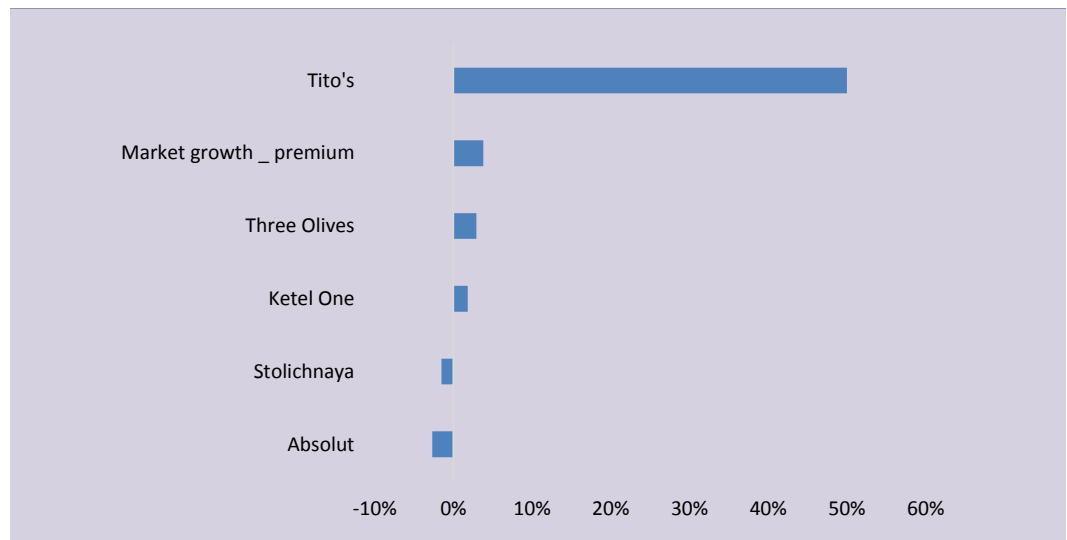


Source: Fifth Generation

The craft trend is particularly strong in the United States, representing 49% of craft spirit launches and numbering 1,280 distillers offering this type of product, a figure up by 16% relative to 2007. This growth is explained in part by the consolidated nature of the distribution system. **The other Western countries have followed.** In Australia, per-capita craft spirit consumption is now exceeding that of the United States. Local ingredients like the bush tomato and pepperberry are used in the preparations. Europe is not to be outdone, with 42% of craft spirit launches taking place in this region.

Craft distilleries are eroding the market shares of the industry majors, irrespective of whether their claims to craft status are justified. Consumer perception is all that counts. **The Tito's brand is a good example of this trend,** having posted an average annual growth rate (in volume) of 50% over the past five years while the premium vodka market (bottle price of \$15 to \$25) grew by 3.8% over the same period. Consumers have focused on the 'handmade' characteristic (clearly visible on the bottle) and have shown resolutely industrial production methods a cold shoulder.

Fig. 14: Average annual growth rate (in volume) for premium brands



Source: Impact Databank

For the big players the consequences of this new competition have been weaker volumes, a loss of pricing power and margin erosion resulting from the increase in investment. **To contend with this, they have changed their communication by showcasing the history and characteristics of their brands.** Their argument is as follows: craft is not an issue of scale but one of authenticity, a characteristic belonging to many of their brands dating back several centuries but which is hidden behind the size of the organisation. **Clan Campbell whisky is a good example.** Ten years ago, the advertising campaigns presented a rather frightening world enveloped in mystery, legends and mist, and within a highly cinematic setting. These days, the advertising puts the emphasis on the origins of the Campbell clan and human know-how.

Fig. 15: Clan Campbell advertising before...

Fig. 16: ...and now



Source: Pernod Ricard

The distilleries now play a leading role in the advertising campaigns for the industry majors. They serve as a back drop to a large number of campaigns: Jim Beam’s ‘A look inside’, Jack Daniel’s ‘Old Fashioned’, ‘Unusual’ at Hendricks Gin, etc. **In parallel, we are seeing a real ‘starification’ phenomenon for master distillers.** Brown-Forman has thus created a limited series dedicated to the seven master distillers belonging to the Jack Daniel’s brand, the first being Jack himself. This was a perfect opportunity to revisit the history of its iconic brand. For its part, Pernod Ricard has launched The Master Distiller’s Reserve limited edition which is dedicated to the master distiller of The Glenlivet. Lastly, Campari has created Russell’s Reserve in honour of the Russell family which gave two master distillers (Jimmie and his son Eddie) to Wild Turkey, a bourbon acquired by the Italian company from Pernod Ricard in 2009. They have even been on a tour of the brand’s key markets, the United States and Australia.

Fig. 17: Master distillers take pride of place in the limited editions



Source: Brown-Forman, Pernod Ricard, Campari



In addition to communication efforts, the industry majors are coming up with variations of their existing brands which are more adapted to the desires of the Millennial generation, irrespective of whether or not these are limited editions. Pernod Ricard has thus created Absolut Elyx which is presented as 'handcrafted' and whose price is double that of Absolut Blue, while Diageo has launched Blender's Batch, a craft version of Johnnie Walker.

**Fig. 18: Absolut Elyx**



**Fig. 19: Johnnie Walker Blender's Batch**



Source: Pernod Ricard, Diageo

The creation of a craft brand from scratch by an industry major is also an option. For the first time in twenty years, Brown-Forman has thus launched a new bourbon, whose name - Coopers' Craft – leaves little doubt as to the US giant's intention of capitalising on the success of craft brands. Pernod Ricard is behind the Our Vodka initiative which is in part distilled, assembled and bottled by hand in microdistilleries located in cities worldwide (Berlin, London, Detroit, Amsterdam, etc). In general they are managed by local entrepreneurs who distribute their production outside the traditional channels. Although the recipes are the same, the ingredients are produced locally in so far as this is possible.

**Fig. 20: New bourbon from Brown-Forman**



**Fig. 21: Our Vodka from Pernod Ricard**



Source: Brown-Forman, Pernod Ricard

Please see the section headed "Important information" on the back page of this report.

Monkey 47 gin, acquired by Pernod Ricard



Source: Pernod Ricard

**The big players may also opt to acquire a craft brand.** One of the first transactions was the 2010 purchase by William Grant & Sons of the craft brand Hudson Whiskey, created by the Tuthilltown Spirits distillery. Note also the acquisition of Angel’s Envy bourbon by Bacardi in 2015, that of Monkey 47 gin by Pernod Ricard, of High West Distillery by Constellation and of the Domaine des Hautes Glaces by Rémy Cointreau in 2016. **Venture capital funds have also been established.** In 2013, Diageo set up Distill Ventures which has subsequently invested in some ten companies. Constellation Ventures was used by the Constellation group to acquire minority shareholdings in Craffhouse Cocktails (Chicago) and Nelson’s Green Brier Distillery (Tennessee). **There is, however, a risk of consumers feeling duped.** The dilemma is insoluble: consumers assimilate authenticity and the locality, and the craft brands also present themselves as local, explaining why their names are often derived from a specific place: the City of London Gin Distillery, Brighton Gin, etc. However, for a company to grow it needs to generate international sales, an imperative that the brewers and distillers of the Middle Ages did not have. Legal proceedings have thus been filed against Maker’s Mark and Tito’s, etc.

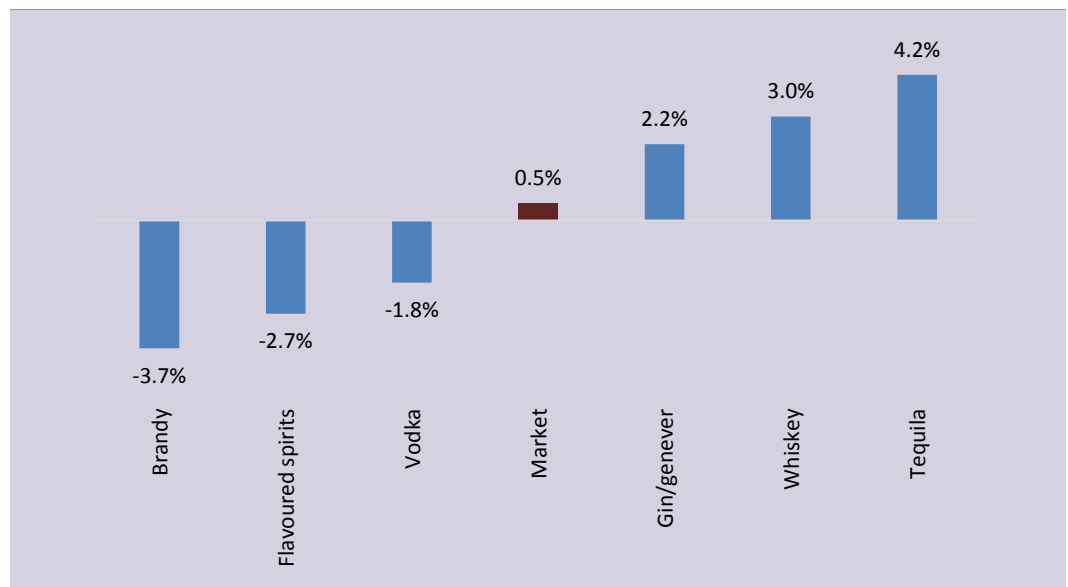
### 3.2. Fashionable categories

The Millennials’ quest for authenticity has enabled the emergence of the craft trend but also led to changes in the growth dynamic between categories and a specific appetite for brown alcohols (whisk(e)ys and cognac) and niche categories like tequila/mezcal and bitters.

#### 3.2.1. Whisk(e)ys

In 2015, whisk(e)y proved to be one of the most dynamic categories with volumes growing by 3% in a market up by 0.5% (IWSR). **It is expected to post an average annual growth rate (in volume) of 4% over the next five years while worldwide spirits sales are expected to grow by 0.5%.**

Fig. 22: Growth by category of spirits (in volume), 2015



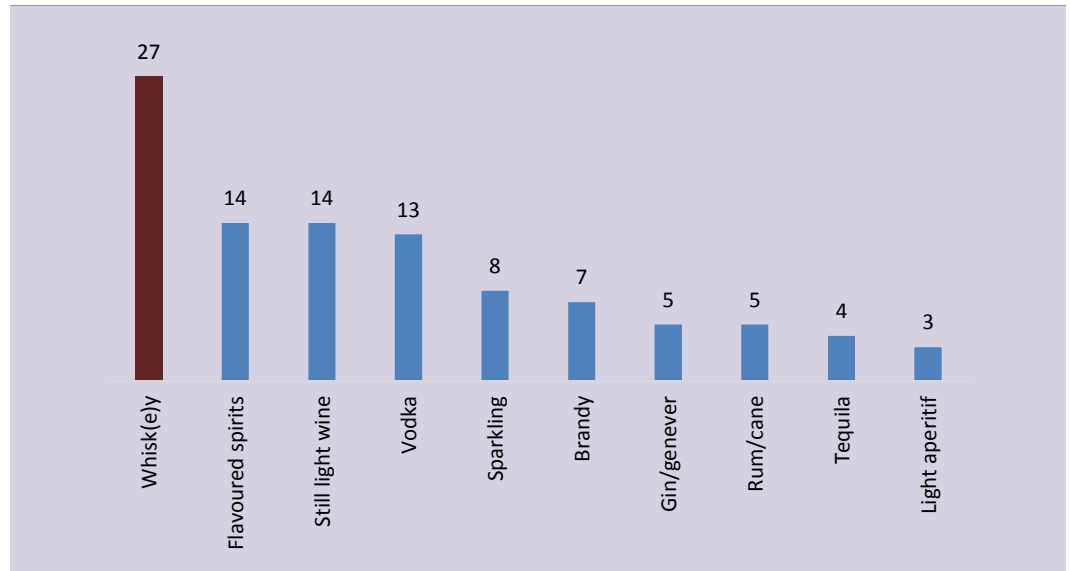
Source: IWSR

Whisk(e)y is one of the most dynamic spirits categories



Whisk(e)y is thus the category the most represented in the IWSR ranking of the 100 most powerful alcoholic beverages brands, with 27 brands.

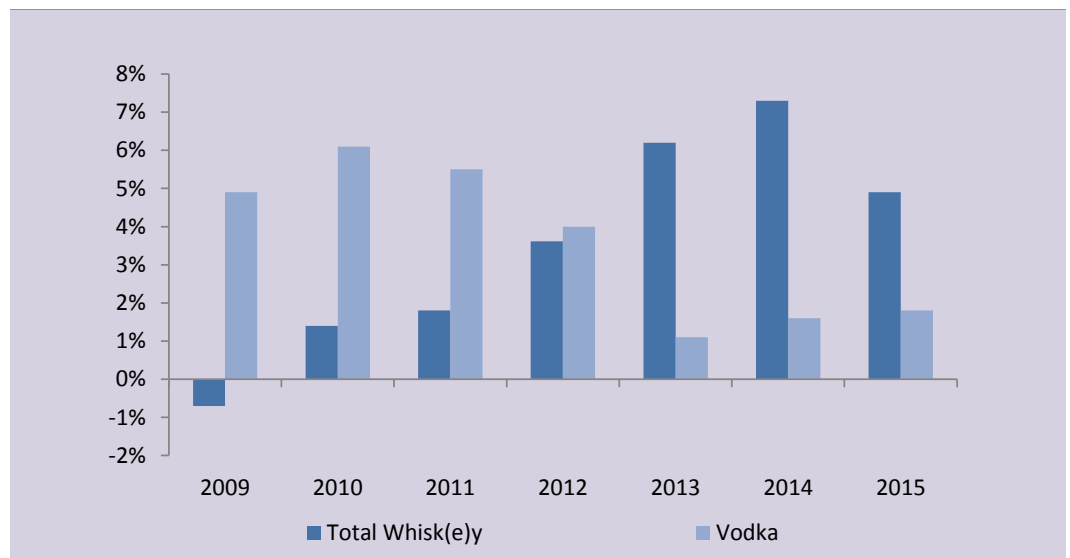
**Fig. 23: 100 most powerful alcoholic beverage brands by category**



Source: IWSR

The trend is particularly marked in the United States. After years of vodka domination, consumers are showing renewed interest in whisk(e)ys. In 2015, their growth rates (in volume) reached 4.9% whereas vodka posted only a 1.8% increase.

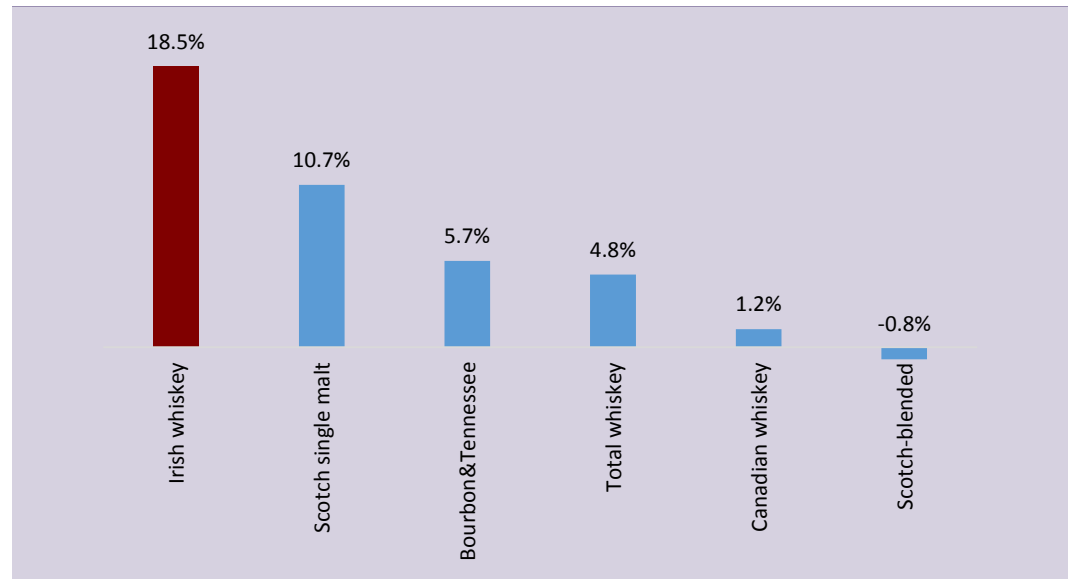
**Fig. 24: Whisk(e)ys/vodka: volume growth rate**



Source: DISCUS

All the varieties are seeing rapid growth but note, however, the outperformance from Irish whiskey, single-malt Scotch whisky and bourbon/tennessee.

**Fig. 25: Average volume growth over the last five years for the different whisk(e)y varieties, United States**



Source: DISCUS

**This whisk(e)y renaissance is mainly explained by a generational shift.** As previously mentioned, Generation Y is more sensitive to the notion of heritage and is thus very interested in authenticity, a quality easily attributed to whisk(e)ys for obvious reasons:

- The rules governing manufacturing are strict and are variety dependent (bourbon, Scotch, etc.)
- Ageing is required
- The packaging on most whisk(e)y brands has remained unchanged for decades and these brands have a story that is easily showcased by visits to fast-growing distilleries.

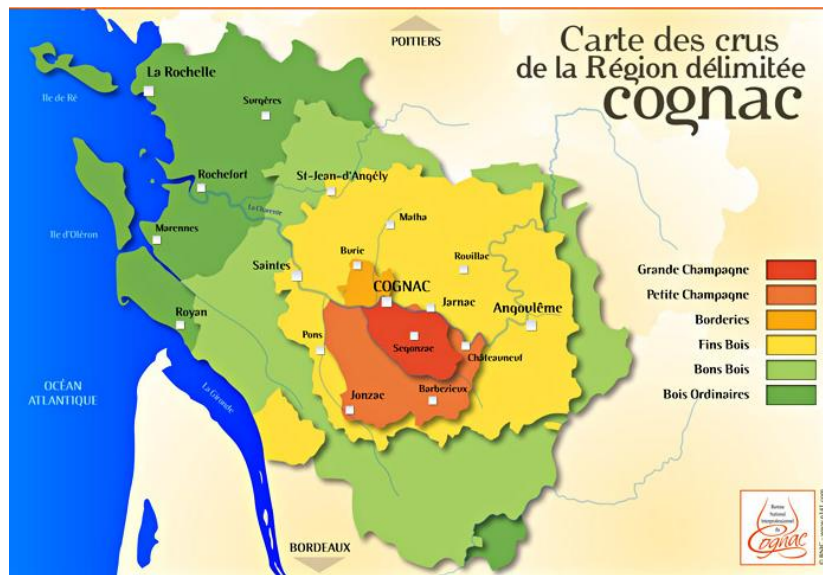
**Inversely, vodka does not correspond to the expectations of this generation.** It does not require ageing and has low barriers to entry resulting in an abundant offer. Very often it has no taste. The proliferation in aromatised versions has succeeded in convincing Generation Y that vodka is no more than a mass market product, hence the backpedaling by companies who are pruning their aromatised beverages portfolios.

Millennials appreciate the strict production rules for whisk(e)y and cognac

### 3.2.2. Cognac

In the past, cognac was largely dependent on just one market: Japan during the 1990s and China during the 2000s. Today it enjoys significant support from Generation Y members in the developed countries who value its authenticity. Let's not forget that cognac, as an *appellation d'origine contrôlée*, benefits from controlled origin status. The harvests take place in a territory limited to around 75,000 hectares, across the Charente-Maritime, a large part of the Charente region and a few communes in the Dordogne and Deux-Sèvres regions. The distillation takes place in two stages and the resulting 70-proof eau-de-vie can then only be stored in oak casks. There are also legal norms relating to the age of eaux-de-vie. A VS is thus a cognac for which the youngest eau-de-vie used in its assembly must be at least two years old (VSOP: minimum of four years and XO: minimum of six ans). Lastly, the product quality varies depending on the origin of the grapes. The vineyards in the Grande and Petite Champagne regions (around Segonzac, Jonzac and Barbezieux) produce higher quality eaux-de-vie.

Fig. 26: Map of the vintages



Source: BNIC

1738

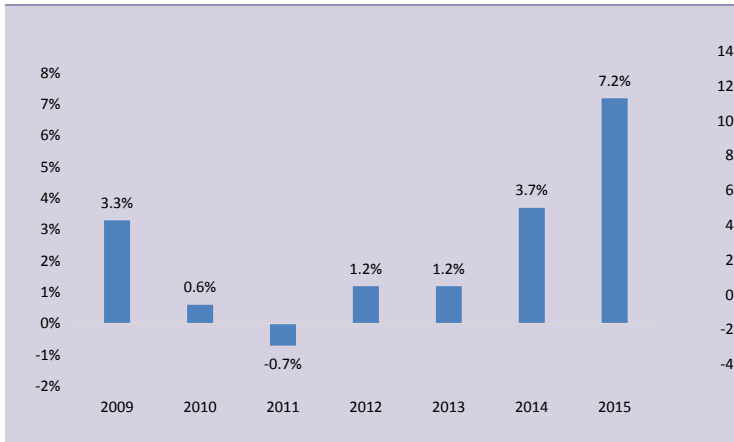


Source: Rémy Cointreau

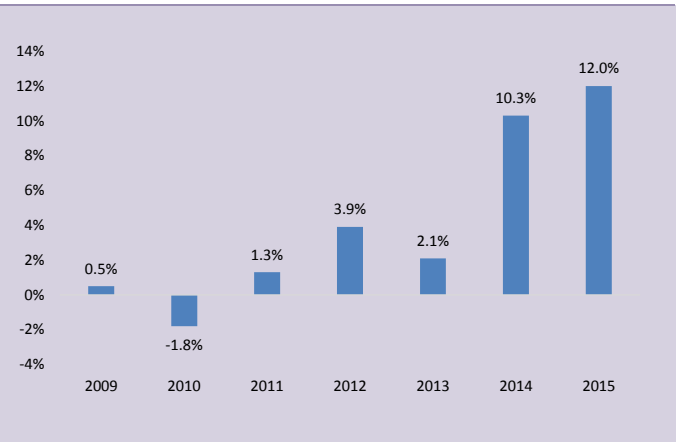
**The very scarcity of cognac is an additional guarantor of its authenticity.** The barriers to entry are high in view of the heavy investment required. Cognac is an oligopolistic industry in which four brands share around 80% of the market (84% of sales and 78% of volumes): Rémy Martin (Rémy Cointreau), Martell (Pernod Ricard), Courvoisier (Beam Suntory) and Hennessy (LVMH).

**Cognac is experiencing significant success in the United States.** Previously consumed by Afro-Americans who were looking for a drink to differentiate them from the WASPs, it is now popular with a wide range of consumers. In 2015, category volumes increased by 7.2%. The market remains mostly dominated by VS but the superior categories (and particularly VSOP) are growing as seen in the success of Rémy Cointreau's 1738 product whose sales increased by 50% in 2015/16.

**Fig. 27: Growth in cognac market volumes in the United States**



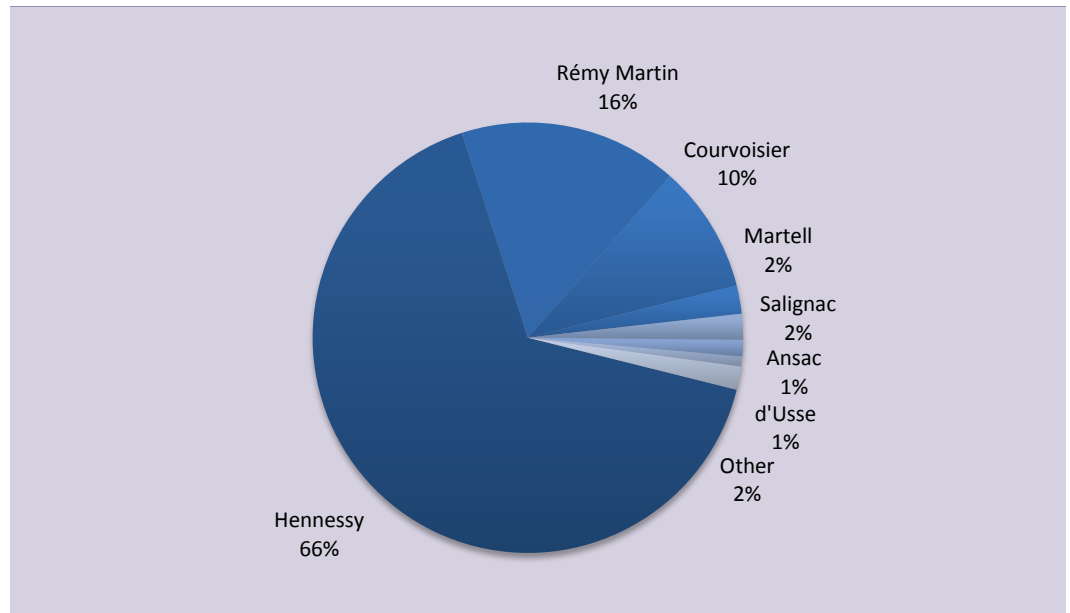
**Fig. 28: Growth in cognac market value in the United States**



Source: DISCUS

With a 66% market share in volume terms, Hennessy is the very clear leader, followed by Rémy Martin (market share: 16%). The success of the category has encouraged a number of players to reinforce their exposure to the United States. This is notably the case for Pernod Ricard whose Martell brand only generates 3% of its sales in the country currently. The category as a whole should benefit from this increase in investment. At present, it is still at an embryonic stage and merchandising efforts will need to be made.

**Fig. 29: Market shares in volume for the different cognac players, United States**

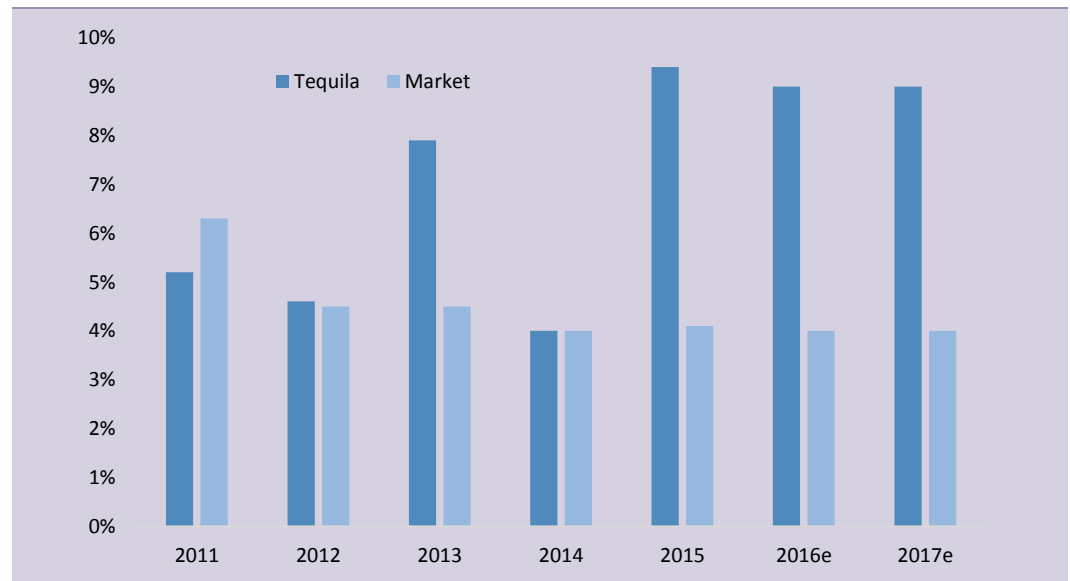


Source: Impact Databank

### 3.2.3. Smells like Latin Spirits

**The success of tequila is driven by the Millennials' appetite for authenticity.** To benefit from the 'tequila' appellation, the eau-de-vie must be produced in a designated geographical area: the state of Jalisco and some neighbouring territories (municipalities of the States of Nayarit, Michoacán, Guanajuato and Tamaulipas, etc.). **The United States is the leading consumer country for tequila in the world ahead of Mexico, posting average annual growth of 9.4% in 2015,** above the average for the past five years (+6.2%). We are forecasting an average annual US growth rate of 9% over the next two years. In the medium term, the Chinese market has significant potential in that the authorities only lifted the ban on varieties 100% produced from agave in 2013.

**Fig. 30: United States: growth in tequila sales relative to the spirits market**



Source: DISCUS, Bryan, Garnier & Co

**The spirits companies have made acquisitions to correct their under-exposure to tequila.** These were particularly numerous during 2014. Constellation purchased Casa Noble and Pernod Ricard acquired a majority shareholding in Avion. Diageo has, however, been the most active, acquiring Peligroso, DeLeon and the remaining 50% in Don Julio, its JV with José Cuervo.

**Mezcal has recently seen renewed interest from consumers. It is deemed to be more authentic than tequila** since the plants are harvested from nature rather than farmed and natural fermentation techniques are used. Rumours suggesting that Pernod has plans to create an in-house brand thus come as no surprise. Within the framework of its strategy to move up market, Rémy Cointreau could resort to acquisitions and mezcal has already been mentioned by the company as a potential target.

Aperol Spritz



Source: Campari

### 3.2.4. Bitters

**Bitters are enjoying a real revival. They have been served as pre and post-dinner drinks and tonics for centuries but many Millennials are discovering them for the first time. Aperol is proving a runaway success.** Its bitter taste is less pronounced and its low alcohol content makes it attractive to young people and women in particular. Volumes increased by 9% in 2015, significantly outperforming the competitor brands, Fernet Branca, Campari and Jagermeister having posted respective volume increases of 3%, 2% and 1% over the year. The performances in France, the United Kingdom, Spain and the United States have been particularly impressive thanks to Aperol Spritz. This cocktail, which traditionally comprises Aperol mixed with sparkling wine and water, has been consumed since the 1920s but only in the Veneto region. Campari began by rolling it out in trendy bars in capital cities before investing in the provinces and second-rank establishments. The product offer is being increased under the effect of the success of the category. Martini has thus relaunched a bitter dating back to the brand’s origins but which had been neglected: Martini Bitter. For its part, Pernod Ricard has developed Essence of Cuba, whose bitterness is supposed to enhance the flavours of Havana Club rum, and Jameson Bitters, a blend of Jameson and a bitters mix of vermouth, gentian and ginseng.

**Fig. 31: The leading bitters and their growth**

Brand	Owner	2011	2012	2013	2014	2015	% 2014-15
Jagermeister	Mast-Jagermeister	6.8	6.9	7.2	6.8	6.9	1%
Fernet Branca	Fratelli Branca Distillerie	3.5	4.2	5	5.2	5.3	3%
Campari	Campari	2.8	2.9	3	3.1	3.2	2%
Aperol	Campari	2.6	2.6	2.6	2.7	3.0	9%

Source: Drinks International

**The current appetite for the bitters category goes hand in hand with the fashion for classical cocktails.** The quest for authenticity, also known as the Mad Men effect (the eponymous TV series), has resulted in the rediscovery of these cocktails. They give star billing to bitters, a category which was negatively impacted by the introduction of Prohibition. Campari is thus an ingredient in the Negroni and Americano cocktails while Angostura is used to make the Old Fashioned and Manhattan, etc.

**This popularity has also resulted in renewed interest in vintage brands.** The example of the success in France of old-style aperitifs is emblematic. The latter enjoyed their finest hour before being mostly ousted by whisk(e)y as the post-war years unfolded, and then by beer and wine. The Suze brand (gentian based) is thus beginning to see a revival with owner Pernod Ricard looking to take advantage of the success of Aperol Spritz by launching its own Suze-based version. Somewhat surprisingly, Byrrh, a wine and quinine-based alcohol that was very popular during the 1950s, is also seeing a resurgence. In September 2016, Pernod Ricard created a department responsible for breathing new life into old-style aperitifs in France. Markets also exist outside France, particularly in Japan and the United States. The acquisition of Grand Marnier by Campari is partly the result of this return to favour for traditional spirits, the Italian company having been attracted by the heritage of the brand and its iconic status.

Please see the section headed “Important information” on the back page of this report.

**Fig. 32: Suze**



**Fig. 33: Byrrh**



Source: Pernod Ricard

## 4. Experimentation

According to Mr Mauricio Vergara, Chief Marketing Director for Bacardi North America, *‘Millennials are not about acquiring products, but about acquiring experiences’*. The quest for experiences is the main driver for this new generation, meaning that consumption is no longer an end in itself. Beyond the pleasure coming from the purchasing act, a new form of satisfaction is attracting consumers; they are seeking a different kind of pleasure which comes from experiences and powerful sensations.

### 4.1. New consumer experiences

The spirits groups cannot afford to restrict themselves to supplying a bottle of alcohol, no matter how unusual. We are no longer just consuming a product but all that its universe can offer. There are numerous manifestations of this: marketing changes, emergence of mixology, importance of the new technologies, ethical considerations, etc.

#### 4.1.1. More ‘adventurous’ marketing

The members of Generation Y are not particularly sensitive to traditional marketing techniques: they reject advertising with explicitly commercial content. Companies are thus going to have to compete on ingenuity to create a connection with consumers. The adjustments in their marketing campaigns result from an emerging awareness of the importance of experience for the Millennials.

**Advertising campaigns have been refocused around the idea of adventure.** For example, Bacardi’s ‘Fly Beyond’ TV spot for its Grey Goose vodka has a group of friends embarking on a voyage in a dirigible during which they watch a black and white film projected onto the clouds while drinking a Grand Fizz, a cocktail based on Grey Goose vodka.

**Fig. 34: Bacardi’s Fly Beyond TV campaign**

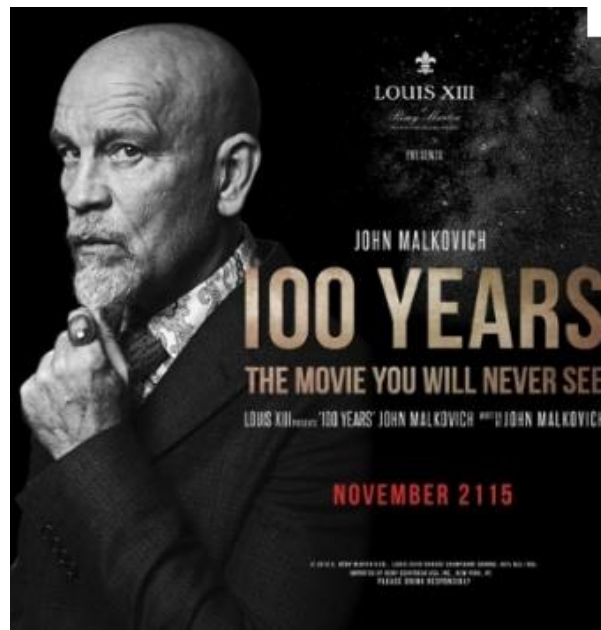


Source: Bacardi



**Innovative advertising channels are also used**, with the film created by Rémy Cointreau with the support of John Malkovich and entitled ‘100 Years, The Movie You Will Never See’ the most telling example. It has been locked in a vault which is supposed to open automatically on 18 November 2115. Potential customers have received invitations to the film premiere which are intended for their descendants. The hundred years evoke the age of the eaux-de-vie contained in a bottle of Louis XIII, the group’s iconic product. Mr Ludovic de Plessis, CEO for the brand, has made no secret of his determination to target the Millennials: *“It is a way to talk to millennials by not giving them instant gratification. It provokes their imagination. With Google, you can find everything. We are forcing them to stop everything and think.”*

**Fig. 35: 100 Years, The Movie You Will Never See**



Source: Rémy Cointreau

**The brands also create events to give their consumers a unique experience.** Bacardi has installed pop-up beach bars in around twenty global locations (Ibiza, The Hamptons, etc.). Grey Goose-branded canapé and cocktail pairings (particularly Le Grand Fizz) have been offered during brunches and dinners. For its part, Rémy Cointreau was behind the Cointreau Fizz Summer Tour: a mobile bar touring the terrasses of a number of French cities and inviting customers to create their own Cointreau Fizz.

**Fig. 36: Cointreau Fizz Summer Tour in France**



Source: Rémy Cointreau

Another solution is to **create consumer networks** to give Millennials detailed information concerning the brand while satisfying their desire for experience. For example, the Patron brand has created the Patron Social Club giving members access to events (dinners, etc.), promotions and exclusive information.

**Fig. 37: The Social Club for the Patron tequila brand**



Source: Patron

#### 4.1.2. The emergence of mixology

**High-end cocktail bars are flourishing in cities across the world.** In under a year, some thirty or so bars have been opened in Paris. These did not exist before the opening of the Experimental Cocktail Club in 2007. In China, 800 cocktail bars have been opened in the past two years. **In parallel, we are witnessing a higher standard of professionalism for the barrista profession who are now frequently called mixologists.** This represents a return to the artistic vocation previously incumbent on the profession by developing ever-more elaborate cocktails. **The cocktails are made following the long-established recipes as closely as possible and follow the mixing instructions and techniques very precisely, modelled on those used during the pre-Prohibition golden age of cocktails in the United States.** The phenomenon is above all generational: Millennials are the principal cocktail enthusiasts. Having been somewhat wrongfooted initially, the industry majors are now stepping up their initiatives. Pernod Ricard is thus enjoying significant success with the *World's Best Bars*. This internet site dedicated to cocktails lists the best bars in the world and posts recipes and video tutorials. The tequila brands of the French company Olmea and Altos offer a tool box enabling consumers to make their own cocktails.

Please see the section headed "Important information" on the back page of this report.

**Fig. 38: The Olmeca and Altos tool box**



Source: Pernod Ricard

For its part, Rémy Cointreau is behind the 1806 Collective, a group of high level professional barristas from across the globe. An exclusive internet site is put at their disposal while they also have access to tutorials and participate in themed trips (e.g. to the island of Islay).

### 4.1.3. Role of the new technologies

The new technologies enable the industry players to satisfy the performance dimension sought by consumers. Connected bottles are proliferating. Rémy Cointreau has created a connected bottle capable of detecting when the cognac is first opened with the aid of a sensor, thereby confirming for the consumer that it is not a counterfeit. Telephone scanning Malibu connected bottles gives access to music playlists, recipes and bar addresses.

**Fig. 39: The Club connected bottle**



**Fig. 40: The Malibu connected bottle**



Source: Rémy Cointreau, Pernod Ricard

**Other initiatives are emerging.** Within the framework of the Absolut Elektrik launch, Pernod Ricard created Elektrik House where guests can taste cocktails prepared by drones. In Korea, the company has set up a system in which points are earned by sharing cocktails, signing up for mixology classes and participating in an evening event. They then confer the right to special benefits like free drinks, invitations to exclusive evening events and Absolut birthday presents.

#### 4.1.4. Ethical considerations

The Millennial generation is more socially responsible than its predecessor. Their choices are oriented towards brands offering a higher purpose than just consumption. Most are prepared to spend more for socially responsible products.

**Fig. 41: % of individuals who say they would spend more on socially responsible products**



Source: Nielsen 2014 (United States)

Conscious of this state of affairs and looking to capture the attention of Generation Y, Pernod Ricard has launched a new rum brand called ‘Rituals’ in Spain. On purchasing a bottle, consumers are offered the opportunity to share the value created by reinvesting this in a cause dear to their hearts. To this end, they are invited to visit an interactive financing website (ronfunding.com), or a website supporting projects developed by Millennials and having a positive impact on society. For its part, Campari has organised Negroni Week to raise funding for local causes chosen by the group’s partners worldwide.

**Fig. 42: Negroni Week**



Source: Campari

Please see the section headed “Important information” on the back page of this report.

## 4.2. New products

However, sensory exploration is also integral to the product itself, which has been specifically designed to create an emotion or a sensation. The implications are numerous: success of aromatised spirits, abolition of frontiers between categories and quest for 'healthy' spirits.

Fireball



Source: Sazerac

### 4.2.1. Aromatised spirits

Millennials value originality and are thus demonstrating a high level of interest in aromatised spirits. They would even be ready to spend 10% more for original flavours which arouse their curiosity (Nielsen). Fourteen aromatised spirits thus figure in the 2015 IWSR ranking of the 100 most powerful alcoholic beverage brands. Aromatised whisk(e)ys are particularly in demand meaning, specifically, bourbon/tennessee/rye like Jack Daniel's, Jim Beam, Evan Williams and Wild Turkey although Canadian whiskeys (Crown Royal and Black Velvet) are also posting very robust performances.

As is almost always the case, the United States is leading the way, with aromatised whisk(e)y volumes having grown by 28% in 2015 (Impact Databank). The market is still largely dominated by Sazerac's Fireball. This cinnamon-aromatised whiskey saw volumes increase by 11% last year and its size has been multiplied ten-fold in five years. Less than two years after its launch, Crown Royal Regal Apple (Diageo) ranks number two amongst the best sellers. But the most impressive success story has probably been that of Jim Beam Apple which reached 140,000 cases a few months after its 2015 launch. Growth relays for aromatised whisk(e)ys exist outside the United States, notably in the United Kingdom, Japan, France and Australia, markets which have hitherto been underinvested.

Fig. 43: The leading aromatised whiskeys in the United States

Brand	Company	2014	2015	% change
Fireball	Sazerac	3940	4375	11%
Crown Royal Regal Apple	Diageo	100	850	750%
Jack Daniel's Tennessee Honey	Brown-Forman	670	679	1%
Jack Daniel's Tennessee Fire	Brown-Forman	77	406	427%
Wild Turkey American Honey	Campari	341	349	2%
Red Stag	Beam Suntory	365	345	-6%
Total leading brands		5493	7004	28%

Source: Impact Databank

Surprising as this may seem, cannabis-aromatised spirits have real potential. The number of products arriving on the US market has grown exponentially in recent years, amongst them Humboldt's Finest from California's Humboldt Distillery and Shotka from MBWS. Currently they don't contain THC, the main psychotropic substance in cannabis but the legislation is changing rapidly, such that the beverage industry is currently exploring the possibility of offering narcotic spirits in the next few years. After only a few years in existence, the legal cannabis market in the US is the same size as that of the cider and ready-to-drink markets combined. To date, 29 US States have legalised marijuana for both recreational and medical purposes.



Fig. 44: Shotka



Fig. 45: Humboldt's Finest

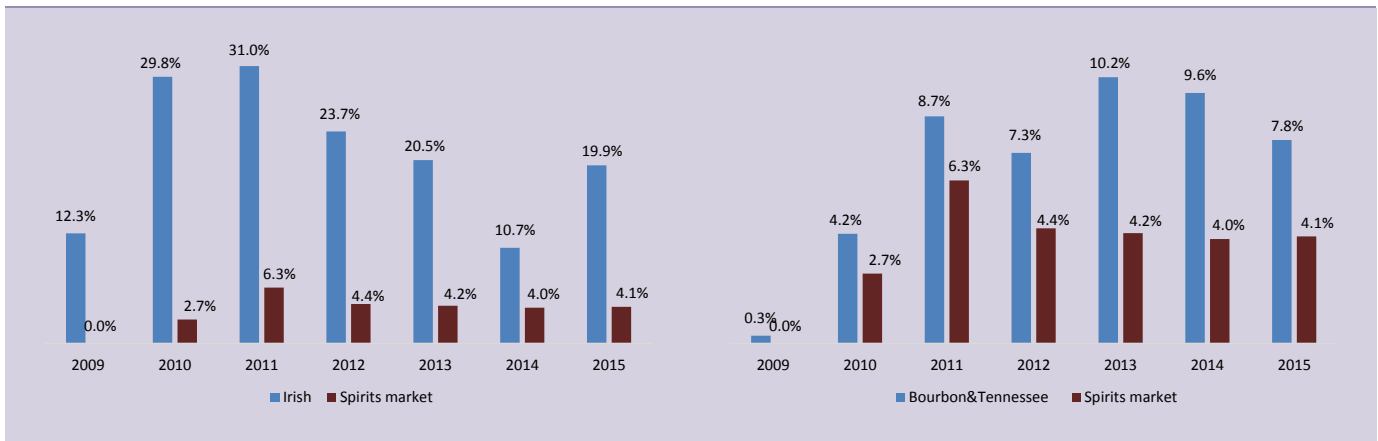


Source: MBWS, California's Humboldt Distillery

This taste for flavours explains the success of whiskey categories that are easily mixable like Irish whiskey and bourbon/tennessee/rye. In 2015, they grew by a respective 19.9% and 7.8% in the United States, very significantly outperforming the broader spirits market (+4%).

Fig. 1: Growth in Irish whiskey market value in the US

Fig. 2: Growth in bourbon/tennessee market value in the US



Source: DISCUS

### 4.2.2. Blurred lines

The frontiers between alcoholic beverages are currently being eroded at the instigation of a Millennial generation in search of new experiences. In the past, there were very few hybrid products. One of the first in the category, Desperado, a tequila-infused light ale, dates back more than 20 years but, until recently, was only sold in a few countries. These days, these original combinations are legion.

Cider/spirits and beer/spirits mixes are particularly popular, being respectively known as spiders (spirit ciders) and speers (spirit beers). Heineken has thus launched Blind Pig, a spirit-infused cider (bourbon, rum, etc.) while the C&C group has created a cider (Magners) and Irish whiskey blend. In the speers space, the Innis & Gin craft beers stand out, their spirits flavours (bourbon, rum and malt whisky) coming from the casks in which they are stored. But the industry majors are not to be outdone. Confronted with the craft success, they see speers as a way to capture the attention of the Millennial generation, the success of this type of product depending, in particular,

Please see the section headed "Important information" on the back page of this report.

on effective marketing. AB InBev has launched Cubanisto (a rum-aromatised beer) and Pernod Ricard is behind Malibu Beer (coconut-rum aromatised beer).

**Fig. 3: ABI's Cubanisto**



**Fig. 4: Pernod Ricard's Malibu Beer**



Source: AB InBev, Pernod Ricard

**Blends of wines and spirits or several spirits are also an option.** For example, Pernod Ricard has created Absolut Tune, an innovative combination of Absolut and sparkling white wine in a champagne bottle. The French company is also behind Malibu Red, a combination of Malibu and tequila and, more recently, Blue Swift, a cognac finished in bourbon casks.

**Fig. 5: Hybrid spirits**

Absolut Tune



Malibu Red



Blue Swift



Source: Pernod Ricard

### 4.2.3. Healthier products

In the food and beverage market, the concept of 'healthy hedonism' has taken off in recent years, i.e. enjoying life while remaining in good health, consuming but doing so in a better way with a degree of moderation. Brands are thus emerging which seek to surf this trend.

- Use of natural ingredients

Pernod Ricard has thus developed Fine Cocktails, a range of ready-to-drink cocktails based on natural ingredients. The bottle is stored in the refrigerator and has a drink-by date. For its part, the Diageo group offers a gluten-free version of its Smirnoff vodka, aromatised with natural fruit juices.

**Fig. 6: Pernod Ricard's Fine Cocktails**



**Fig. 7: Diageo's Smirnoff Sourced**



Source: Pernod Ricard, Diageo

- Low in calories

In the past few years, Beam Suntory has been very successful with its Skinnygirl brand which offers wines and cocktails which are low in calories. For its part, Pernod Ricard has launched Malibu Island Spiced, a spiced rum containing the sweetener Truvia, and very clearly targeting female customers.

**Fig. 8: Beam Suntory's Skinnygirl**



**Fig. 9: Pernod Ricard's Malibu Island Spiced**



Source: Beam Suntory, Pernod Ricard

- Low in alcohol

The anti-alcohol rhetoric is gaining traction: revisions to health standards and guidelines, punitive taxation, bans on advertising. Alcohol consumption, whether it be occasional (once a month) or excessive (binge drinking), is declining. The reduction in alcohol content and the expansion of non-alcoholic beverage portfolios constitutes the industry's first line of defence. Distill Ventures, the venture capital company set up by the Diageo group, recently invested in Seedlip, a non-alcoholic spirit intended to be drunk on its own or as part of a cocktail. Pernod Ricard has developed an alcohol-free version of Jacob's Creek, Jacob's Creek UnVINED, which is currently only available on the Swedish market.

Seedlip



Source: Diageo



## 5. Rémy Cointreau: the best positioned

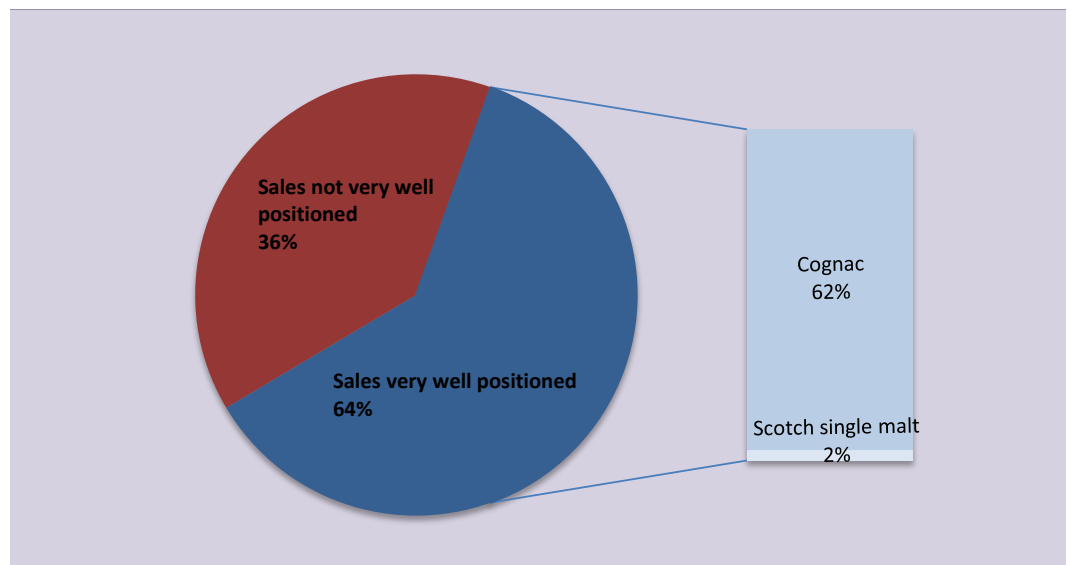
Rémy Cointreau generates 64% of its sales in categories in phase with the Millennial generation (5.1), i.e. mainly cognac (62% of sales) but also, to a lesser extent, single-malt scotch (2%). The Campari portfolio, with its high proportion of bitters and bourbon, is also attractive (5.2). We calculate that 39% of the Italian company's sales are generated in products that are popular with Generation Y. In the case of diversified companies like Pernod Ricard (5.3) and Diageo (5.4), this percentage falls to a respective 21% and 11%. Lastly, we estimate that only 3% of MBWS sales are aligned with Generation Y tastes (5.5), the company not being very present in countries where this population group is the most prevalent (China, United States, etc.).

### 5.1. Rémy Cointreau: 64% of sales

According to our estimates, 64% of Rémy Cointreau's sales are aligned with the tastes of the Millennial generation, i.e. cognac (62% of sales) but also, to a lesser extent, single-malt scotch (2%). The company's other categories remain interesting and some are posting good performances but the attraction they have for Generation Y is less obvious in our view.

Rémy Cointreau: the best positioned to contend with Generation Y

**Fig. 10: The Rémy Cointreau portfolio (% of group sales)**

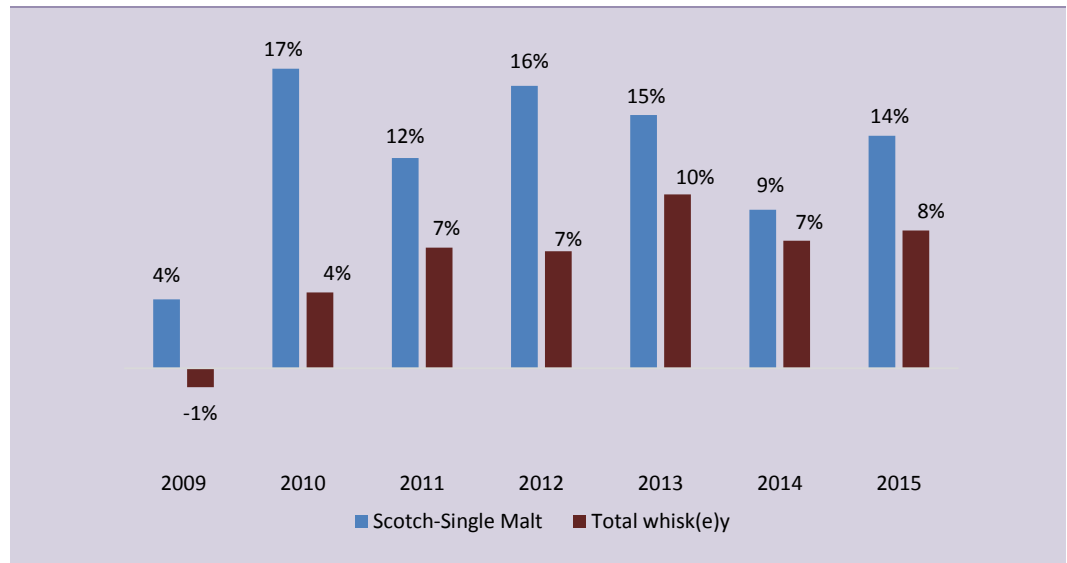


Source: Rémy Cointreau, Bryan, Garnier & Co

- **Single-malt scotch: 2% of sales**

Whisk(e)ys are proving highly successful with the Millennial generation who value their authenticity and the wealth of their history. The single-malt scotch segment is growing particularly rapidly in the United States. In 2015, single-malt sales were up by 14% in the US, very significantly outperforming the broader whisk(e)y market (+8%).

**Fig. 11: United States: single-malt scotch value growth relative to the whisk(e)y market**



Source: DISCUS

Rémy Cointreau purchased the Bruichladdich distillery in 2012, thereby doubling its production capacity, and is now increasing its storage capacity. **In 2015/16 and in H1 2016/17, the company reported double-digit growth for its whisk(e)y brands Bruichladdich, Port Charlotte and Octomore.**



Source: Rémy Cointreau

- **Cognac: 62% of sales**

Cognac consumption in the United States has changed from being emblematic of a community to a generational symbol

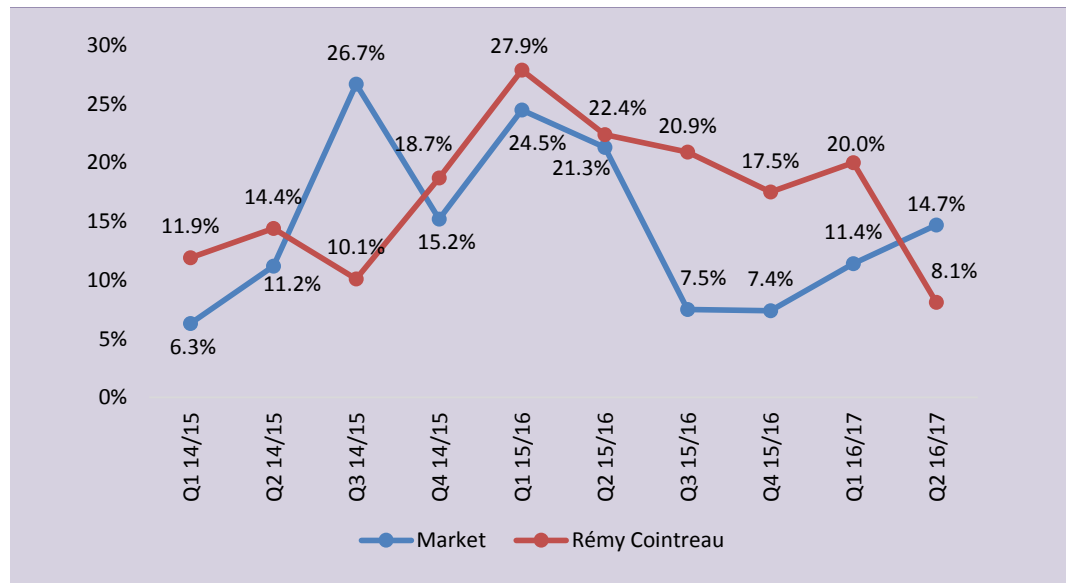
As outlined above, cognac is a spirit that resonates with the Millennial generation in that its *appellation d'origine contrôlée* status guarantees the authenticity of the product. Rémy Cointreau might almost be considered a quasi pure player in cognac since the company derives 62% of its sales from this category.

The United States, where 40% of the company's cognac sales are generated, are seeing very robust growth. **Consumption in this country has changed from being emblematic of a community to a generational symbol. Thus, Afro-Americans who used to constitute 60% of cognac drinkers now only represent one third, with Caucasians and Latino-Americans accounting for the remaining**

Please see the section headed "Important information" on the back page of this report.

two thirds. In the United States, Rémy Cointreau has astutely repositioned itself on the most superior qualities (VSOP and XO), enabling it to virtually-consistently outperform the cognac market in the past two years, the recent slow-down being explained by retailer destocking following the price rises at the beginning of the year.

**Fig. 12: Cognac depletions (value) in the United States: Rémy Cointreau / market**



Source: Rémy Cointreau, Bryan, Garnier & Co.

In the United States, performance is mainly being driven by 1738, an ‘intermediary’ product sold at USD60 a bottle, whose sales increased by 50% in 2015/16, partly due to the ‘One Life/Live Them’ marketing campaign with Jeremy Reiner. The fact is that, while Pernod Ricard’s increased investment in Martell in the United States might have prompted some concerns, Rémy Cointreau does not currently seem to be suffering from this.

Continued strong growth in the United States and a gradual pick-up in China

China, the number two cognac market for Rémy Cointreau (32% of sales), is also showing very clear signs of a pick-up. Rémy Cointreau reported mid-single-digit growth in its depletions in value during H1 2016/17, i.e. a very marked acceleration relative to the stable trend of the 2015/16 financial year. **Private consumption which had been dampened by a collective paranoia after the implementation of the anti-extravagance policy in 2012 has been normalising since the summer of 2015, particularly in Mainland China.** In this country, the company has also benefited from its ‘One Life/Live Them’ marketing campaign showcasing the Chinese star Huang Xiomeng. The iconic product for the company remains the Club (EUR80 a bottle). Rémy Cointreau’s guidance for 2016/17, i.e. a return to growth for Chinese sales and depletions, remains unchanged.

**Fig. 13: 'One Life/Live Them' campaign in the United States ...**

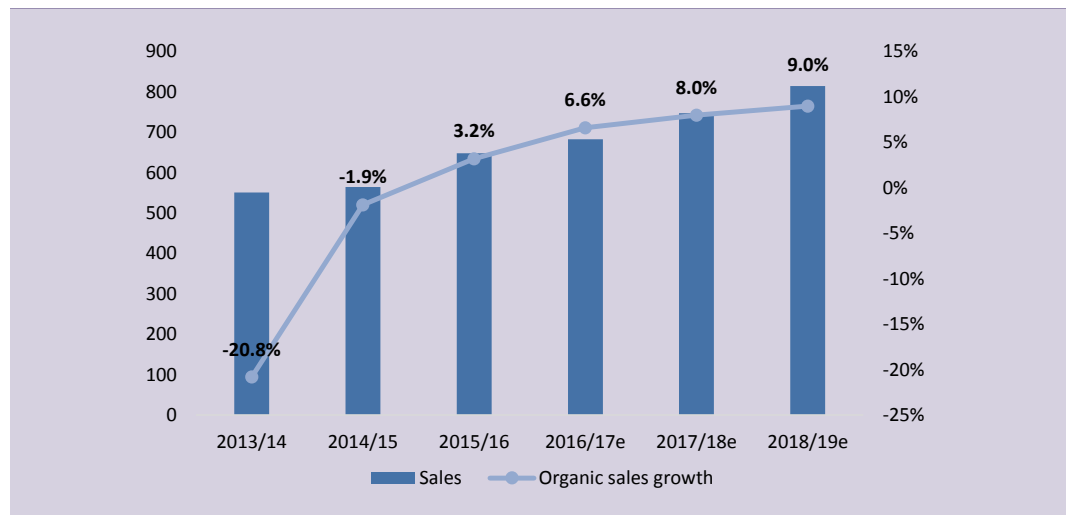
**Fig. 14: ...and in China**



Source: Rémy Cointreau

The Cognac division is expected to be the main growth driver for Rémy Cointreau in the coming years. Our forecasts show sales increasing by 6.6% in 2016/17, a marked acceleration on the 2015/16 level (+3.2%).

**Fig. 15: Sales forecasts**



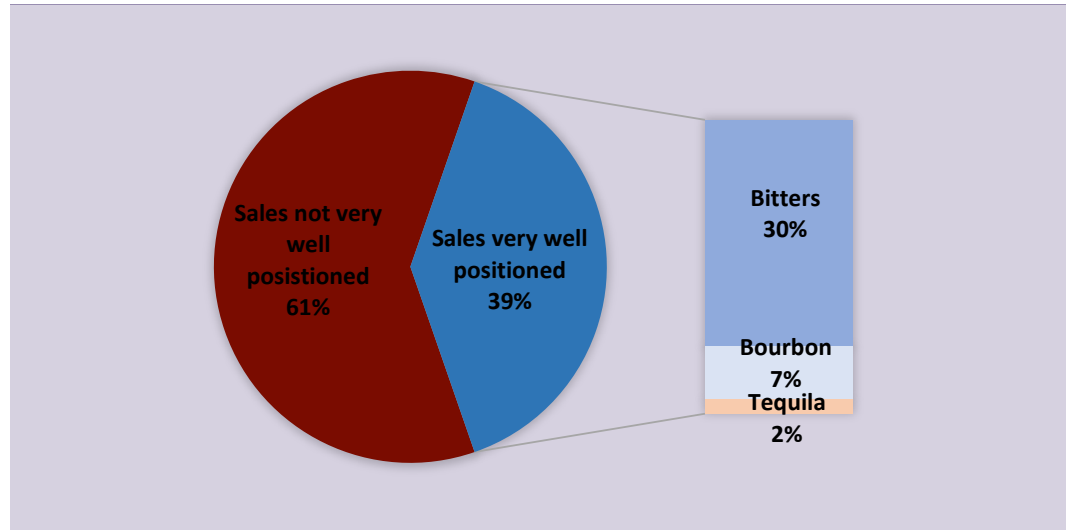
Source: Rémy Cointreau, Bryan, Garnier & Co

## 5.2. Campari: 39% of sales

Bitters: Campari's key asset when it comes to targeting Generation Y

We calculate that 39% of Campari's sales are aligned with the tastes of the **Millennial generation**. The Millennials have been responsible for the renaissance of bitters which account for 30% of the Italian company's sales and are also having a positive impact on bourbon and tequila which contributes 7% and 2% of sales, respectively.

**Fig. 16: The Campari portfolio (% of group sales)**



Source: Campari, Bryan, Garnier & Co

- Bitters: 30% of sales

Campari generates 30% of its sales in bitters, a far higher proportion than for its competitors. We estimate that Pernod Ricard and Diageo derive a respective 3% and 2% of their sales in this category while Rémy Cointreau has no exposure.

**Fig. 17: Bitter brands by player**

CAMPARI	PERNOD RICARD	DIAGEO	REMY COINTREAU	BROWN-FORMAN
Campari	Ramazotti	Romana Sambuca		Tuaca
Aperol	Becherovka			
Campari Soda	Suze			
Cynar				
Averna				
Biancosarti				

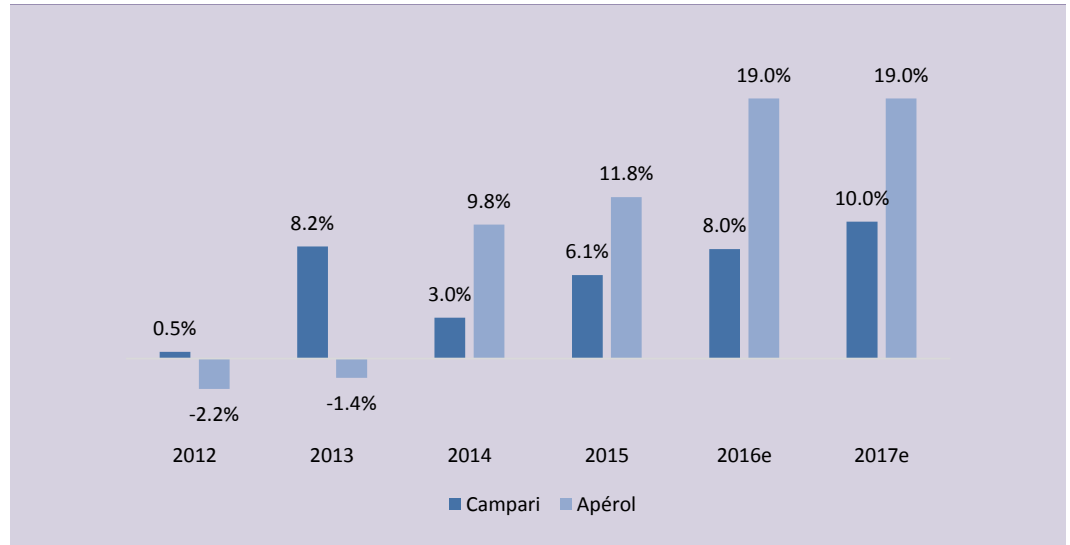
Source: Companies

A growth acceleration for Campari and Aperol in 9M 2016

**Aperol and Campari are the company's two flagship brands, each representing 10% of total sales.** They benefit from strong brand recognition, respectively occupying 63rd and 71st positions in the ranking of the 100 most powerful brands (IWSR 2015). Aperol has a less bitter taste and lower alcohol content which differentiate it from Campari and enable it to address a younger, more

feminine customer base and to compete with beer (possible consumption during the day). This is the key ingredient of the Aperol Spritz cocktail which has a number of strengths explaining its marketing success: a very simple recipe and an extremely low cost (between 80 and 90 cents a glass) compared with competitor drinks (the mojito, for example, costs double this figure). **Campari and Aperol sales grew by a respective 6.1% and 11.8% in 2015 before gaining momentum during the first nine months of 2016, with respective increases of 8.1% and 19.3%.**

**Fig. 18: Organic sales growth for Campari and Aperol**



Source: Campari, Bryan, Garnier & Co

**Campari and Aperol’s historic markets are now improving after a difficult few years.** In Germany, Aperol initially proved a very major success but, in Q4 2011, its sales began to decline, a phenomenon which continued during 2012 and 2013, mainly owing to competition from ‘me-toos’ and notably from Hugo, manufactured from elderberries. Aperol sales finally stabilised in 2015 before growing by 13.7% in the first nine months of 2016. In Italy, Campari and Aperol posted respective growth of 9.5% and 5.7% over nine months. This is a significant acceleration relative to 2015, marked by respective increases of 2.9% and 4.8%.

The Negroni cocktail



Source: Campari

**Campari and Aperol are also enjoying exponential growth in new markets.** In the United States, Campari and Aperol have seen triple-digit growth over several years and now account for 25% of the Italian company’s sales in the country. As outlined above, the fashion for classical cocktails has led to strong demand for the bitters category. Campari has thus benefitted greatly from the interest in Negroni. Aperol Spritz is, however, currently making in-roads. Aperol sales in the United States thus grew by 42% in organic terms over the first nine months. The brand is also seeing very strong growth in Europe: in 2015, +96% in France, +119% in Spain and +233% in the United Kingdom.

- Bourbon: 7% of sales

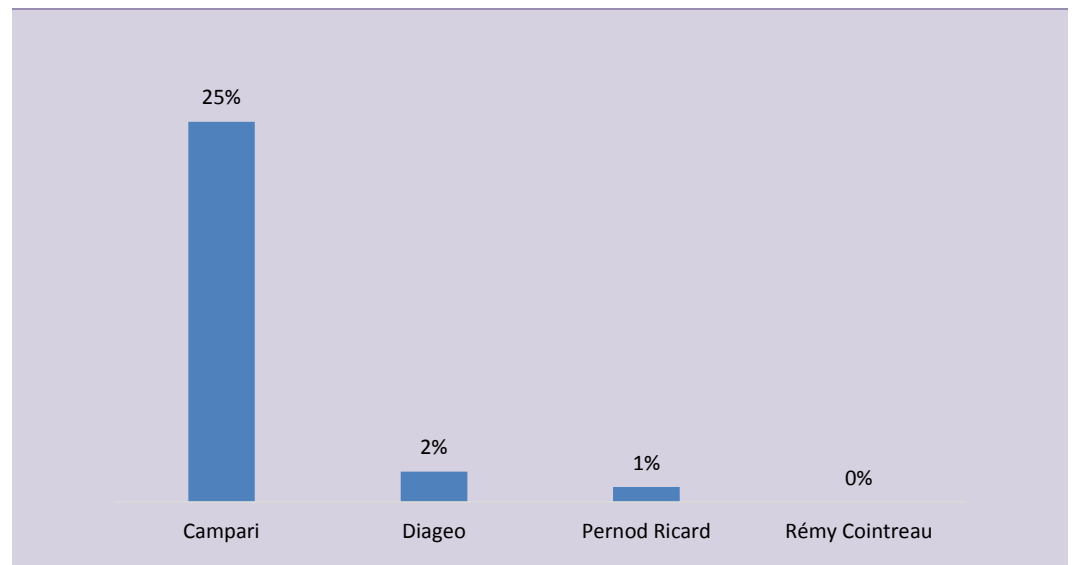
**Bourbon has grown by more than 30% since 2010 in the United States (Impact Databank).** The category is approaching 20 million cases, a level which had not been seen in three decades. **As the United States’ only truly home-grown alcohol, it has the authentic character sought by the Millennials.** Generally consumed by young, comfortably-off men, this spirit has conquered an unexpected audience with women and Hispanics. Craft distilleries have thus proliferated but some of

Please see the section headed “Important information” on the back page of this report.

the spirits majors, especially Brown-Forman and Suntory Beam, have been able to benefit from this trend. Popular culture has also had a strong influence on Generation Y, with TV series like Mad Men and Boardwalk Empire prompting renewed interest from Americans in bourbon/tennessee. We can draw a parallel with the James Bond films which contributed to the fashion for vodka as of the 1980s.

**Campari, the only company in our sample with a bourbon brand of significant size, thus has an advantage in the key United States market. Its Wild Turkey brand posted sales growth of 7.3% over the first nine months, broadly in line with 2015 (+7.6%), but well above that of the broader spirits market (+4%).**

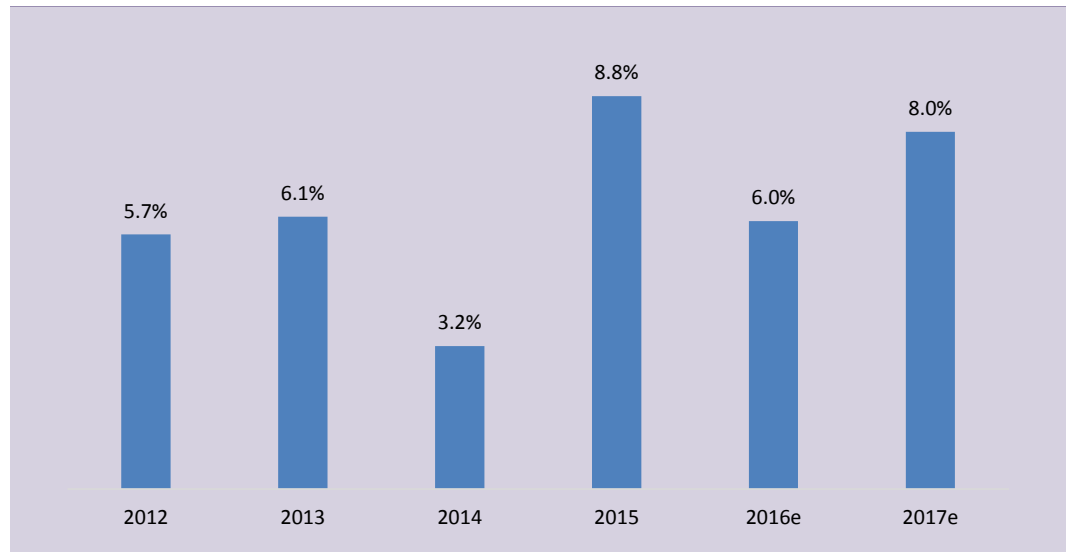
**Fig. 19: Percentage of bourbon and tennessee in US sales**



Source: Companies, Bryan, Garnier & Co

**The United States consume 70% of bourbon product volumes but export markets, which did not exist just twenty-five years ago, are also proving dynamic, for example the United Kingdom, Germany, Australia, France, Spain and the Netherlands. Wild Turkey’s success thus extends beyond the US domestic market. At global level, our forecasts show organic sales increasing by 6% in 2016 and 8% in 2017.**

**Fig. 20: Organic sales growth for Wild Turkey**



Source: Campari, Bryan, Garnier & Co

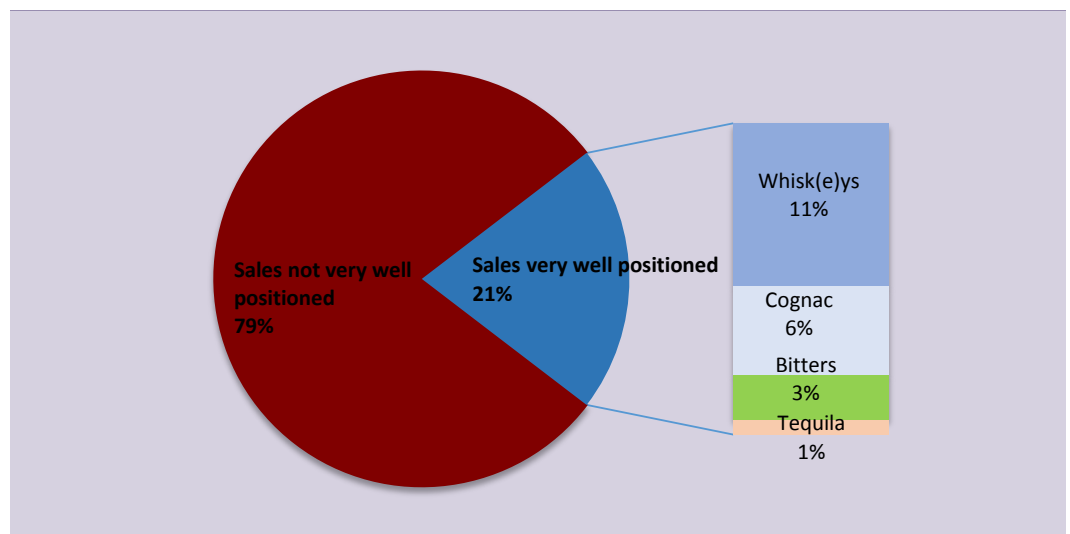
- **Tequila: 2% of sales**

Millennials value the authenticity of tequila. Campari owns the Espolon brand which accounts for 2% of the group's sales. It posted sales growth of 35% in 2015 and 43% in 9M 2016.

### 5.3. Pernod Ricard: 21% of sales

Analysis becomes more difficult for well-diversified companies like Diageo and Pernod Ricard. **We estimate that 21% of the French company's sales are aligned with the tastes of the Millennial generation, i.e. whisk(e)ys (11% of sales), cognac (6%), bitters (3%) and tequila (1%).**

**Fig. 21: The Pernod Ricard portfolio (% of group sales)**



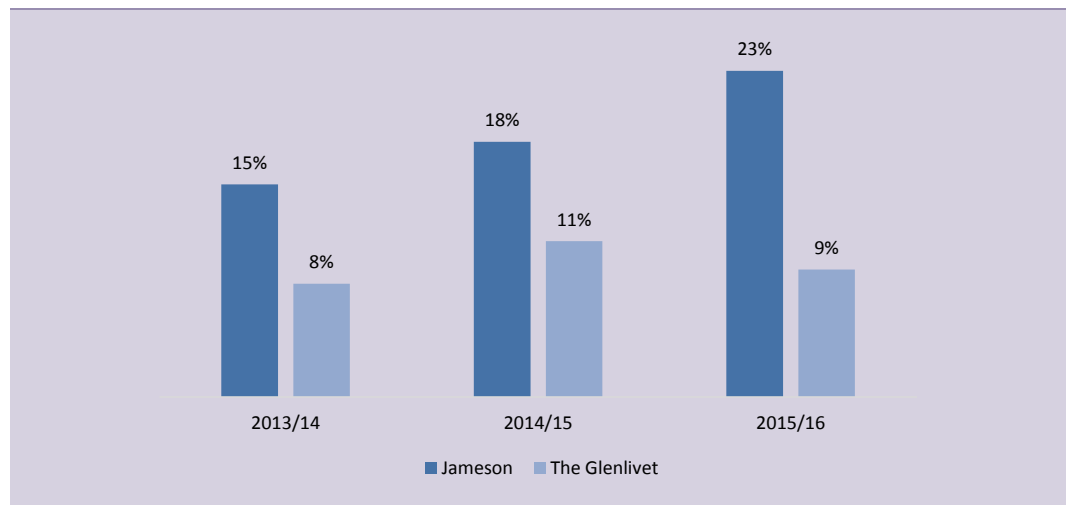
Source: Pernod Ricard, Bryan, Garnier & Co



- Whisk(e)ys: 11% of sales

We estimate that the Pernod Ricards whisk(e)y portfolio represents 32% of sales. It comprises a plethora of different segments and brands, both local and international, making it difficult to estimate the percentage of well-positioned sales. We have, however, been able to break out the sales of the Irish whiskey Jameson and the single-malt scotch The Glenlivet, which represent a respective 9% and 2% of the group's sales. These two brands posted average annual growth rates of 15% and 13% respectively over the past five years. They are growing very fast in the United States. Their respective sell-outs increased by 23% and 9% last year.

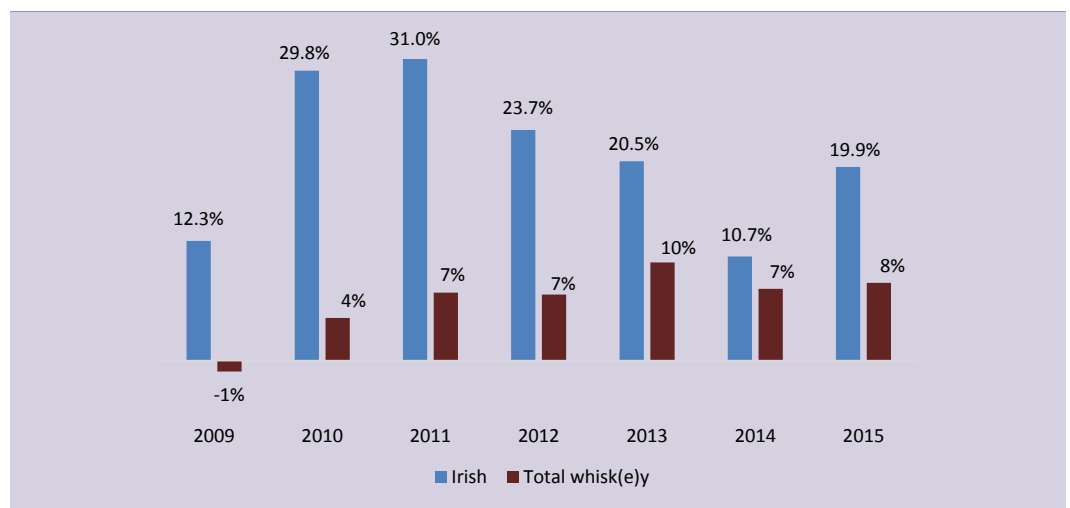
**Fig. 22: Sell-out in the United States for Jameson and The Glenlivet**



Source: Nielsen

Like the single-malt scotch (see chart in section 5.1), the Irish whiskey has tended to outperform the other whisk(e)y varieties in the United States, its attraction for the Millennials principally residing in its mixability.

**Fig. 23: US market: growth in value for the Irish whiskey relative to the other segments**



Source: DISCUS

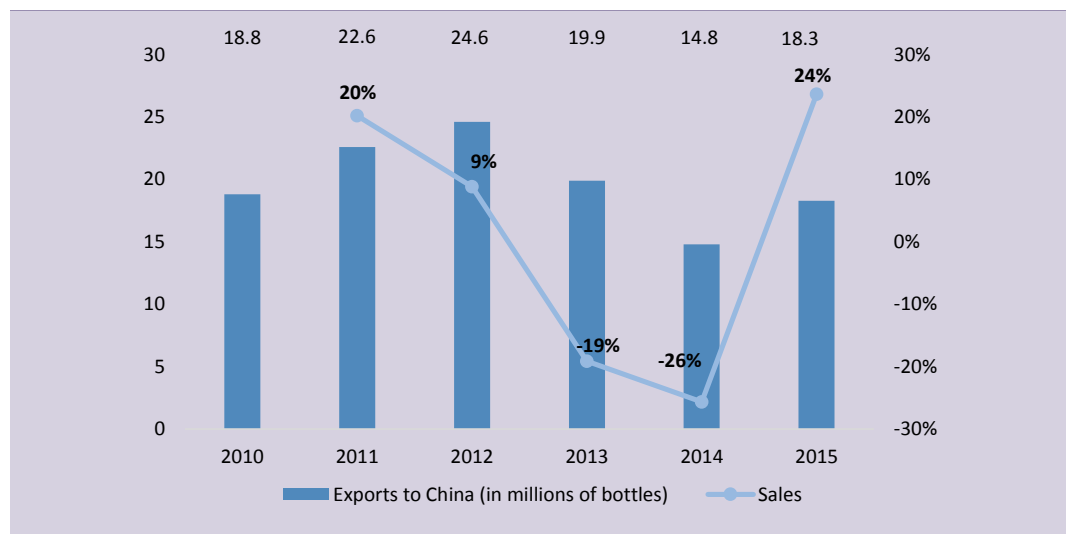
Please see the section headed "Important information" on the back page of this report.

- **Cognac: 6% of sales**

Martell sales in China increased by 3% in Q1 2016/17

Unlike with Rémy Cointreau, China remains by far the number one cognac market for Pernod Ricard. After the implementation of the anti-extravagance policy in China, Pernod Ricard was the first company to experience an end to destocking in 2013/14. Its sales declined by only 2% in 2014/15 before posting a 9% fall in 2015/16. **This deterioration was mainly due to whisk(e)ys which continued to see double-digit falls whereas Martell cognac was only slightly down for the year as a whole thanks to a normalisation in consumption behaviour, before returning to positive territory in Q1 2016/17 (+3%).** For the moment, performance remains driven by Noblige although Cordon Bleu is showing signs of an improvement.

**Fig. 24: Market: cognac exports to China**

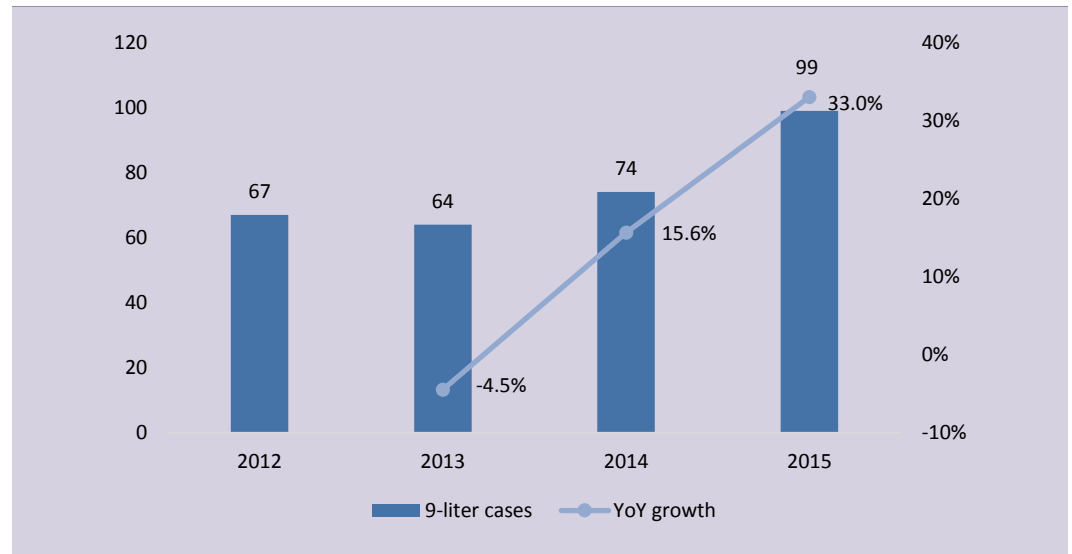


Source: BNIC

Diversification under way towards the United States

At present, Martell only generates 3% of its sales in the United States where cognac has become extremely popular. However, Pernod Ricard is currently stepping up its investment in the country. The company has notably taken advantage of the momentum behind bourbon and cognac to create a hybrid product, Blue Swift (USD50), a cognac finished in bourbon casks. **Martell recorded 2015 volume growth of 33% in the United States.**

**Fig. 25: Martell volumes in the United States**



Source: Impact Databank

- **Bitters: 3% of sales**

Principally the Suze brand for which we have already outlined the revival in the French market.

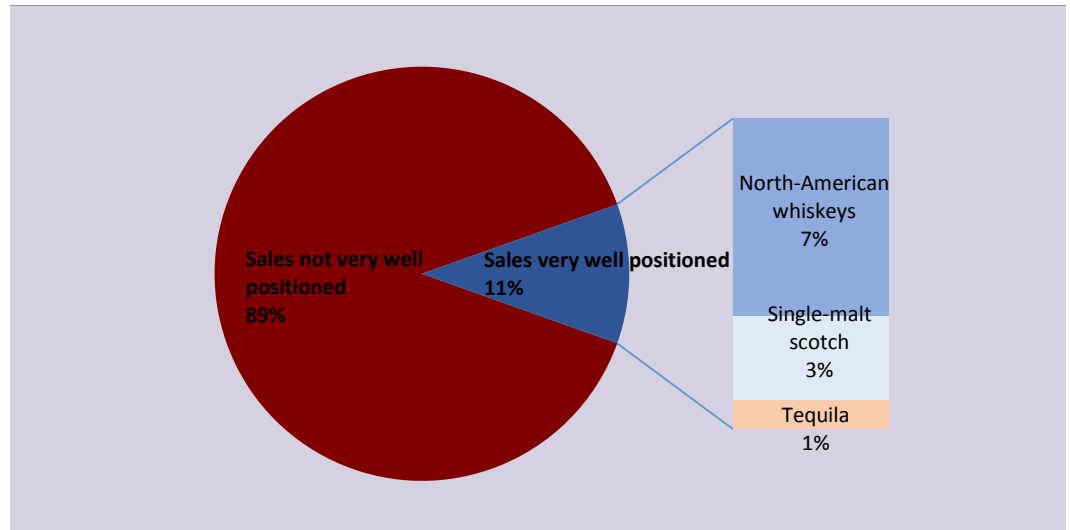
- **Tequila: 1% of sales**

The category has been a fairly late development for Pernod Ricard and currently accounts for no more than 1% of sales. In 2015/16, the distribution of the ultra-premium tequila Premium Avi3n has been expanded to 11 new international markets, Altos brand volumes have progressed by more than 40% and Olmeca has recorded excellent results in several markets. Driven by a strong performance in the United States, tequila sales posted overall growth of 7% in 2015/16.

## 5.4. Diageo: 11% of sales

We calculate that 10% of Diageo’s sales are aligned with the tastes of the Millennial generation, i.e. North-American whiskey (7% of sales), single-malt scotch (3%) and tequila (1%).

**Fig. 26: The Diageo portfolio (% of sales)**



Source: Diageo, Bryan, Garnier & Co

- **North-American whiskeys: 7% of sales**

The North-American whiskey portfolio grew by 6% in 2015/16, driving the group’s growth (+2.8%). **This concerns principally Crown Royal and Bulleit which represent 7% of Diageo’s sales.** We exclude Seagram’s 7 Crown which is positioned in the entry-level segment and is thus not popular with consumers.

The United States is the main growth driver for these two brands. Crown-Royal is a Canadian whiskey, a variety which is underperforming Irish whiskey, bourbon/tennessee and single-malt scotch. Diageo nonetheless managed to return the brand to positive territory in 2014/15, notably thanks to the innovation Crow Royal Regal Apple. In 2015/16, this apple-aromatised whiskey once more posted very robust growth of 15%, enabling the brand’s sales to grow by 6%. The high-end version Crown Royal Deluxe is also proving very dynamic. Its growth of 5% in 2015/16 was enabled by the ‘The One Made For A King’ marketing campaign focused on the brand’s heritage. Smaller in size, the Bulleit bourbon recorded growth of 28% in 2015/16 (+36% in 2014/15).

- **Single-malt scotch: 3% of sales**

Scotch whiskies account for 24% of Diageo’s sales but the proportion of single-malt Scotch whiske(y)s is no more than 3% and includes the The Singleton, Cardhu, Talisker, and Lagavulin brands.

In the United States, North-American whiskeys contributed 50% of the growth in the group’s spirits sales

Please see the section headed “Important information” on the back page of this report.

Don Julio



Source: Diageo

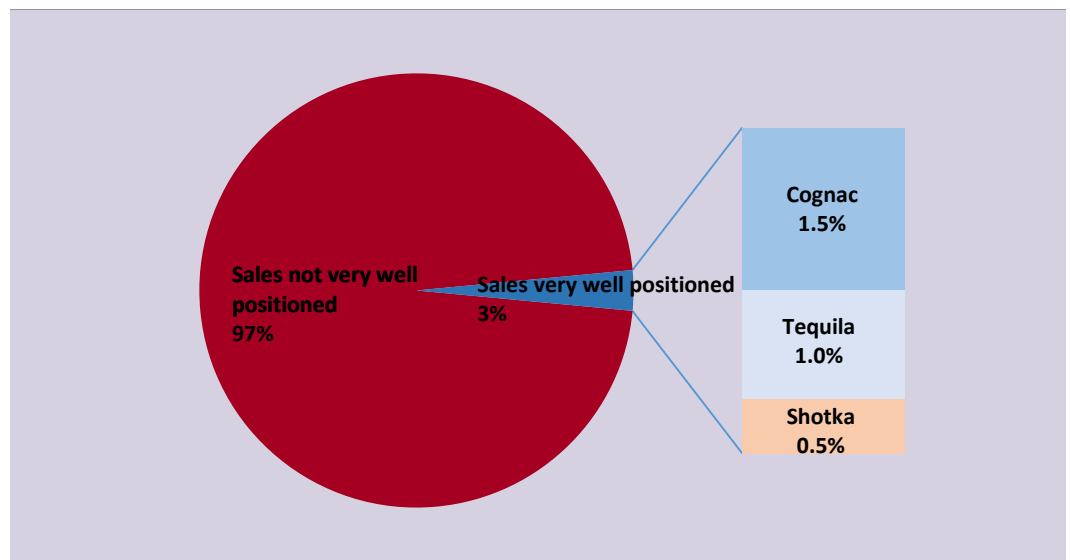
- **Tequila: 1% of sales**

Tequila, which accounts for 1% of Diageo’s total sales, grew by 8% in 2015/16, this performance mainly being driven by the 34% growth for Don Julio in its number one market, the United States. The UK group undertook multiple transactions in 2014 to increase its exposure to tequila: acquisition of Peligroso (super-premium), purchase of the José Cuervo group’s 50% share in their JV with Don Julio (super-premium) and the establishment of the DeLeon (ultra-premium) joint venture with Sean Combs.

### 5.5. MBWS: 3% of sales

MBWS generates 3% of its sales in categories aligned with the tastes of the Millennial generation. **This under-weighting relative to the competition is entirely consistent with the group’s geographical exposure, in that it has very little presence in countries characterised by a high Generation Y population.** For example, the United States represents only 5% of its sales and the weight of China is virtually zero.

**Fig. 27: The MBWS portfolio (% of sales)**



Source: MBWS, Bryan, Garnier & Co

- **Cognac: 1.5% of sales**

Cognac brand Gautier currently represents only 1.5% of MBWS sales. Despite the under-investment in the brand in recent years, it has twice been voted the best cognac in the world. Since it is aware of the potential, MBWS has engaged in a global relaunch for Gautier in 2016, supported by an increased advertising spend. The brand is now being rolled out in France, the United Kingdom, Canada, the United States and in Duty Free, the aim being to make it the number ten cognac brand in the world compared with today’s 20th position.

- **Tequila: 1% of sales**

San José represents only 1% of MBWS's total sales. This brand is nonetheless the leading tequila in France with a market share approaching 42%. It is expected to be re-energised within the framework of the BIG 2.0 strategic plan, with the creation of a pre-mix notably on the cards.

- **Shotka: 0.5% of sales**

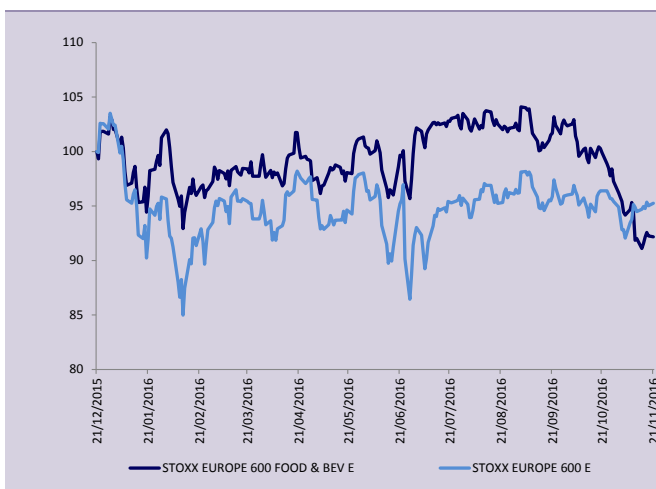
The group has created the Shotka brand which is perfectly in keeping with customer demand for experimental products. Cannabis-aromatised spirits are deemed to be the next major industry trend. The brand was initially tested in Spain before being launched in other countries like the United States, France and Poland.

## 6. Our preferred stocks

### 6.1. A Food & Beverage sector under pressure

Over the last three months, the Food & Beverage sector has underperformed the market by 10%. The Food segment posted the worst performance (-12%), followed by the Spirits (-8%) and the Brewers (-7%). In their capacity as bond proxies, the Food & Beverage stocks have been negatively impacted by rising bond yields.

**Fig. 28: Stock market performance of the Stoxx Europe 600 Food & Beverage and the DJ Stoxx**



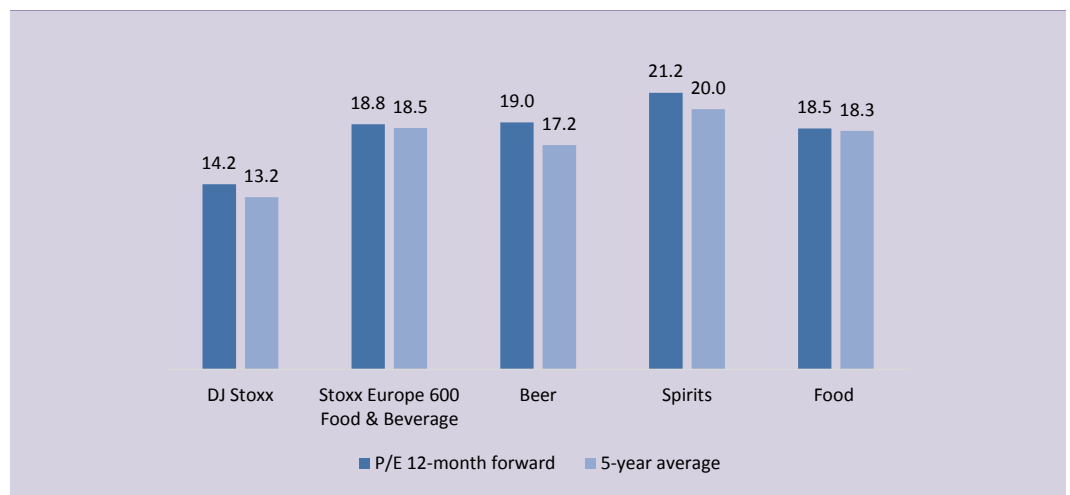
**Fig. 29: Relative stock market performances of spirits, brewers and food companies compared with the DJ Stoxx**



Source: Thomson Reuters

The Food & Beverage sector is currently trading at a 12-month forward P/E of 18.8x, i.e. an 2% premium relative to its average of the past five years. The Spirits premium is 6% (Brewers: +10%, Food: +1%).

**Fig. 30: P/E 12-month forward**



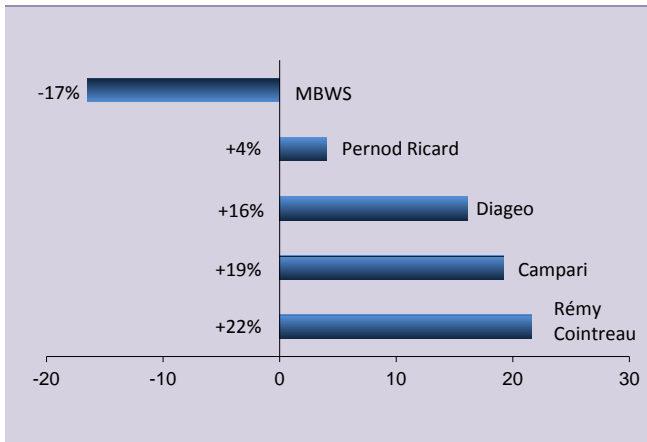
Source: Thomson Reuters

Please see the section headed "Important information" on the back page of this report.

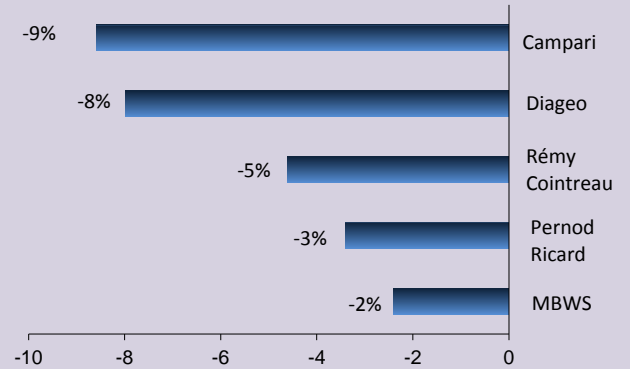
## 6.2. Comparative valuation of the players

The sector rotation had the most detrimental impact on the stock performances of Campari (-9% vs DJ Stoxx), Diageo (-8%) and Rémy Cointreau (-5%). In terms of EV/EBIT, Pernod Ricard and Campari are trading at significant discounts, of respectively 11% and 8%.

**Fig. 31: Year-to-date performance vs the DJ Stoxx**

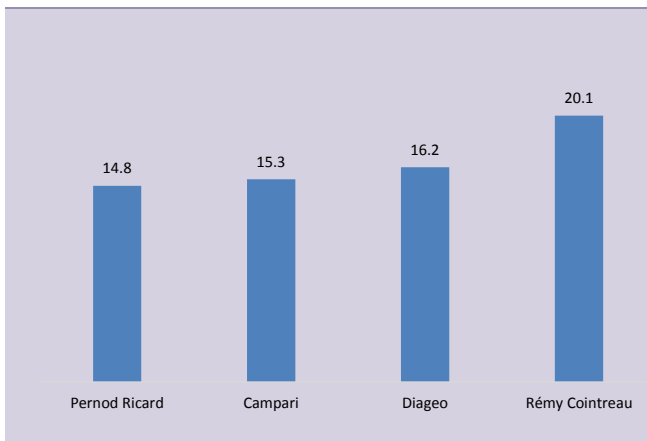


**Fig. 32: Performance over the last three months vs the DJ Stoxx**

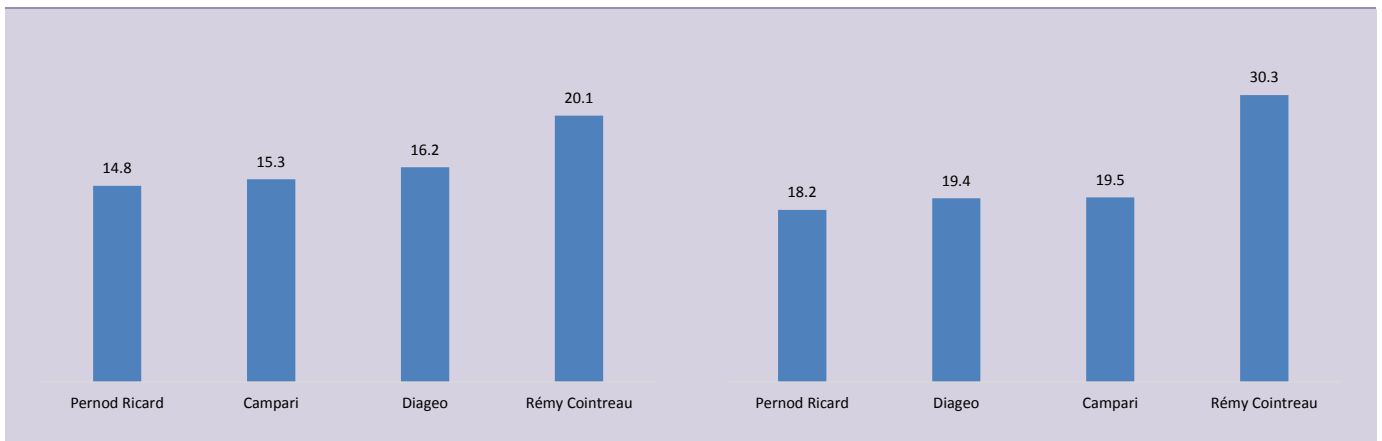


Source: Thomson Reuters

**Fig. 33: 2017<sup>e</sup> EV/EBIT**



**Fig. 34: 2017<sup>e</sup> P/E**



Source: Bryan, Garnier & Co



### 6.3. Our recommendations

Below we summarise our recommendations and fair values for the stocks under coverage:

- **Rémy Cointreau**

In view of its status as a quasi pure player in cognac, Rémy Cointreau is the company the best positioned to address the Millennial generation. The group is also benefiting from robust momentum in the United States and a pick-up in China while its strategic plan is on the right track. We reiterate our Buy recommendation and our Fair Value of EUR84.

- **Campari**

Campari remains one of our favourite spirits stocks. Not only is the group benefiting from a portfolio well aligned with the tastes of Generation Y but its financial position could also enable new acquisitions as of 2017. Our Buy recommendation remains unchanged with a Fair Value of EUR10.7.

- **Pernod Ricard**

Organic sales growth should accelerate in 2016/17 thanks to a pick-up in China and Europe while US sales are expected to maintain their strong momentum. We maintain our Buy recommendation that we upgraded on November 18<sup>th</sup> (Fair Value: EUR115).

- **Diageo**

In our view, the acceleration in organic sales growth thanks to the improved trends in all the Group's markets excepting the Europe/Russia/Turkey region is already priced in. We maintain our Neutral recommendation but we revise downwards our Fair Value from 2,200p to 2,150p due to FX effects.

- **MBWS**

The MBWS restructuring is now complete with the exit from the continuation plan. The company is henceforth embarking on a new chapter – one of growth – which promises to be more difficult. We are initiating coverage with a Neutral recommendation and a Fair Value of EUR17.1.

**Fig. 35: Summary table for the stocks under coverage**

	Price	Recommendation	Fair Value
<b>Campari</b>	EUR8.9	BUY	EUR10.7
<b>Diageo</b>	2,005p	NEUTRAL	2150p
<b>Pernod Ricard</b>	EUR101.8	BUY	EUR115
<b>Rémy Cointreau</b>	EUR74.7	BUY	EUR84
<b>MBWS</b>	EUR15.7	NEUTRAL	EUR17.1

Source: Thomson Reuters, Bryan, Garnier & Co



# Rémy Cointreau (Fair Value EUR84, BUY - Top Pick)

**Near-ideal positioning**

















# Campari (Fair Value EUR10.7, BUY)

## Italian specialties





















# Pernod Ricard (Fair Value EUR115, BUY)

**Getting better!**



























## MBWS (NEUTRAL Coverage initiated)

### A change in the equity story



































































# Diageo (Fair Value 2150p vs. 2200p, NEUTRAL)

**An improvement in trajectory**





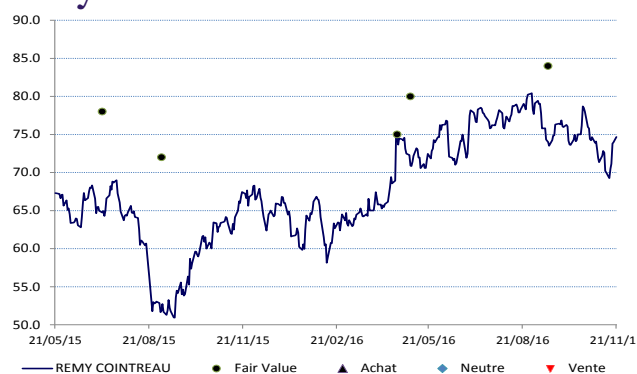






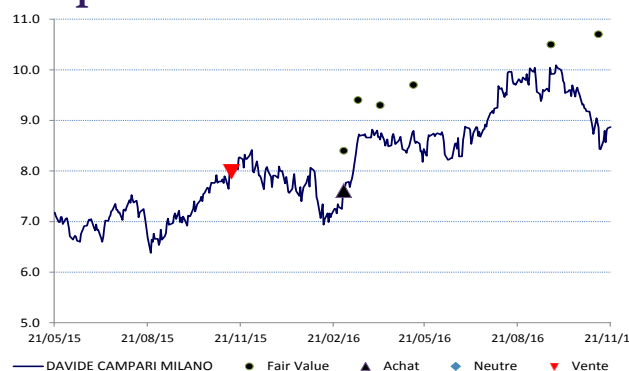
# Price Chart and Rating History

## Rémy Cointreau



Ratings			Target Price	
Date	Ratings	Price	Date	Target price
23/03/15	BUY	EUR68.98	15/09/16	EUR84
02/10/14	NEUTRAL	EUR55.49	03/05/16	EUR80
27/03/14	BUY	EUR58.79	20/04/16	EUR75
			02/09/15	EUR72
			06/07/15	EUR78
			16/04/15	EUR81
			23/03/15	EUR78
			23/01/15	EUR61
			28/11/14	EUR62
			02/10/14	EUR60
			22/09/14	EUR71
			10/06/14	EUR75
			22/04/14	EUR67
			27/03/14	EUR70

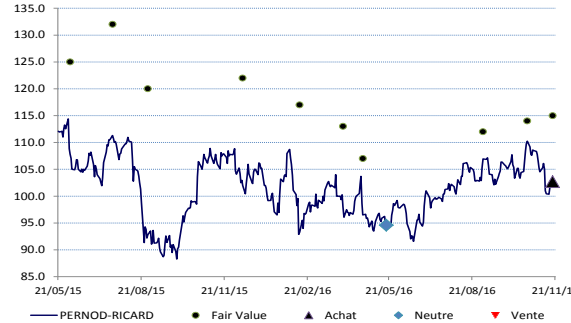
## Campari



Ratings			Target Price	
Date	Ratings	Price	Date	Target price
02/03/16	BUY	EUR7.51	09/11/16	EUR10.7
12/11/15	SELL	EUR8	23/09/16	EUR10.5
17/09/14	NEUTRAL	EUR5.8	10/05/16	EUR9.7
			07/04/16	EUR9.3
			16/03/16	EUR9.4
			02/03/16	EUR8.4
			13/05/15	EUR7.1
			08/04/15	EUR7
			11/02/15	EUR6.4
			08/01/15	EUR6.2
			09/12/14	EUR5.8
			13/11/14	EUR5.9
			17/09/14	EUR6



## Pernod Ricard



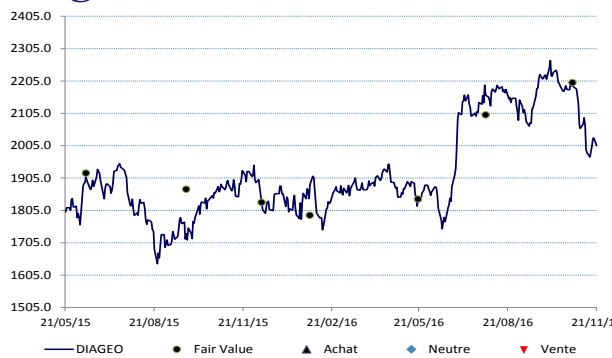
### Ratings

Date	Ratings	Price
18/11/16	BUY	EUR102.75
18/05/16	NEUTRAL	EUR94.95
29/08/14	BUY	EUR88.75
28/05/14	NEUTRAL	EUR89.24

### Target Price

Date	Target price
18/11/16	EUR115
21/10/16	EUR114
02/09/16	EUR112
22/04/16	EUR107
31/03/16	EUR113
12/02/16	EUR117
11/12/15	EUR122
28/08/15	EUR120
20/07/15	EUR132
03/06/15	EUR125
24/04/15	EUR129
27/03/15	EUR122
13/02/15	EUR110
08/01/15	EUR102
24/10/14	EUR101
29/08/14	EUR103
28/05/14	EUR94

## Diageo



### Ratings

Date	Ratings	Price
12/04/14	NEUTRAL	1945p

### Target Price

Date	Target price
23/11/16	2150p
27/10/16	2200p
29/07/16	2100p
28/07/16	Under review
20/05/16	1840p
29/01/16	1790p
10/12/15	1830p
23/09/15	1870p
11/06/15	1920p
17/04/15	1950p
01/04/15	2000p
30/01/15	1880p
08/01/15	1800p
04/12/14	1815p

## Bryan Garnier stock rating system

For the purposes of this Report, the Bryan Garnier stock rating system is defined as follows:

### Stock rating

BUY	Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
NEUTRAL	Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
SELL	Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

### Distribution of stock ratings

BUY ratings 56.7%

NEUTRAL ratings 31.8%

SELL ratings 11.5%

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