

Investing in Cognac Producing Vineyards to Hedge Wealth While Receiving High Returns

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Abstract

The general trend over the last decade for investments has been moving towards emerging markets, where investors are promised high returns for risky investments. These kind of investments favor the brave and bold, but are frightening for the risk averse. In this paper I will be presenting the opportunities that an investment into cognac producing vineyards can offer. High return and relatively low risk investment opportunities that exists in France. Included in the paper will be examples of large investments made recently into the industry. I will analyze the trends in the market over the past 8 years for the prices of land, cognac itself and the ease of sales of such products. There will also be an in-depth explanation of why cognac is today's least risky product to invest into, comparing it to the Champagne regions' similar historic trends. The findings show that land prices have increased at an average of 10% while simultaneously the price of cognac, has grow at an average of 14%. This product also has a unique hedging opportunity for investors. In short, excluding the growth of cognac prices in general the product itself gains value the longer it is stored, by an average of 12%. In this industry there are 5 big players that compete with each other on quality and also access to future stocks. This reality gives an investor the unique ability to sign futures contracts for 100% of their production over a 5 year period (standard market contract). Similar contracts can be signed with cooperatives who manage the lands for the investor, making the investment hassle free. This allows for an assured projection of both costs and returns for an unprecedented length of time compared to any other industry today. In conclusion, cognac producing vineyards are an investment that can potentially bring high returns, while being able to hedge the investment and see capital gains over the course of time. There will be a final simulation of a 5 year investment into vineyards of 10 Hectares. The only issue left is to find vineyard owners that are willing to sell.

Keywords: *Cognac, Vineyard, Hedge wealth, Economy, Law.*

Introduction

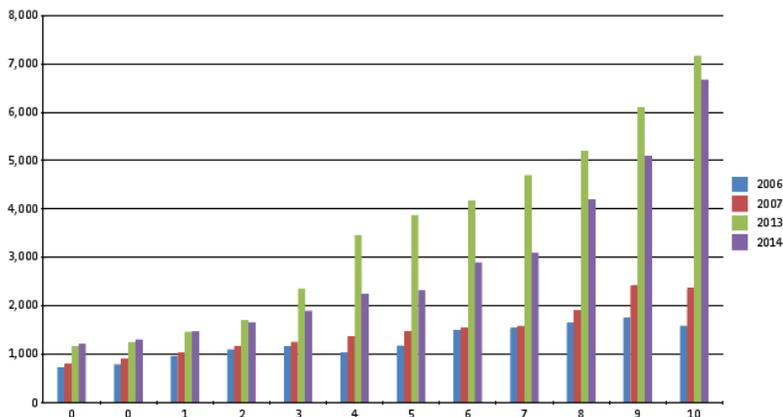
This research paper will look at the investment opportunities of vineyards producing cognac. Since the crisis of 2008 the world's investment market has shifted towards Asia. The low returns and high taxes of the European Union and the relative instability, of recent years, has forced investors to go abroad. Similarly the fall in the purchasing power of the currencies of developing countries has also resulted in a significant fall in foreign direct investment in the EU. This trend can be observed in almost all spheres of business in Europe, except cognac. Over the last decade investors from Russia, China and beyond have flocked to the region to invest their fortunes into this noble drink. At first glance this

seems to be a purchase made for status, and personal pleasure, but once you get down to the numbers involved, you begin to realize that these are cold hard calculations, made for the sole purpose of protecting and accumulating wealth. Between the Russians and the Chinese fervently buying both vineyards and Chateaus in the region, the trend doesn't show signs of slowing down. In 2014 the oldest and largest alcohol distribution company in Japan, Suntory, bought Beam for 16 Bill. US \$. One of the main assets of Beam being the renowned cognac houses, Courvoisier (Suntory, 2015).

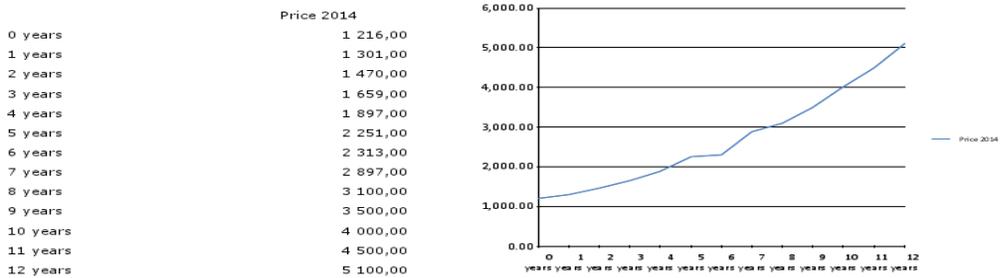
Let's start with the investment into the land itself. These vineyards can be found only in the country of France and only in the region of Charent; All other such products around the world do not have the right to be called Cognac, they are called Brandy. This is similar to the Champagne producing region of France in the north of the Paris. The Champagne region has only 33,500 hectares licensed to produce this drink (Anon, 2015). There is a fixed number of hectares licensed to have the right to produce cognac as well (87,313 hectares). (BNIC.fr, 2015) This means that even within the region a vineyard without a license cannot produce cognac, only brandy. In simple terms: An increase in demand cannot be matched by an increase in supply. With the world's middle class growing (mainly in developing countries), the demand for cognac is rising. This naturally pushes the price of the land up. Between the years 2006 and 2015 land in the cognac region has grown steadily by an average of 10% from 35,000 to 80,000 Euros per hectare (BNIC.fr, 2015) This figure will only grow larger based on historic data from the Champagne region, which began such a trend in the early 90's and doesn't show signs of stopping. Today the price of a hectare of champagne vineyards is worth 900,000 Euros on average. (Anon, 2015) From the date of their first definition, neither area has added the number of licenses for vineyards. Champagne since 1927 and Cognac since 1909. (BNIC.fr, 2015) This will not change, in my professional opinion, and the land prices will continue growing arithmetically, if not geometrically, for the following decade.

Changes in Price over History

Выдержка/год 0 0	0	1	2	3	4	5	6	7	8	9	10
2006	728	790	954	1100	1154	1031	1177	1492	1540	1650	1749
2007	796	909	1033	1168	1254	1368	1479	1542	1585	1900	2422
2013	1154	1249	1461	1696	2356	3463	3874	4164	4700	5200	6100
2014	1216	1301	1470	1659	1897	2251	2313	2897	3100	4200	5100



Natural Growth of Cognac Price Through Aging – A: 12%



How is this fact significant to an investor?

If the cognac prices in general fall from one year to the next, the natural growth of the worth of your stock gains on average 12% annually, hedging your net worth. This kind of hedging is very difficult to find in any other product. This is also the reason that a lot of investors look for land that is being sold, along with a stock of cognac. This practice allows for the investor to have a portion of the investment in a highly liquid asset. If this kind of hedging is not enough for an investor then there exists an even safer option. As cognac houses are constantly battling for access to this limited production, they are very happy to sign futures contracts, obliging them to buy 100% of the production of and given plot, for up to 5 years. This does reduce the potential gains from both stocking cognac to sell it off at an older age and of changes in the market prices, but it is the safest option available.

Hectars:	10	Price Per Hectar	80 000 €
Per Hectar Yeild:	10	Total Investmen	800 000 €
Total Yeild HL:	100		
Maintenance Cost Per hec	7 000,00 €	5Y Land Price:	1 288 000 €
Total Cost Per Year:	70 000,00 €	5 Years Profits:	275 000 €
Contract Price Per HL:	1 250,00 €	Total Return:	1 563 000 €
Total Yearly Revenue:	125 000,00 €	5Y ROI:	763 000 €
 		Yearly ROI:	17,33%
Total Yearly Profit:	55 000,00 €		

To give the reader a clear understanding of what this means I will provide a simulation of an investment into 10 Hectares of vineyards over a 5 year period of time, with a futures contract. In this simulation we consider the base market price of cognac production (including all aspects of growing, collection, pressing, and distilling of the grapes) at 7000euros per hectare and a base futures contract for a 0 year old cognac at 1250 euros per

hectoliter. Also we assume the market average of 10 hectoliters produced per hectare. We will assume growth in capital to stay constant at a 10% rate and ignore growth in prices of cognac from aging or market changes as we are using a futures contract in this simulation.

As the numbers clearly show, even using the most risk averse methods of investment, an investor stands to gain 17.33% yearly ROI. The question now remains. Why do people sell their vineyards when it is such a safe and lucrative business?

The answer here is simply heritage. The region is sparsely populated and not very active in terms of Universities and other activities for young people. This has created a trend in young people moving out of their home towns and going to big cities, and choosing to stay there. With an aging population of landowners, and no interest in the business from the younger generation, numerous plots of land are being put on to the market every year.

With owners happy to sell, investing in cognac producing vineyards is a smart move for today's risk adverse investors. The market will keep on growing as the emerging markets grow their middle classes and with them, the price of cognac and the value of such land. The product holds great respect in the alcohol producing world and in my professional opinion; we will continue to see a growth in both private and corporate investments in this market.

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