31st March 2016

Food & Beverages

Pernod Ricard

Price EUR100.25

Downwards revisions of consensus could provide an attractive entry point

Fair Value EUR113 vs. EUR117 (+13%) **BUY**

Bloomberg	RI FP
Reuters	PERP.PA
12-month High / Low (EUR)	117.3 / 88.3
Market Cap (EUR)	26,608
Ev (BG Estimates) (EUR)	35,312
Avg. 6m daily volume (000)	516.5
3y EPS CAGR	4.5%

	1 M	3 M	6 M	31/12/15
Absolute perf.	2.2%	-5.5%	11.2%	-4.7%
Food & Bev.	2.5%	-3.1%	6.0%	-2.3%
DJ Stoxx 600	2.2%	-7.2%	-1.9%	-6.7%

YEnd Jun. (EURm)	06/15	06/16e	06/17e	06/18e
Sales	8,558	8,759	8,860	9,160
% change		*2.4%*	*1.1%*	*3.4%*
EBITDA	2,456	2,630	2,638	2,735
EBIT	2,238	2,280	2,301	2,405
% change		*1.9%*	*0.9%*	*4.5%*
Net income	1,329	1,380	1,422	1,516
% change		*3.9%*	*3.1%*	*6.6%*

	06/15	06/16e	06/17e	06/18e
Operating margin	26.2	26.0	26.0	26.3
Net margin	10.1	15.0	15.3	15.8
ROE	6.6	9.5	9.6	9.7
ROCE	8.8	11.0	10.9	11.2
Gearing	67.9	61.7	58.1	52.2

(EUR)	06/15	06/16e	06/17e	06/18e
EPS	4.99	5.18	5.34	5.69
% change	-	*3.9%*	*3.1%*	*6.6%*
P/E	20.1x	19.3x	18.8x	17.6x
FCF yield (%)	4.3%	4.1%	4.3%	4.7%
Dividends (EUR)	1.80	1.89	1.94	2.07
Div yield (%)	1.8%	1.9%	1.9%	2.1%
EV/Sales	4.2x	4.0x	3.9x	3.8x
EV/EBITDA	14.5x	13.4x	13.2x	12.6x
EV/EBIT	15.9x	15.5x	15.2x	14.4x

The growth in 2015/16 and especially in 2016/17 should be lower than previously expected due to China. We revise our EPS estimates by 2% on average over the next two years, which positions us 2% and 4% below market expectations in 2015/16 and 2016/17, respectively. The consensus adjustment could provide an attractive entry point. Pernod Ricard provides a good visibility and execution while it remains the cheapest stocks in the spirits sector. This is a fact that the improvement in China takes longer to materialize. But we think it is also worthwhile to remind that India accounts for the same weight than China (9% of the group's sales) and the United States are almost twice as big (17% of the group's sales). We maintain our Buy recommendation but we remove the stock from the top pick list. Our Fair Value is adjusted to EUR113.

ANALYSIS

- **Q3 organic sales should be flat due to technical effects in China and Brazil. Asia-ROW (41% of group's sales)** should post a 1% organic decline in sales as the group shipped in Q2 for the Chinese New Year. Organic sales in **Americas (27% of group's sales)** are expected to be flat this quarter. The United States should grow 3% organically in Q3, reflecting the gradual improvement of Absolut and the continued good momentum of Jameson and The Glenlivet. This should be partly offset by a 20% drop in Brazil following the excise duty hike at the beginning of December that boosted Q2 sales (+25% org in H1). **Europe (32% of group's sales)** should accelerate in Q3, with sales expected to be up 2% organically (-0.6% in Q2). The trend should remain solid in Spain, Germany and the UK, while France which was down 7% organically in H1 on technical effects is anticipated to be stable, in line with the underlying trend. Russia should benefit from a very favourable comparison base in Q3.
- **No much change for 2015/16.** We now expect 2015/16 organic sales growth of 2.3% vs +2.7% previously. This factors a 5% organic decline (-4% previously) in China over the year, globally in line with the value depletions and the 2014/15 trend. **These difficulties in China continue to be offset by a very strong organic growth in India** (+14% expected over the year) **and an improvement in the United States where the group is narrowing its underperformance vs the market** thanks to the initiatives taken on Absolut. We expect full year EBIT to grow 2% organically, in the mid range of the group's guidance (1-3%). This is an acceleration vs last year (+1.6%) and results from a slightly more positive pricing environment and a decrease of the negative geographic mix with the return to growth in the US.
- **2016/17 to be slightly better than 2015/16. We now expect organic sales and EBIT to rise 2.7% and +3% in 2016/17 (vs +3.6% and +4% previously). China is the main cause for this revision.** The effects of the anti-extravagance policy proves to be longer than expected and the macroeconomic environment is not helping. Besides, around 20% of Pernod Ricard's sales in China are generated on scotch, a category which is still declining in the high double digits. We do not think that the group will satisfy its mid-term guidance of 4/5% organic sales growth in the next three years.
- **Consensus too high in our view. We revise our EPS estimates by 2% on average over the next two years, which positions us 2% and 4% below market expectations in 2015/16 and 2016/17, respectively. Revisions could provide an attractive entry point.** This is a fact that the difficulties in China are more significant than it was previously anticipated. But we remind that the country only accounts for 9% of the groups' sales, that is to say the same weight than India and half the weight of the US. Besides, we think that Pernod Ricard distinguishes itself by its good visibility and execution.

VALUATION

- Our DCF now points to a Fair value of EUR113. This takes into account the change in estimates but also the new BG Research valuation metrics. **At yesterday's share price, the stock is trading at 19.3x P/E 2015/16. This is 18% below the peers' average and 13% below Diageo. Of note, the 3-year EPS CAGR is 4.5% for Pernod Ricard vs 2.2% for Diageo.**

NEXT CATALYST

- Q3 2015/16 sales due on April 21st

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