

18th May 2016

Food & Beverages

Pernod Ricard

Price EUR94.95

Strong fundamentals overshadowed by short-term weakness**Fair Value EUR107 (+13%)****NEUTRAL vs. BUY**

There is no doubt that the fundamentals of the group are strong: the US and Western Europe are accelerating, while India remains a growth driver in Asia. But there is weakness in the short-term: organic sales in China should be down 10% this year and there is uncertainty regarding the extent of a recovery in 2016/17. Our estimates and our Fair Value of EUR107 are unchanged, but we downgrade our recommendation to Neutral. We think that the stock will be dead money for some time.

ANALYSIS

- Strong fundamentals. The group's performance in the US is improving.** The spirits market in the country continues to grow strongly, at around 6.4% over 9M 2015/16 (Nielsen data), and Pernod Ricard is closing the gap with the market. Management said that organic sales growth over the year should be between 3% and 4% (our estimate: +3%), accelerating vs last year when sales were flat. The company is multiplying initiatives in the US. Between 2014 and 2015, it has tripled its dedicated salesforce. The price of Absolut has been repositioned in order to better face the competition and new packaging has been introduced. Pernod Ricard is also streamlining the flavours, premiumising the brand with Absolut Elyx (an halo effect is expected) and strengthening its quality credentials, notably with a new marketing campaign which was launched at the beginning of April and is focused on authenticity. The lifting of the embargo on Cuba remains a positive catalyst. The US accounts for as much as 40% of the global rum market and Pernod Ricard should benefit from the rebellious Cuban image of Havana Club. **In Asia, India remains very strong**, with organic sales up 14% in Q3. Pernod Ricard generates volumes that are four times lower, but profits three times higher than its closest competitor in the region. Its market share now reaches 47% vs 33% six years ago. **Western markets are picking up**, in particular Spain which grew high single digit every quarter since the beginning of this fiscal year. The country represents 4% of the group's sales and has a margin in the mid forties (i.e. the same as in the US). The recovery is driven by gin which accounts for 40% of the market, but whiskies are also better. The UK is also doing well, as is Germany.
- Yet short-term weakness. We forecast 1% organic sales decline in Q4 (+2.5% in 9M)** due to: 1/ the reversal of shipment loading in the US in Q3, 2/ an unfavourable comparison base in France as the group overshipped in Q4 2014/15 before the merger of Pernod's and Ricard's IT systems, 3/ an organic sales decline of 10% in China, in line with what the group indicated, and 4/ destocking in South East Asia (Vietnam, Indonesia, Malaysia...). Over the year, organic sales should grow 1.7% with +1.5% in Asia/ROW, +3.3% in Americas and +0.6% in Europe. **We expect EBIT to grow 1% organically over the year, at the low end of the group's guidance (1/3%). We think that 2016/17 should accelerate only slightly vs 2015/16.** There is uncertainty regarding the extent of a recovery in China. The effects of the anti-extravagance policy is proving to be longer than expected and the macroeconomic environment is not helping. Besides, around 20% of Pernod Ricard's China sales are generated by scotch, a category which is still declining in the high double digits. We expect organic sales in 2016/17 to rise 2.6% (China: -5%).

VALUATION

- We downgrade our recommendation to Neutral**, but we maintain our estimates and our Fair Value of EUR107. The stock is relatively inexpensive vs its peers. At yesterday's share price, it is trading at 15.0x EV/EBIT 2015/16e and 14.8x EV/EBIT 2016/17e, 17% and 10% below the peer average. **We think that it will be dead money for some time.** We maintain our preference for Rémy Cointreau and Campari.

NEXT CATALYSTS

- Conference call on Asia on May 31st
- 2015/16 results in August

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Bloomberg	RI FP
Reuters	PERP.PA
12-month High / Low (EUR)	114.4 / 88.3
Market Cap (EUR)	25,202
Ev (BG Estimates) (EUR)	33,756
Avg. 6m daily volume (000)	517.6
3y EPS CAGR	2.8%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-5.1%	-1.9%	-12.2%	-9.7%
Food & Bev.	-1.7%	0.5%	-7.0%	-4.0%
DJ Stoxx 600	-2.4%	1.8%	-11.9%	-8.5%

YEnd Jun. (EURm)	06/15	06/16e	06/17e	06/18e
Sales	8,558	8,693	8,797	9,089
% change		1.6%	1.2%	3.3%
EBITDA	2,456	2,595	2,583	2,663
EBIT	2,238	2,247	2,249	2,336
% change		0.4%	0.1%	3.9%
Net income	1,329	1,343	1,365	1,443
% change		1.0%	1.6%	5.7%

	06/15	06/16e	06/17e	06/18e
Operating margin	26.2	25.8	25.6	25.7
Net margin	10.1	14.7	14.8	15.2
ROE	6.6	9.1	9.0	9.1
ROCE	8.8	10.9	10.7	10.9
Gearing	67.9	60.0	55.1	50.0

(EUR)	06/15	06/16e	06/17e	06/18e
EPS	4.99	5.04	5.13	5.42
% change	-	1.1%	1.6%	5.7%
P/E	19.0x	18.8x	18.5x	17.5x
FCF yield (%)	4.6%	4.6%	4.5%	4.7%
Dividends (EUR)	1.80	1.83	1.86	1.97
Div yield (%)	1.9%	1.9%	2.0%	2.1%
EV/Sales	4.0x	3.9x	3.8x	3.6x
EV/EBITDA	13.9x	13.0x	12.9x	12.4x
EV/EBIT	15.3x	15.0x	14.8x	14.1x



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