2nd September 2016

Food & Beverages

Pernod Ricard

Price EUR105.30

Better year to come

Fair Value EUR112 vs. EUR107 (+6%) **NEUTRAL**

Bloomberg	RI FP
Reuters	PERP.PA
12-month High / Low (EUR)	108.9 / 88.3
Market Cap (EUR)	27,949
Ev (BG Estimates) (EUR)	36,260
Avg. 6m daily volume (000)	496.4
3y EPS CAGR	6.0%

	1 M	3 M	6 M	31/12/15
Absolute perf.	3.5%	7.6%	4.9%	0.1%
Food & Bev.	-1.0%	1.5%	3.4%	-0.1%
DJ Stoxx 600	1.1%	-0.1%	1.5%	-6.1%

YEnd Jun. (EURm)	06/16	06/17e	06/18e	06/19e
Sales	8,682	8,855	9,168	9,556
% change		*2.0%*	*3.5%*	*4.2%*
EBITDA	2,494	2,571	2,680	2,823
EBIT	2,277	2,350	2,451	2,584
% change		*3.2%*	*4.3%*	*5.4%*
Net income	1,380	1,444	1,537	1,642
% change		*4.6%*	*6.4%*	*6.8%*

	06/16	06/17e	06/18e	06/19e
Operating margin	26.2	26.5	26.7	27.0
Net margin	14.2	15.6	16.1	16.5
ROE	9.3	9.7	9.8	9.8
ROCE	6.7	11.3	11.5	11.8
Gearing	64.5	57.8	51.6	45.5

(EUR)	06/16	06/17e	06/18e	06/19e
EPS	5.20	5.44	5.79	6.18
% change	-	*4.6%*	*6.4%*	*6.8%*
P/E	20.3x	19.4x	18.2x	17.0x
FCF yield (%)	4.3%	4.7%	4.8%	4.9%
Dividends (EUR)	1.88	1.97	2.08	8.41
Div yield (%)	1.8%	1.9%	2.0%	8.0%
EV/Sales	4.2x	4.1x	3.9x	3.7x
EV/EBITDA	14.7x	14.1x	13.4x	12.5x
EV/EBIT	16.1x	15.4x	14.6x	13.7x

2016/17 should show an acceleration in organic sales growth mainly driven by China. However, operating leverage is expected to remain limited as the negative mix will only be partly offset by cost savings. We now expect organic sales and EBIT to grow 2.9% and 3.2% respectively compared with previous forecasts for 2.6% and 3.5%. We also adjust for FX. Overall we have revised our EBIT estimates upwards by 3% on average over the next three years. We roll forward by one year and increase our Fair Value to EUR112. Neutral recommendation maintained.

ANALYSIS

- **Acceleration in organic sales growth in 2016/17... We expect organic sales to rise 2.9% next year, which is slightly better than our previous estimate (+2.6%), implying an improving trend vs 2015/16 (+1.8%) which should be mainly driven by China.** Organic sales in the country are now expected to be flat next year (- 5% previously). This compares to a 9% decline in 2015/16. Pernod Ricard was penalised by Scotch whiskeys (20% of its Chinese sales), which continued to drop double digit. The group's value depletions in China have decreased 7% over the past year. **We also factor into our estimates a deceleration in India**, which is the now the no. 2 market (an estimated 10% of group's sales). Organic sales in the country should increase 12% next year, in line with the 2015/16 trend. **We think there is limited room for acceleration in the no. 1 market, the United States.** Sales should rise 4.5% organically in 2016/17 after a 4% increase in 2015/16 and a flattish trend in 2014/15. Jameson and The Glenlivet continued to be the growth drivers. According to Nielsen data, their value depletions were respectively up 23% and 9% last year. The trend of Absolut improved in 2015/16, but sales remained in negative territory. Stabilising the brand is a medium-term objective.
- **…but limited operating leverage. We now expect 3.2% organic EBIT growth in 2016/17 vs +3.5% previously. This is in the mid-range of the group's guidance (2-4%)** and implies a margin improvement of 9bp in organic terms after +7bp in 2015/16. **Pernod Ricard is set to remain penalised by the negative mix (stronger growth in India…), only partly offset by the first benefits of the cost savings programme.** The company expects to generate savings of EUR200m over the 2016-2020 period mainly impacting A&P and costs of goods sold, and to a lesser extent structural costs. Half of these are set to be reinvested, implying a 4% boost to EBIT.
- **EBIT estimates lifted by 3% on average over the next three years. This move takes into account a change in our FX forecast for 2016/17. CFO said that the impact on EBIT should be modestly positive. The GST system voted in August and due to come into force in April 2017 is a downside risk.** Spirits have been excluded, but not their inputs. Consequently, Pernod Ricard and its competitors in India will continue to suffer from tax inefficiencies, while facing an increase in input costs. A drop in margin by 200bp cannot be excluded. The group is currently lobbing for 1) input costs to be excluded from the GST and/or 2) its prices to be increased.

VALUATION

- We roll forward by one year and increase our Fair Value to EUR112. Our Neutral recommendation remains unchanged.

NEXT CATALYSTS

- Rémy Cointreau: Q2 sales on 18th October
- Pernod Ricard: Q1 sales on 20th October

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