INDEPENDENT RESEARCH

23rd November 2016

# Spirits

## Rising to the Generation Y challenge

### Spirits

| | | | |
|---|---|---|---|
| **REMY COINTREAU** | | **BUY** | **FV EUR84** |
| 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 |

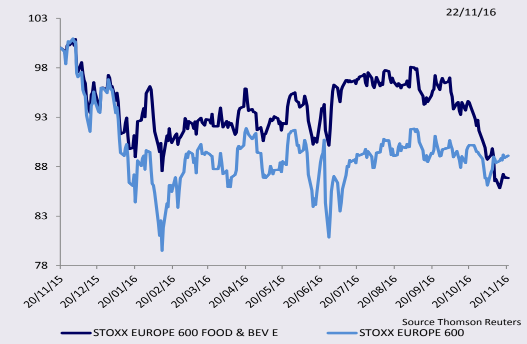
| | | | |
|---|---|---|---|
| **CAMPARI** | | **BUY** | **FV EUR10.7** |
| Bloomberg | CPR IM | Reuters | CPR.MI |
| Price | EUR8.87 | High/Low | 10.09/6.94 |
| Market Cap. | EUR5,152m | Enterprise Val | EUR6,453m |
| PE (2016e) | 25.0x | EV/EBIT (2016e) | 18.2x |

| | | | |
|---|---|---|---|
| **PERNOD RICARD** | | **BUY** | **FV EUR115** |
| 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 |

| | | | |
|---|---|---|---|
| **MBWS** | | **NEUTRAL** | **FV EUR17.1** |
| | **COVERAGE INITIATION** | | |
| 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 |

| | | | |
|---|---|---|---|
| **DIAGEO** | | **NEUTRAL** | **FV 2200p** |
| 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 21st 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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# Table of contents

# 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

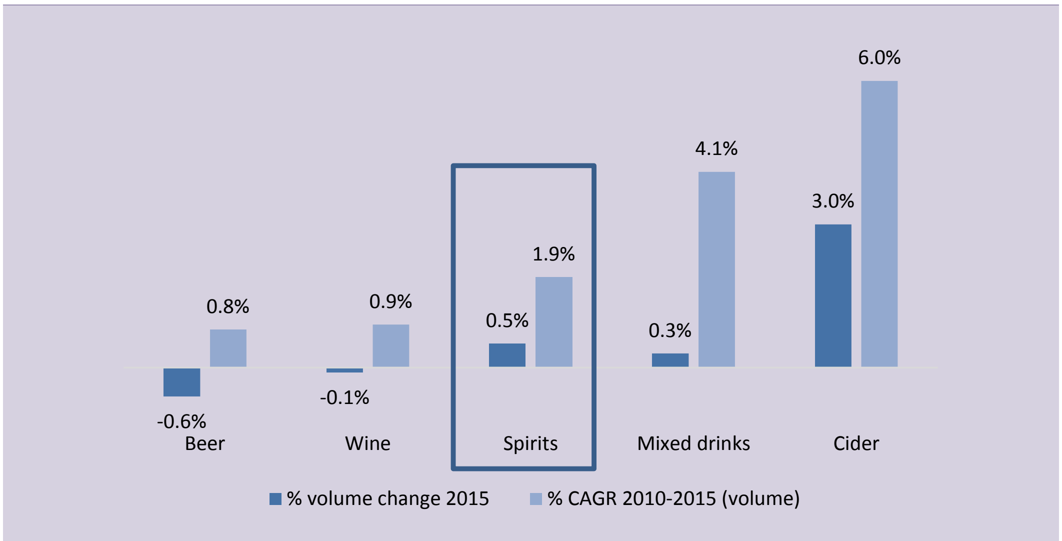
Faced with sluggish growth, it becomes all the more important for spirits companies to be able to capture the attention of the Millennial generation. The representatives of this age bracket represent the driving force in consumption.

## 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.**

Global spirits volumes grew by only 0.5% in 2015

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

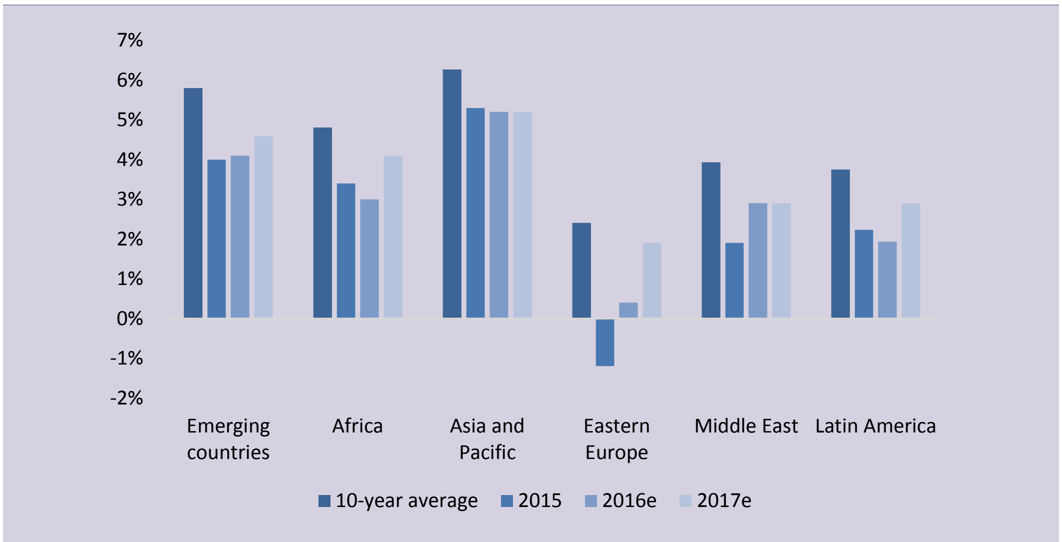



*Source: IWSR*

### 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**



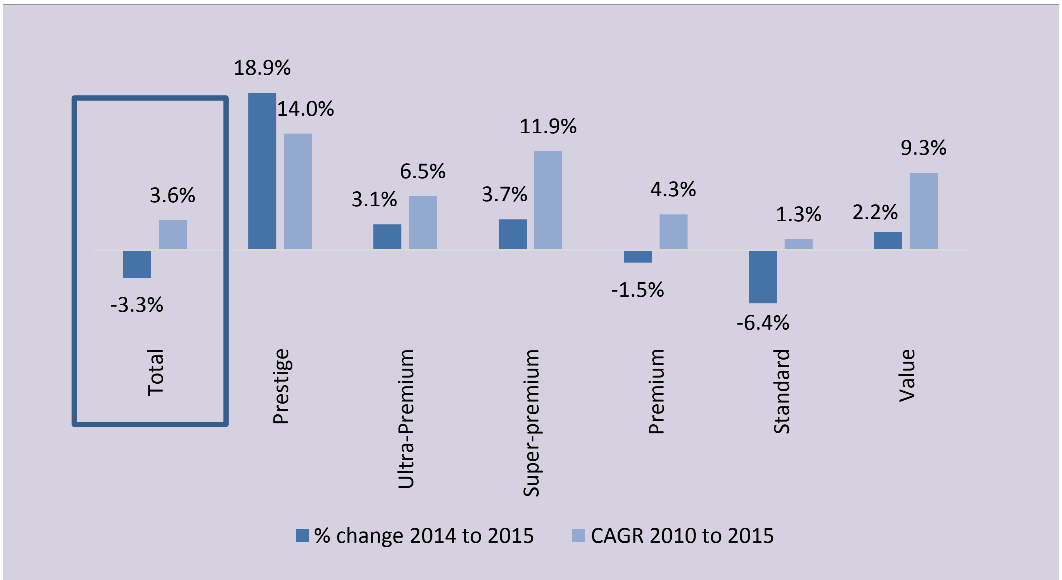

*Source: IMF*

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**

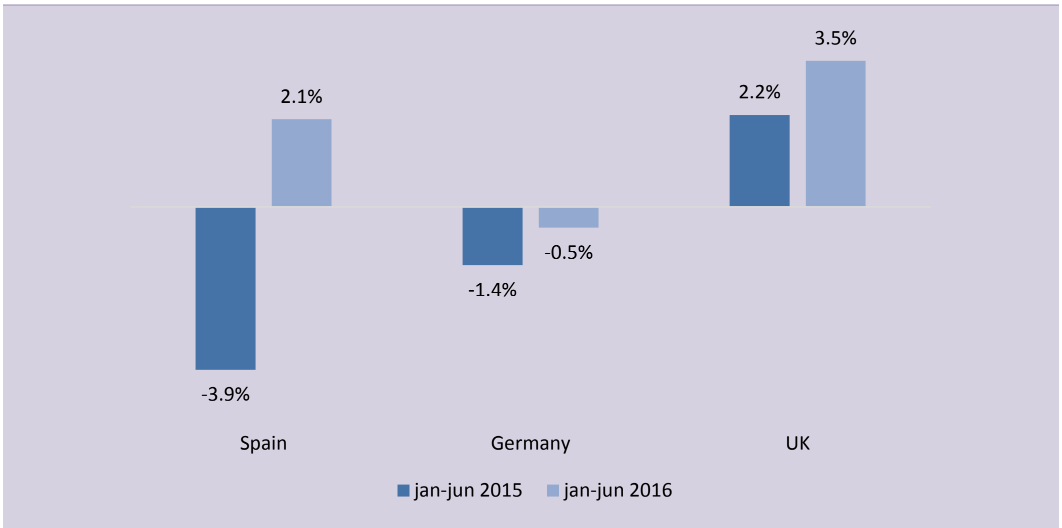



*Source: IWSR*

## 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**

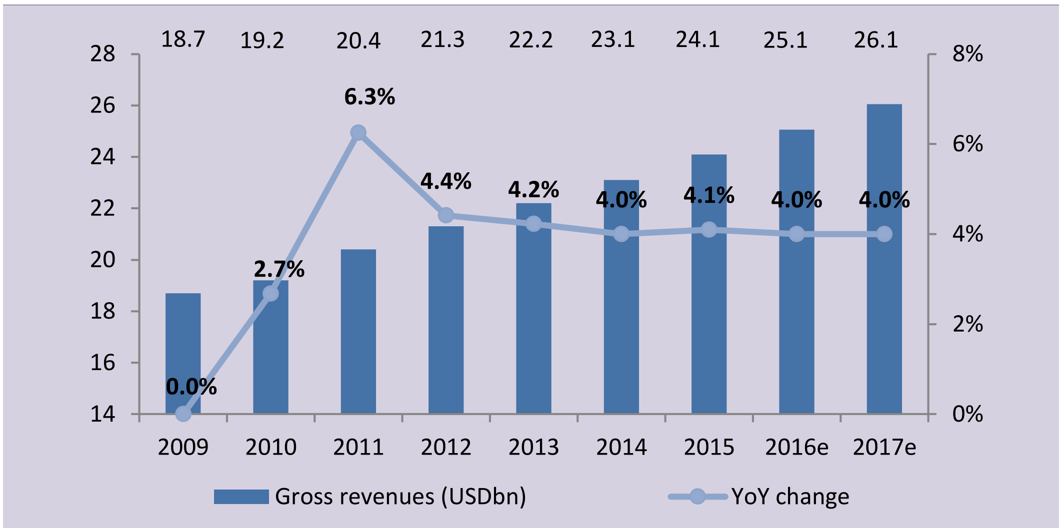



*Source: Nielsen*

**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%.

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

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

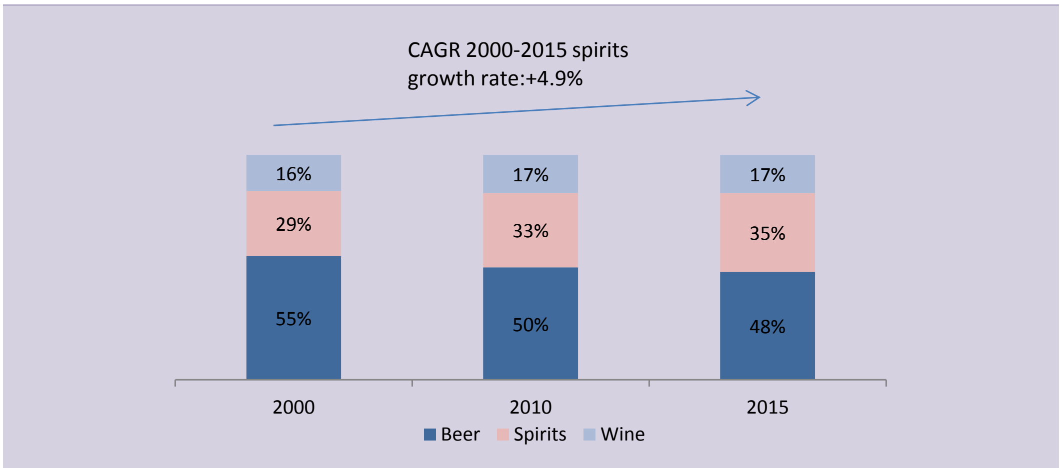



*Source: DISCUS*

**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**

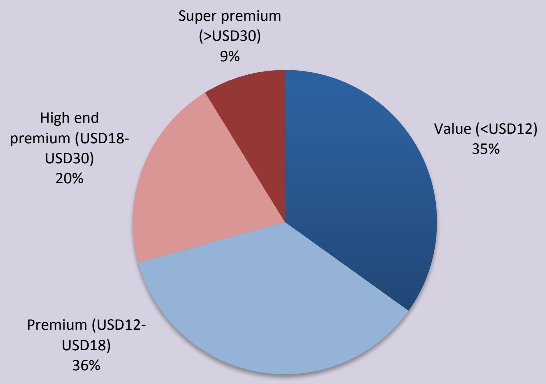
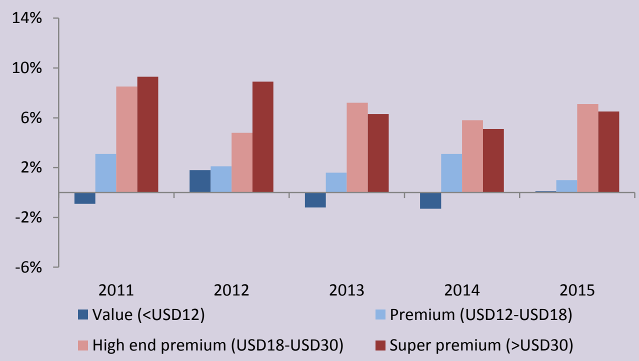



**Fig. 8: Annual volume growth by price segment**



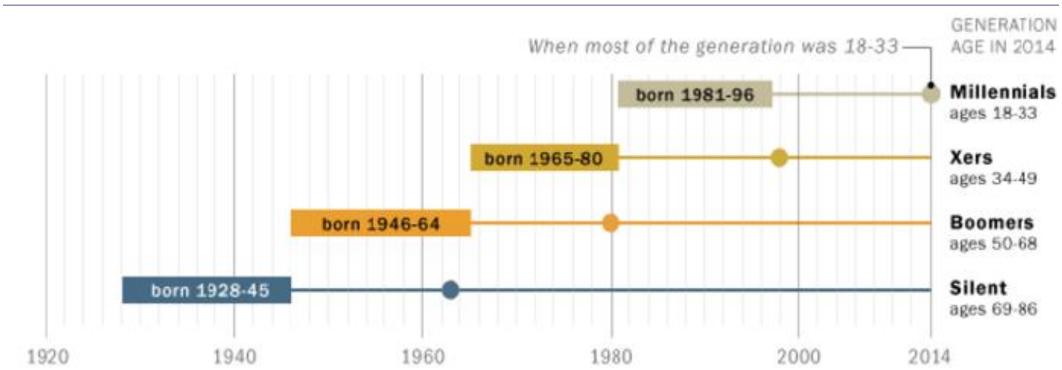

*Source: Distilled Spirits Council of the United States*

- **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**

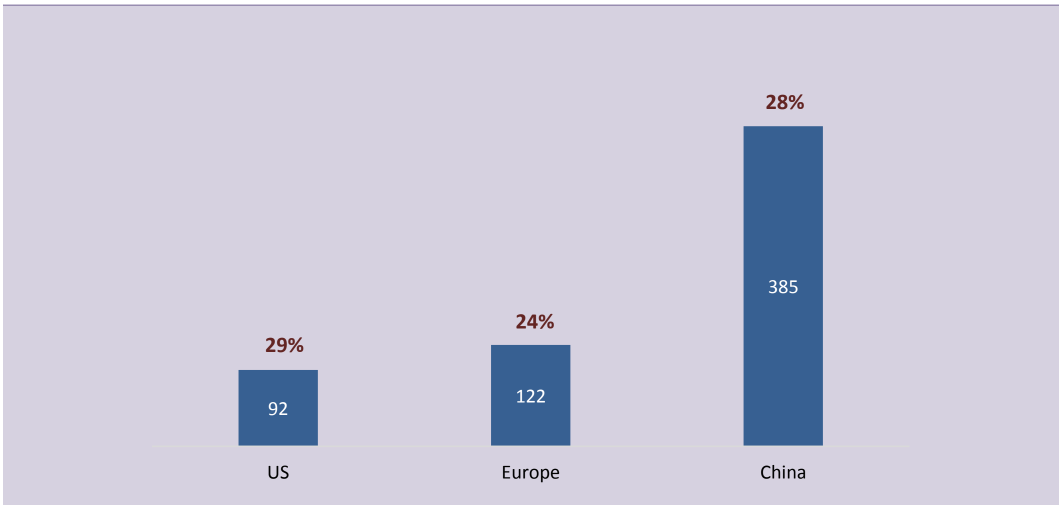



*Source: Pew Research Center*

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.

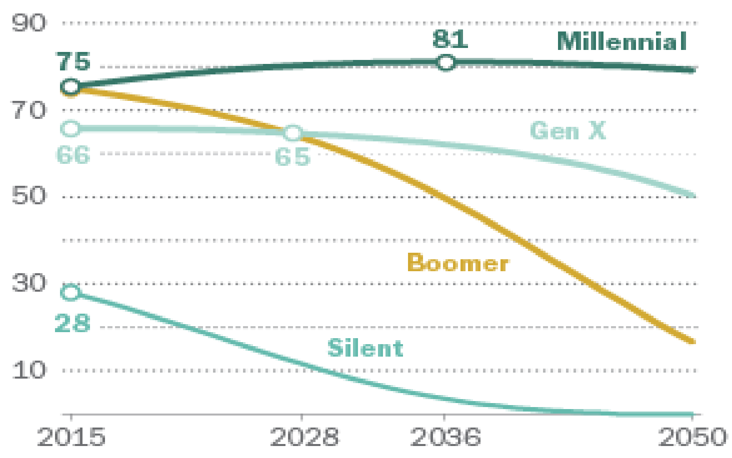
**Fig. 10: The Millennials: their number (in millions) and their percentage of the population**




*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*

What is a Millennial?

**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:**

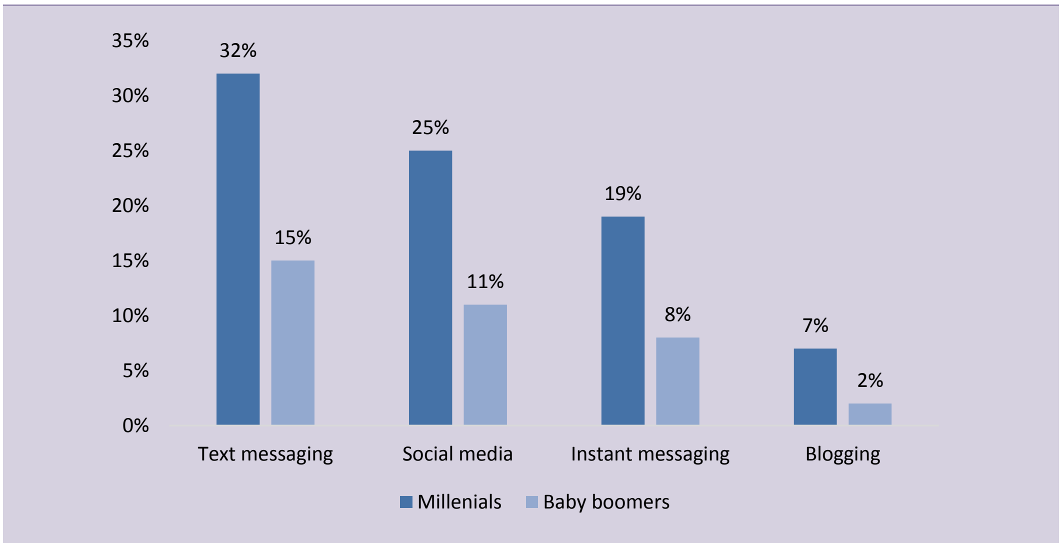
- **They think 'collective'.** Contrary to common belief, the members of Generation Y are far less individualistic than their Generation X elders. Millenials are thus not particularly receptive to 'me against the world'-style advertising and more receptive to campaigns focusing on team spirit, solidarity 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 synomynous 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*

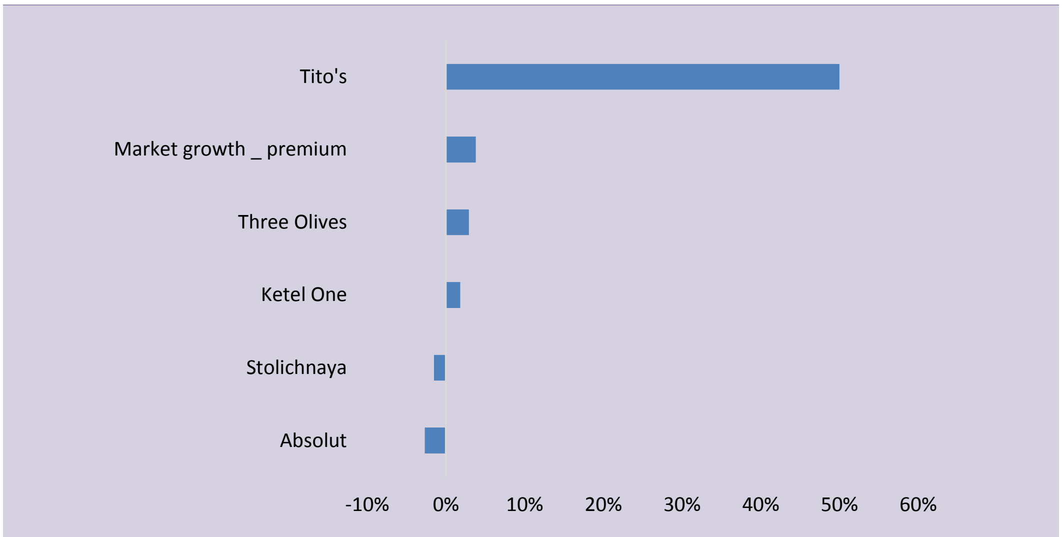
**The craft trend is particularly strong in the United States, representing 49% of craft spirit launches and numbering 1,280 distillers offering this type of product, a figure up by 16% relative to 2007.** This growth is explained in part by the consolidated nature of the distribution system. **The other 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.

Tito's


*Source: Fifth Generation*

**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**

| Jack Daniel's Master Distiller Series no.1/2/3 | The Master Distiller's Reserve | Russell's Reserve |
|---|---|---|


*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 Crafthouse Cocktails (Chicago) and Nelson's Green Brier Distillery (Tennessee). **There is, however, a risk of consumers feeling duped.** The dilemma is insoluble: consumers assimulate 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

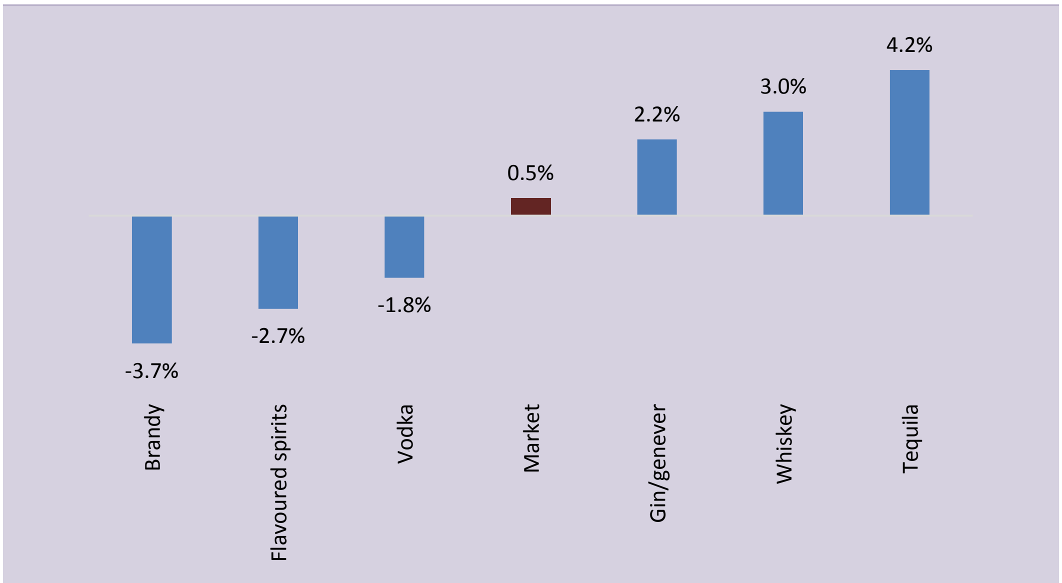
The Millennials' quest for authenticity has enabled the emergence of the craft trend but also led to changes in the growth dynamic between categories and a specific appetite for brown alcohols (whisk(e)ys and cognac) and niche categories like tequila/mezcal and bitters.

### 3.2.1. Whisk(e)ys

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

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%.**

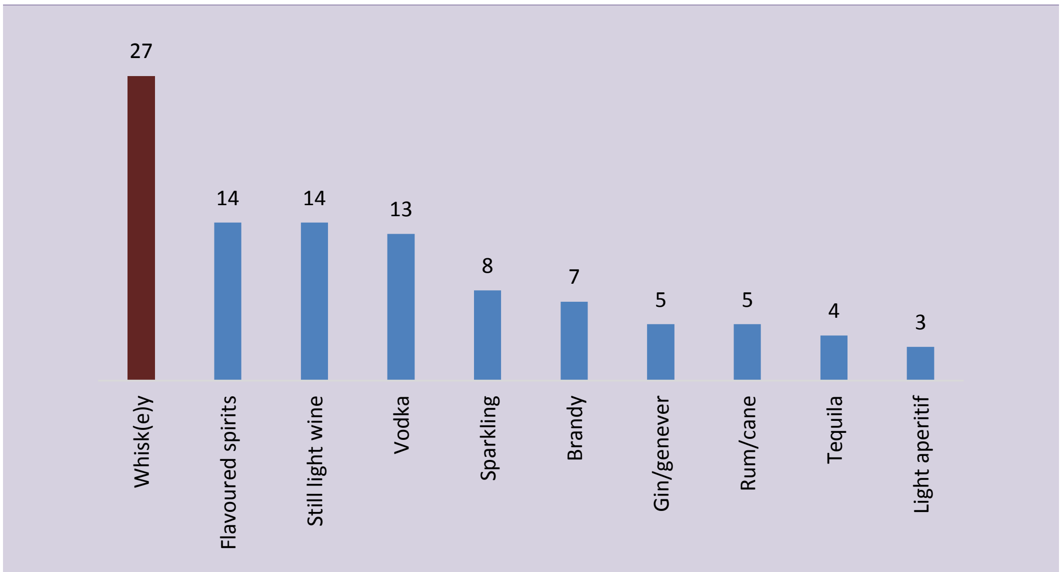
**Fig. 22: Growth by category of spirits (in volume), 2015**




*Source: IWSR*

Whisk(e)y is 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*

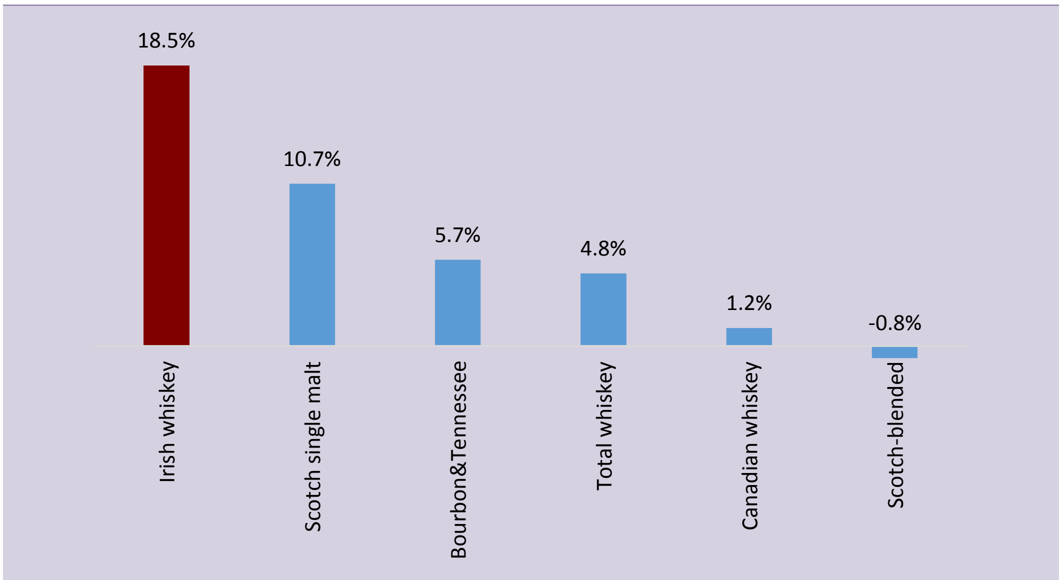
**The trend is particularly marked in the United States. After years of vodka domination, consumers are showing renewed interest in whisk(e)ys.** In 2015, their growth rates (in volume) reached 4.9% whereas vodka posted only a 1.8% increase.

**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.

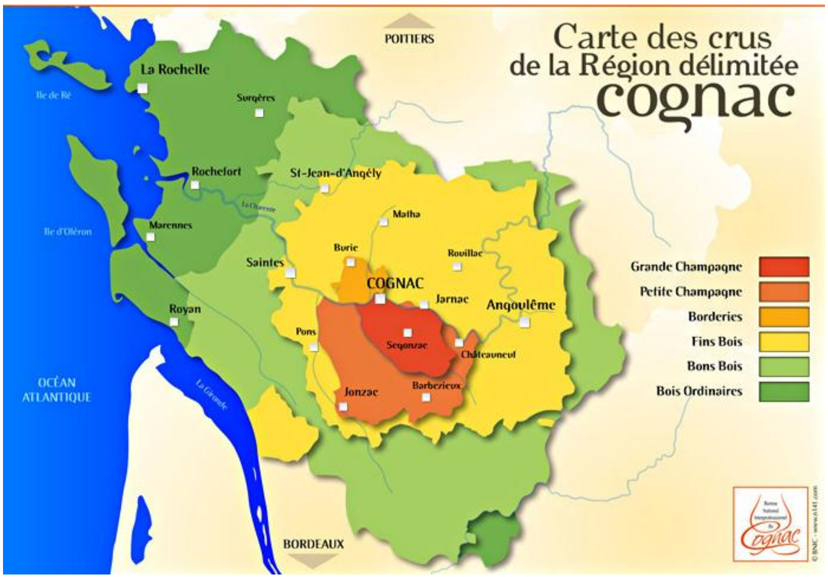
**Inversely, vodka does not correspond to the expectations of this generation.** It does not require ageing and has low barriers to entry resulting in an abundant offer. Very often it has no taste. The proliferation in aromatised versions has succeeded in convincing Generation Y that vodka is no more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

### 3.2.2. Cognac

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

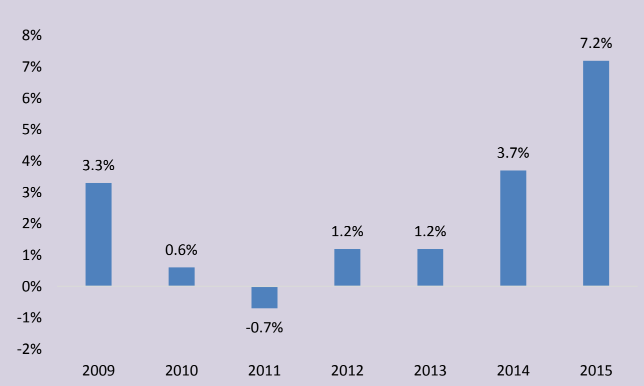
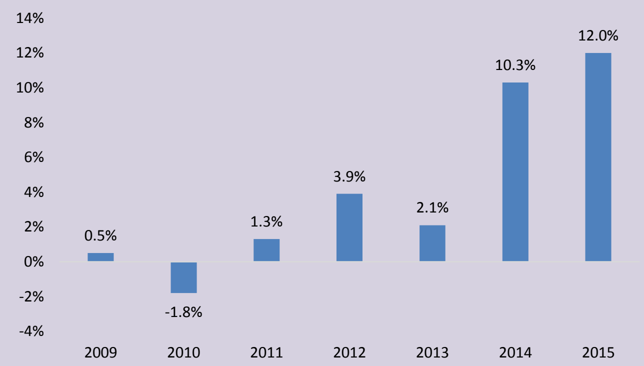


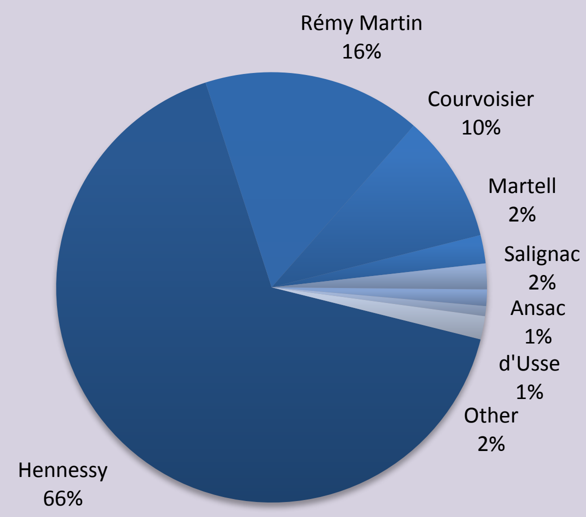

**Fig. 28: Growth in cognac market value in the United States**




*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**

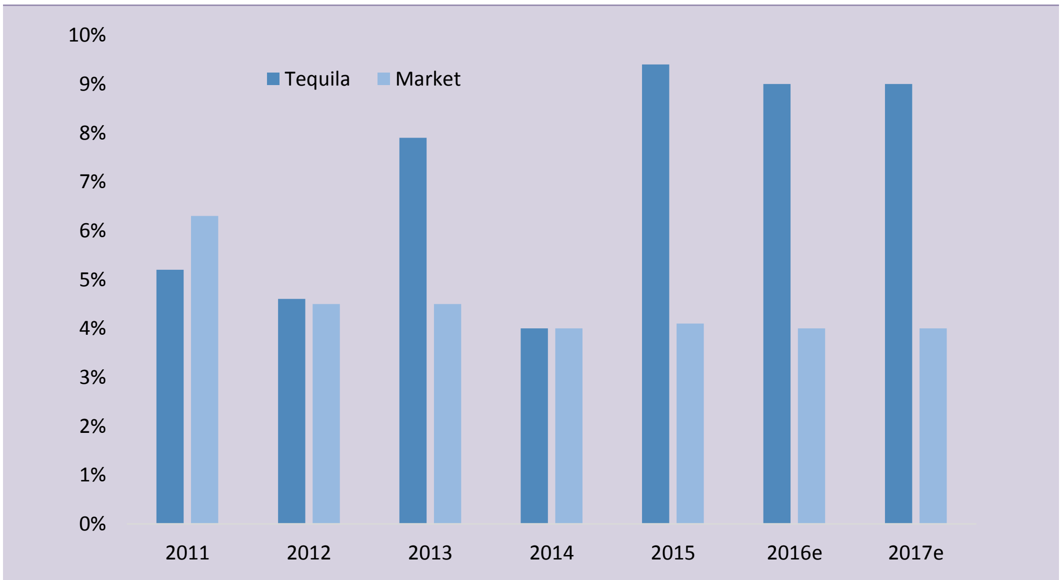



*Source: Impact Databank*

### 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.

**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.

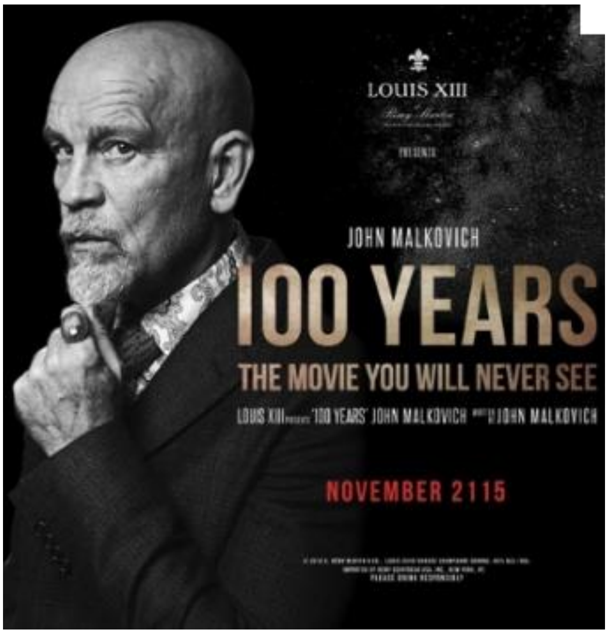
**Advertising campaigns have been refocused around the idea of adventure.** For example, Bacardi's 'Fly Beyond' TV spot for its Grey Goose vodka has a group of friends embarking on a voyage in a dirigible during which they watch a black and white film projected onto the clouds while drinking a Grand 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 Olmeca and Altos offer a tool box enabling consumers to make their own cocktails.

**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**

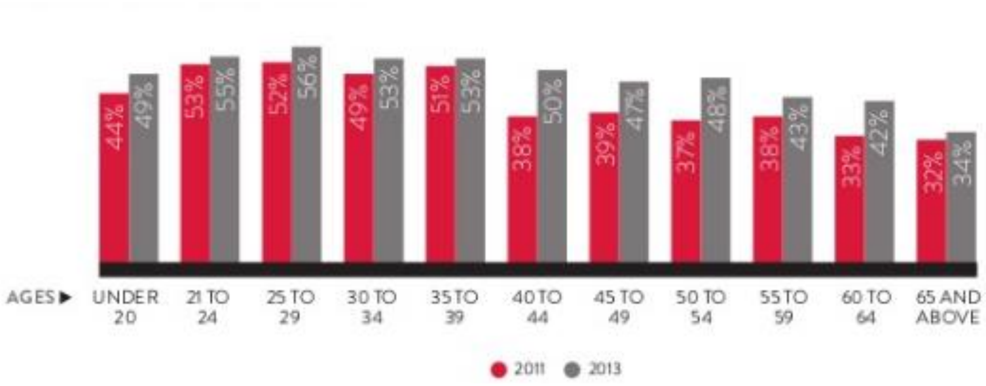

*Source: Rémy Cointreau, Pernod Ricard*

**Other initiatives are emerging**. Within the framework of the Absolut Electrik launch, Pernod Ricard created Electrik 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*

## 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 cannibis 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**

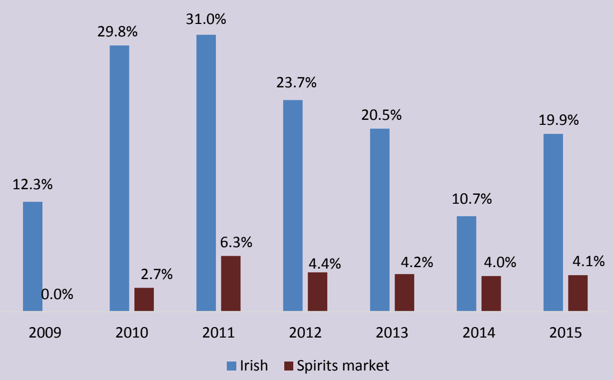
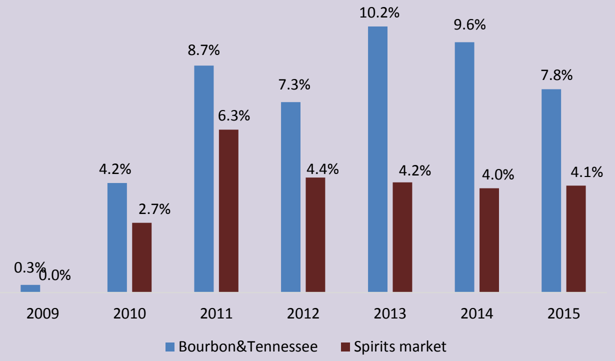



**Fig. 2: Growth in bourbon/tennesse market value in the US**




*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, 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*

Seedlip


*Source: Diageo*

- **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.

# 5. Rémy Cointreau: the best positioned

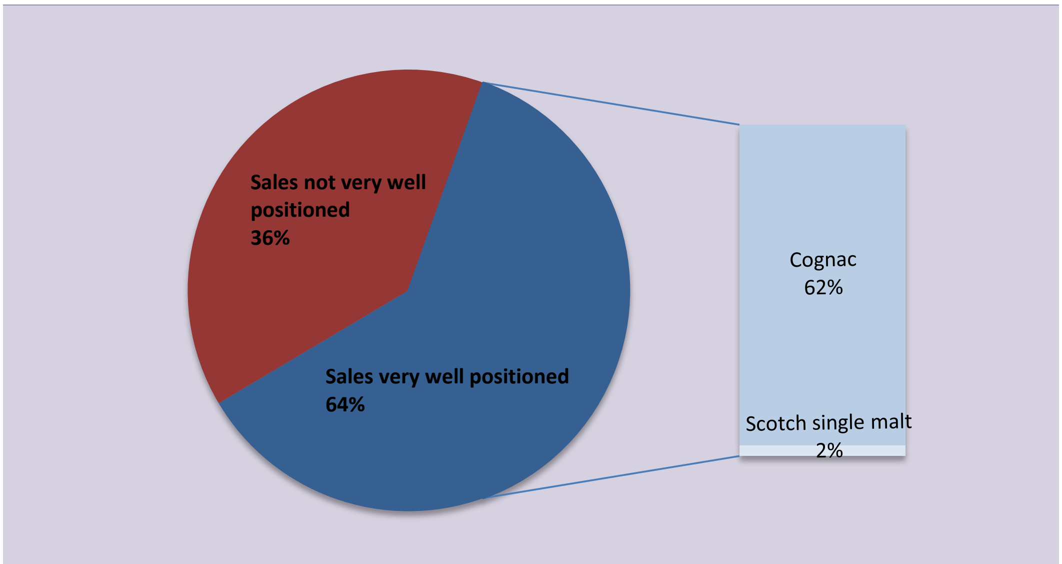
Rémy Cointreau generates 64% of its sales in categories in phase with the Millennial generation (5.1), i.e. mainly cognac (62% of sales) but also, to a lesser extent, single-malt scotch (2%). The Campari portfolio, with its high proportion of bitters and bourbon, is also attractive (5.2). We calculate 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

Rémy Cointreau: the best positioned to contend with Generation Y

**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.

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

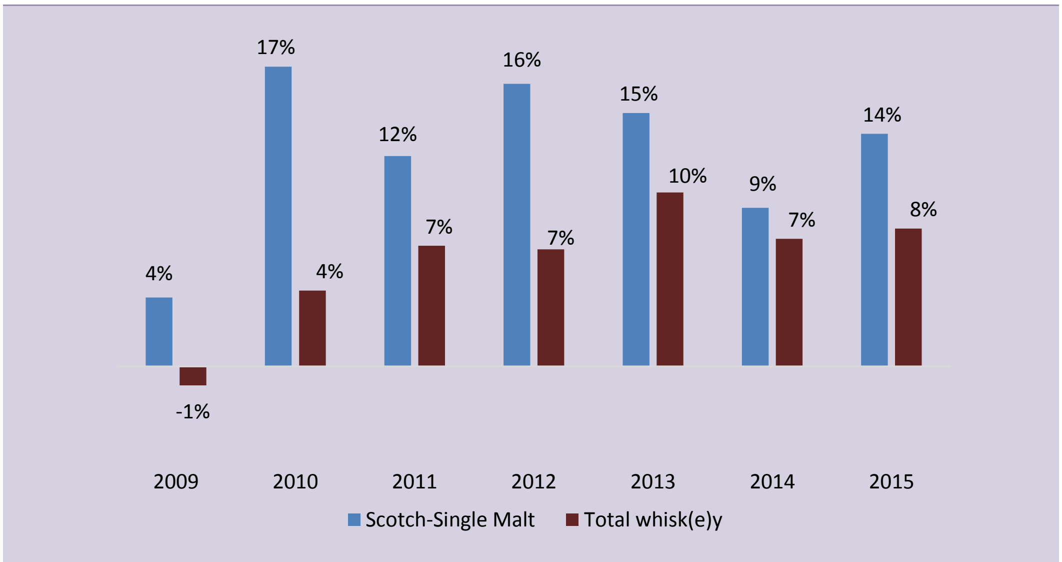



*Source: Rémy Cointreau, Bryan, Garnier & Co*

- **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.**

| Bruichladdich | Port Charlotte | Octomore |
|---|---|---|
|  |  |  |

*Source: Rémy Cointreau*

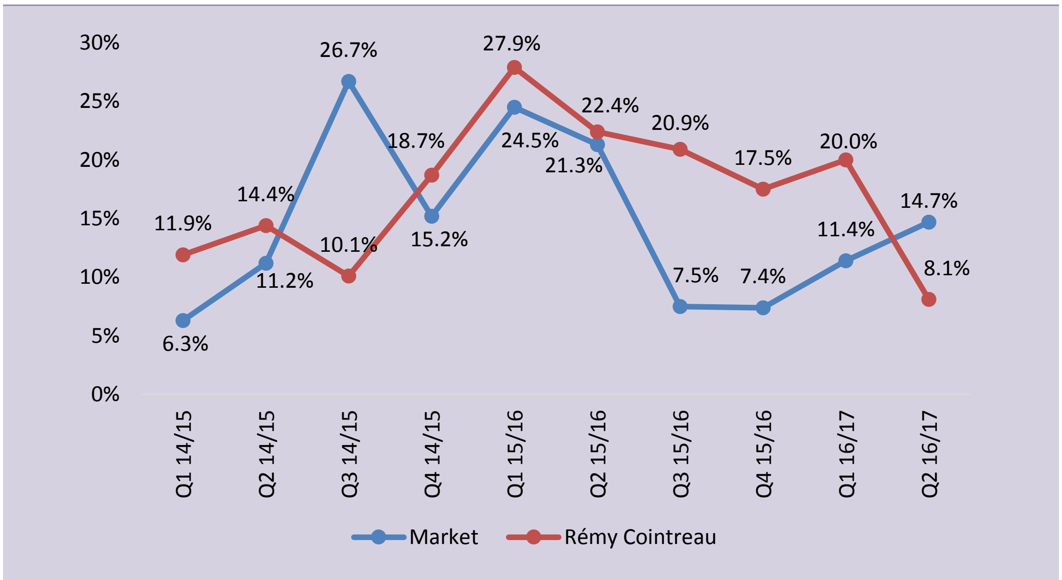
- **Cognac: 62% of sales**

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 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 Xioming. 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.

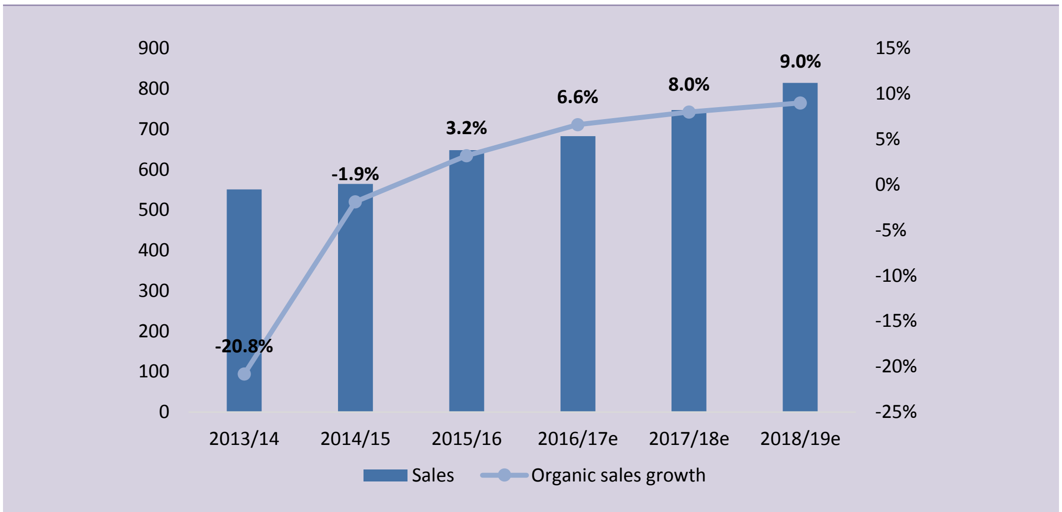
**Fig. 13: 'One Life/Live Them' campaign in the United States …**

**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**



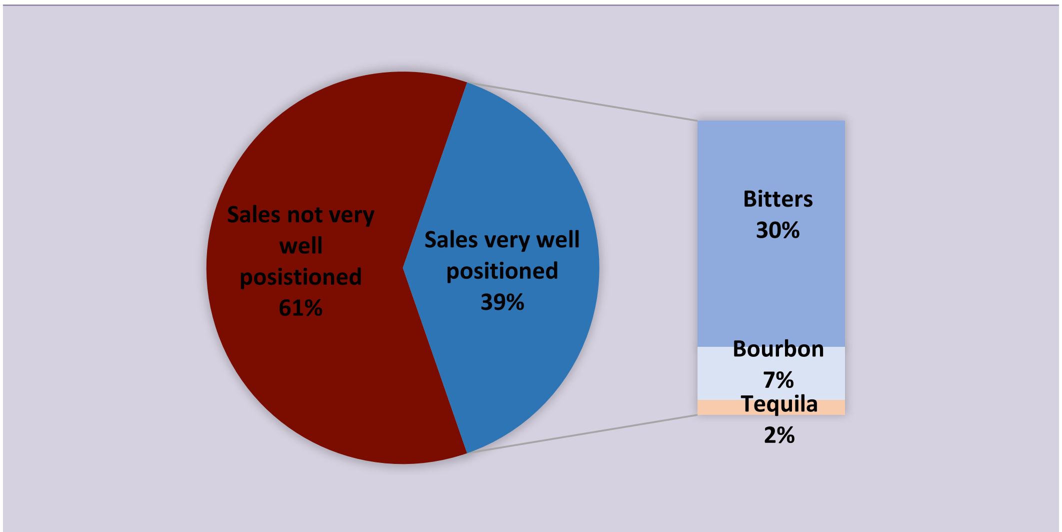

*Source: Rémy Cointreau, Bryan, Garnier & Co*

## 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**

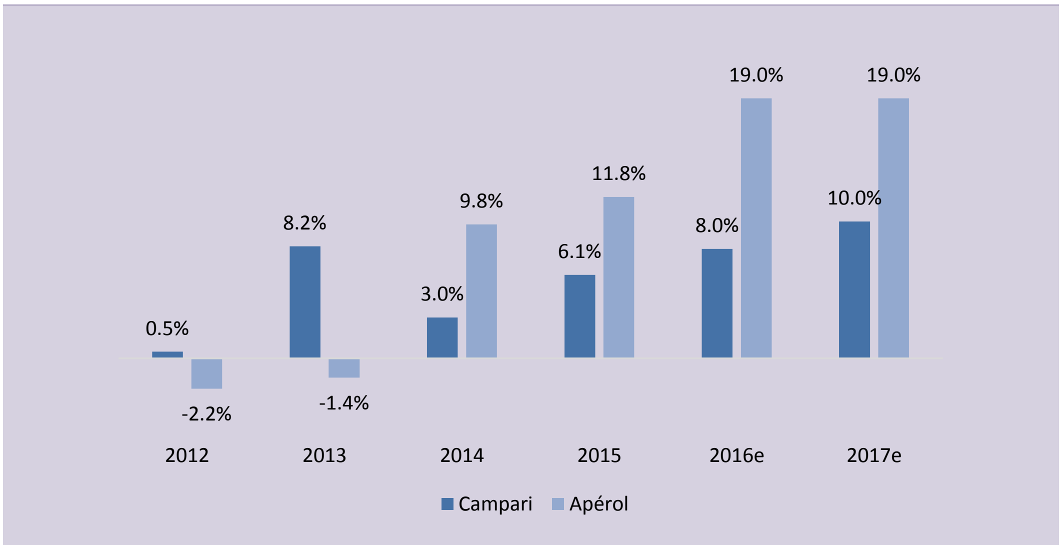
| CAMPARI | PERNOD RICARD | DIAGEO | REMY COINTREAU | BROWN-FORMAN |
|---|---|---|---|---|
| Campari | Ramazotti | Romana Sambuca | | Tuaca |
| Aperol | Becherovka | | | |
| Campari Soda | Suze | | | |
| Cynar | | | | |
| Averna | | | | |
| Biancosarti | | | | |

*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 accleration relative to 2015, marked by respective increases of 2.9% and 4.8%.

The Negroni cocktail


*Source: Campari*

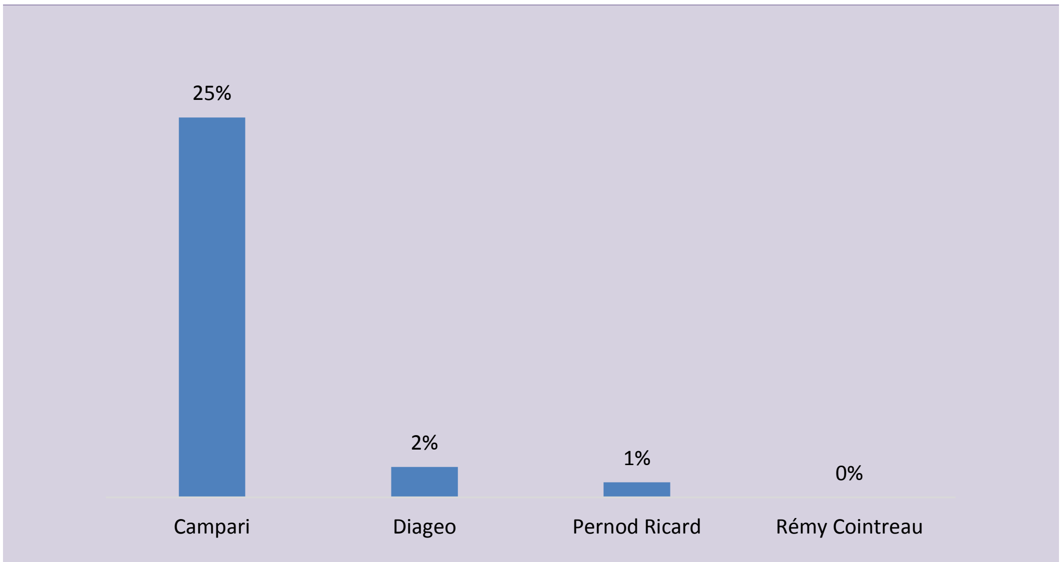
**Campari and Aperol are also enjoying exponential growth in new markets.** In the United States, Campari and Aperol have seen triple-digit growth over several years and now account for 25% of the Italian company's sales in the country. As outlined above, the fashion for classical cocktails has led to 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 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%).

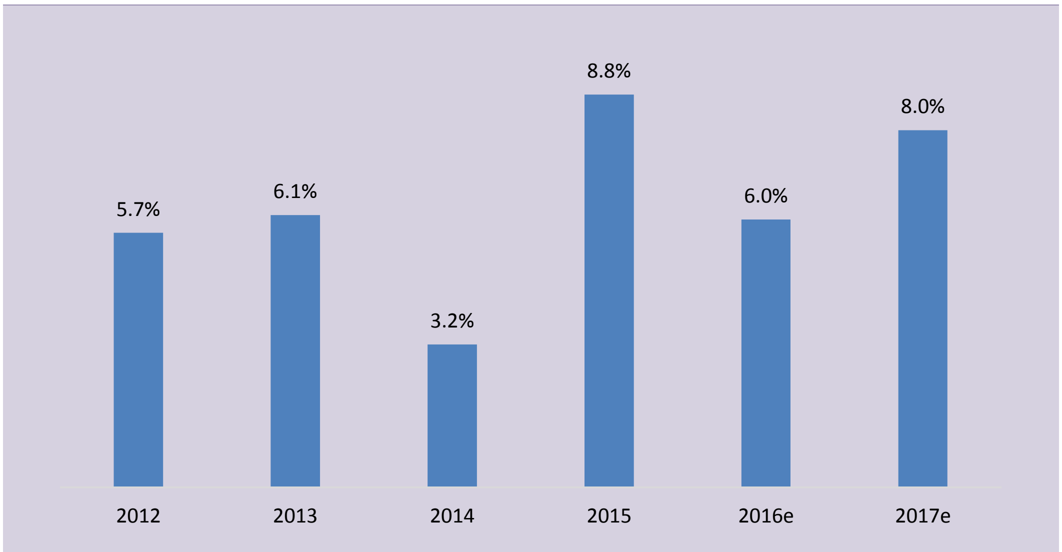
**Fig. 19: Percentage of bourbon and tennessee in US sales**




*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%).

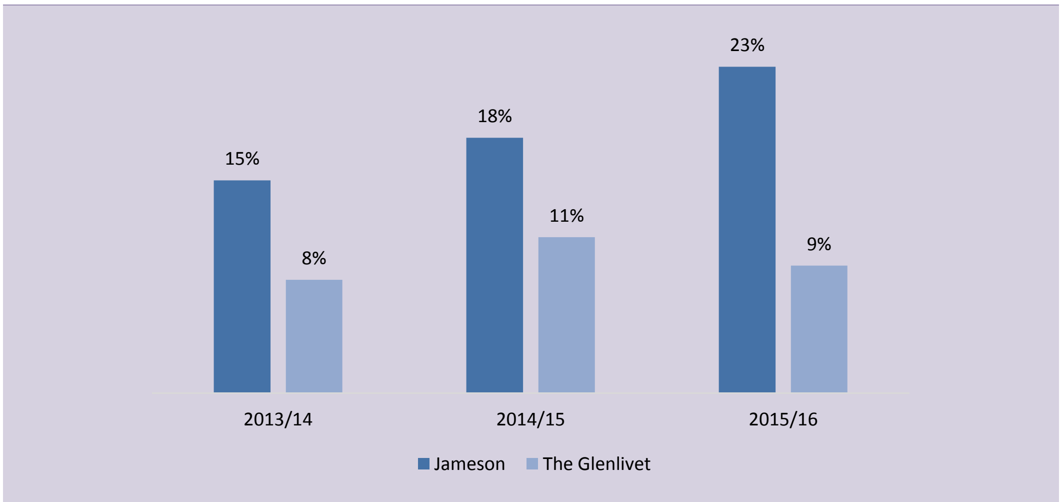
**Fig. 21: The Pernod Ricard portfolio (% of group sales)**


*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.

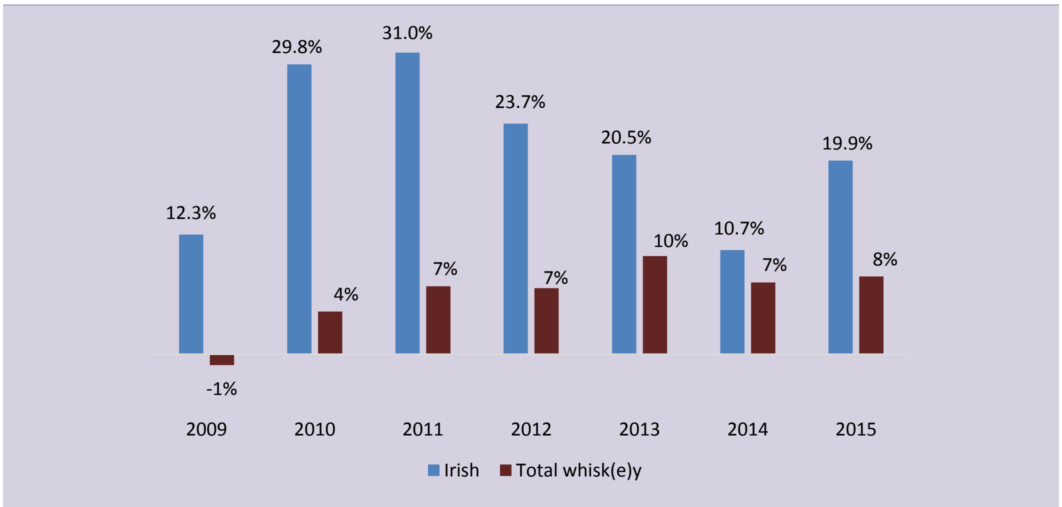
**Fig. 22: Sell-out in the United States for Jameson and The Glenlivet**




*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**



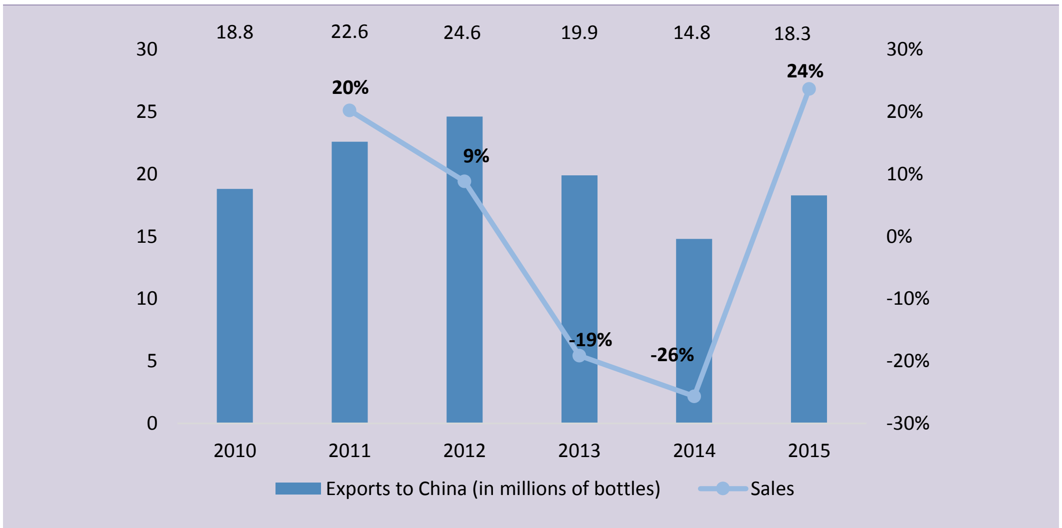

*Source: DISCUS*

- **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**

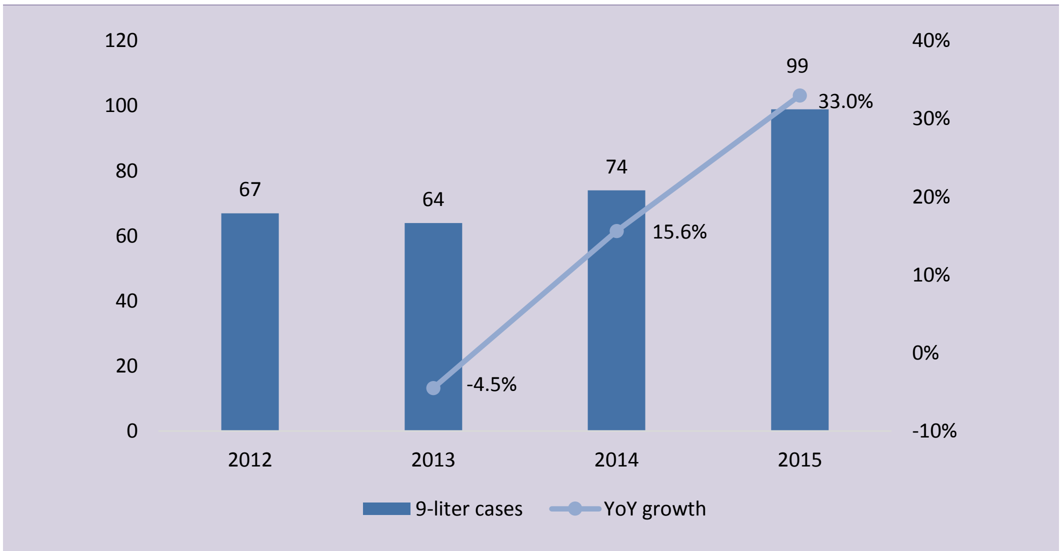



*Source: BNIC*

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.

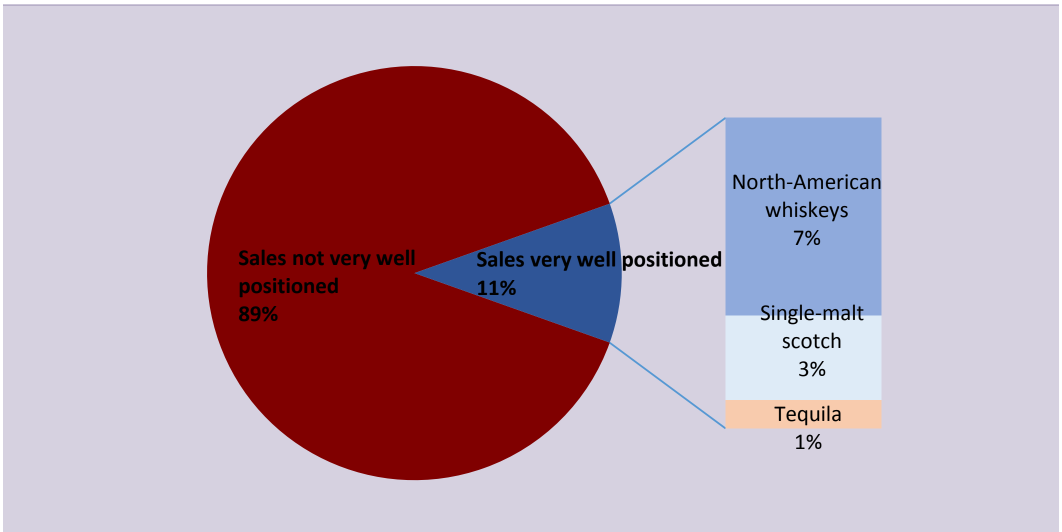
- **Tequila: 1% of sales**

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 Avión 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**

In the United States, North-American whiskeys contributed 50% of the growth in the group's spirits 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 acccount 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.

Don Julio


*Source: Diageo*

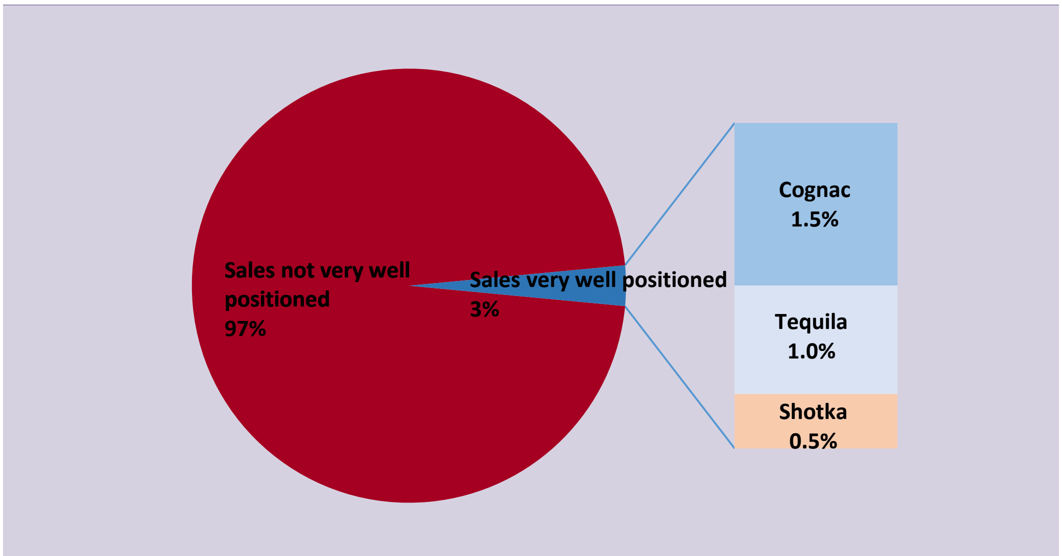
- **Tequila: 1% of sales**

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**

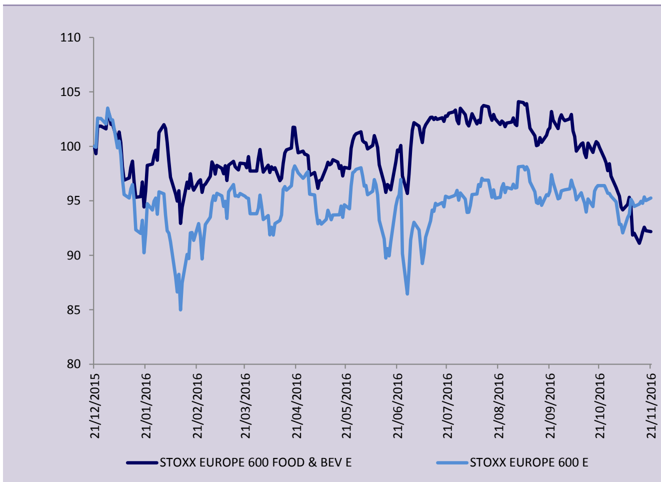
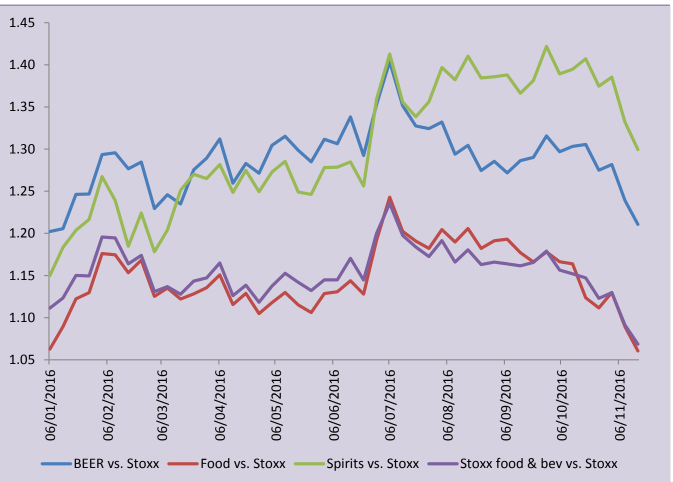


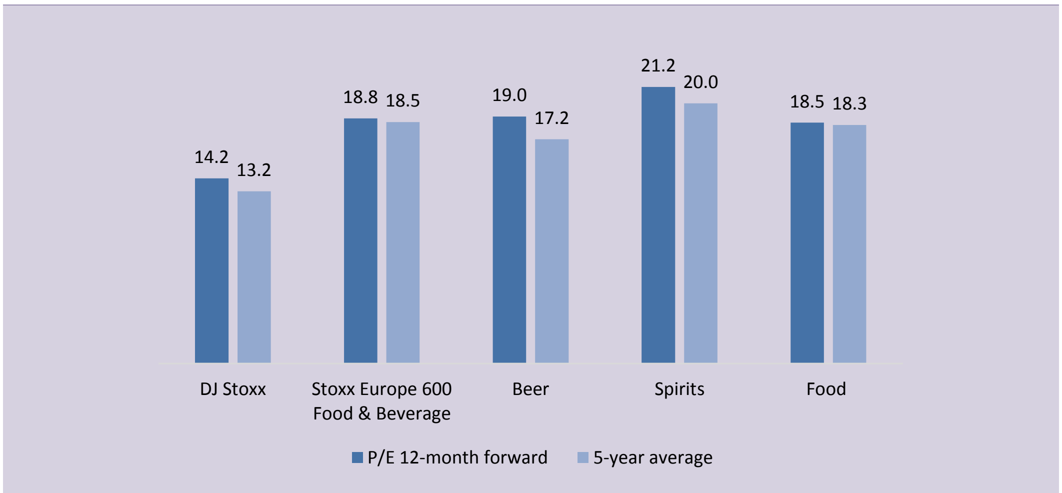

**Fig. 29: Relative stock market performances of spirits, brewers and food companies compared with the DJ Stoxx**




*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*

## 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**

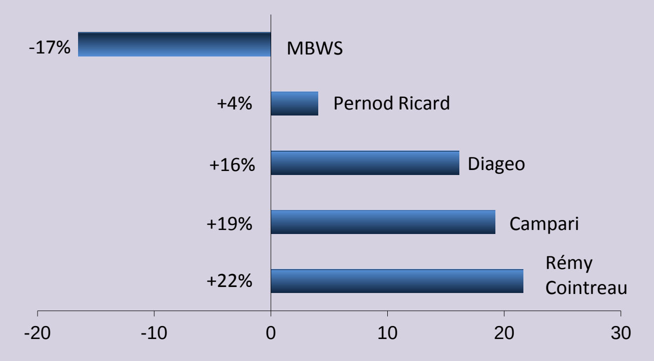
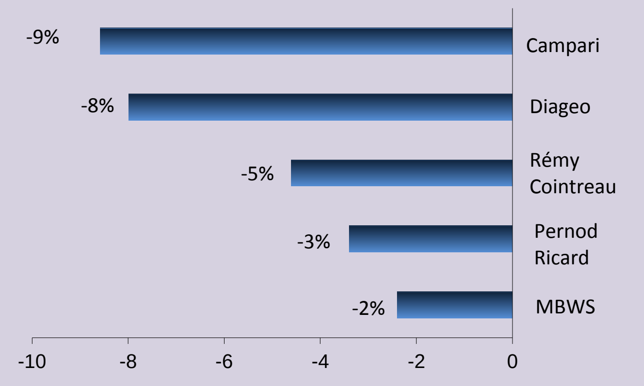



**Fig. 32: Performance over the last three months vs the DJ Stoxx**




*Source: Thomson Reuters*

**Fig. 33: 2017e EV/EBIT**

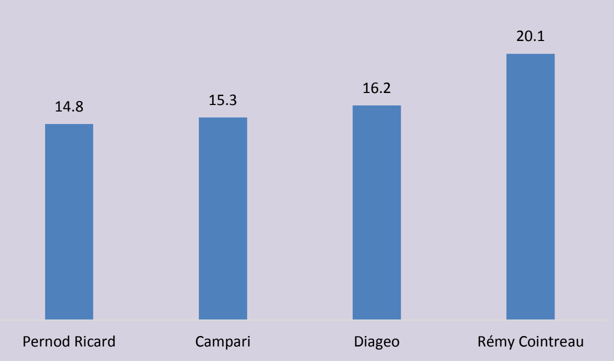
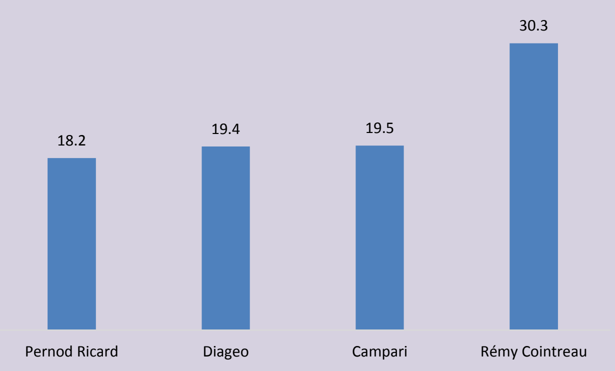



**Fig. 34: 2017e P/E**




*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 18th (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 |
|---|---|---|---|
| **Campari** | EUR8.9 | BUY | EUR10.7 |
| **Diageo** | 2,005p | NEUTRAL | 2150p |
| **Pernod Ricard** | EUR101.8 | BUY | EUR115 |
| **Rémy Cointreau** | EUR74.7 | BUY | EUR84 |
| **MBWS** | EUR15.7 | NEUTRAL | EUR17.1 |

*Source: Thomson Reuters, Bryan, Garnier & Co*

INDEPENDENT RESEARCH UPDATE

23rd November 2016

Food & Beverages

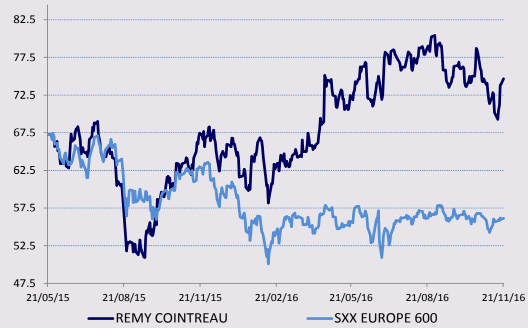
# Rémy Cointreau

## Near-ideal positioning

**Fair Value EUR84** (price EUR74.67) **BUY-Top Picks**

| | |
|---|---|
| Bloomberg | RCO FP |
| Reuters | RCOP.PA |
| 12-month High / Low (EUR) | 80.4 / 58.1 |
| Market capitalisation (EURm) | 3,711 |
| Enterprise Value (BG estimates EURm) | 4,145 |
| Avg. 6m daily volume ('000 shares) | 93.10 |
| Free Float | 45.7% |
| 3y EPS CAGR | 12.6% |
| Gearing (03/16) | 41% |
| Dividend yield (03/17e) | 2.14% |

| YE March | 03/16 | 03/17e | 03/18e | 03/19e |
|---|---|---|---|---|
| Revenue (EURm) | 1,051 | 1,076 | 1,145 | 1,227 |
| EBIT (EURm) | 178.40 | 206.46 | 227.56 | 256.28 |
| Basic EPS (EUR) | 2.11 | 2.46 | 2.84 | 3.24 |
| Diluted EPS (EUR) | 2.27 | 2.46 | 2.84 | 3.24 |
| EV/Sales | 3.97x | 3.85x | 3.59x | 3.31x |
| EV/EBITDA | 20.9x | 18.3x | 16.4x | 14.4x |
| EV/EBIT | 23.4x | 20.1x | 18.1x | 15.8x |
| P/E | 32.9x | 30.3x | 26.3x | 23.0x |
| ROCE | 16.5 | 17.3 | 18.0 | 18.3 |




**In view of its status as a quasi pure cognac player, Rémy Cointreau is the company the best positioned to contend with the Millennial generation. We reiterate our Buy recommendation and our Fair Value of EUR84.**

- **A dynamic US market…**The group's largest market, representing 35% of sales and 44% of the operating result, is posting very robust growth rates. Value depletions have increased by 13% in the last twelve months, mainly driven by cognac whose consumption has changed from being emblematic of a community to a generational symbol.

- **…and a pick-up in China**. This country is also showing very marked signs of an improvement. The company reported 5% growth in its Chinese value depletions in the first half of the year, representing a significant acceleration after the flat outcome in 2015/16. Rémy Cointreau is targeting a return to sales growth in 2016/17.

- **A strategic plan on the right track.** The company is aiming to become the leader in exceptional spirits which should represent 60% to 65% of sales by 2019/20. 2015/16 may be deemed to represent a first successful step in this direction, in that their proportion of sales progressed by 400bps in one year to 49%.

**BUY. Fair Value of EUR84**. In our sector report, we calculate that 64% of Rémy Cointreau's sales are aligned with the tastes of the Millennial generation. These are mostly generated from cognac (62% of sales) but also, to a lesser extent, from single-malt scotch (2%). This reinforces our positive conviction on the stock. We reiterate our Buy recommendation and our DCF-derived Fair Value of EUR84.

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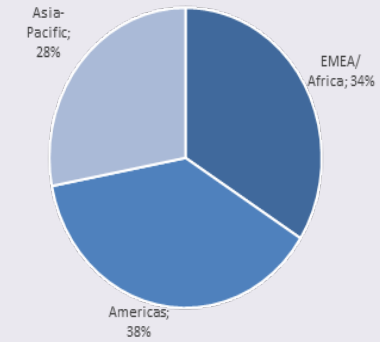
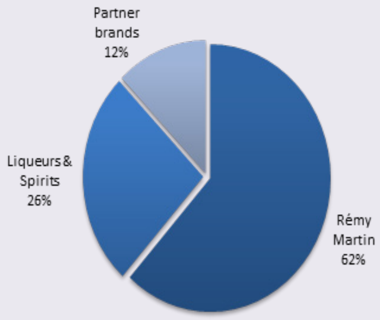
Cédric Rossi




## Company description

Founded in 1724, Rémy Cointreau is a major player in the Wines & Spirits industry. It has a portfolio of widely recognised premium brands and is a reference in the cognac industry (60% of sales). The Hériard-Dubreuil family ows 52% of the capital and 69% of the voting rights.

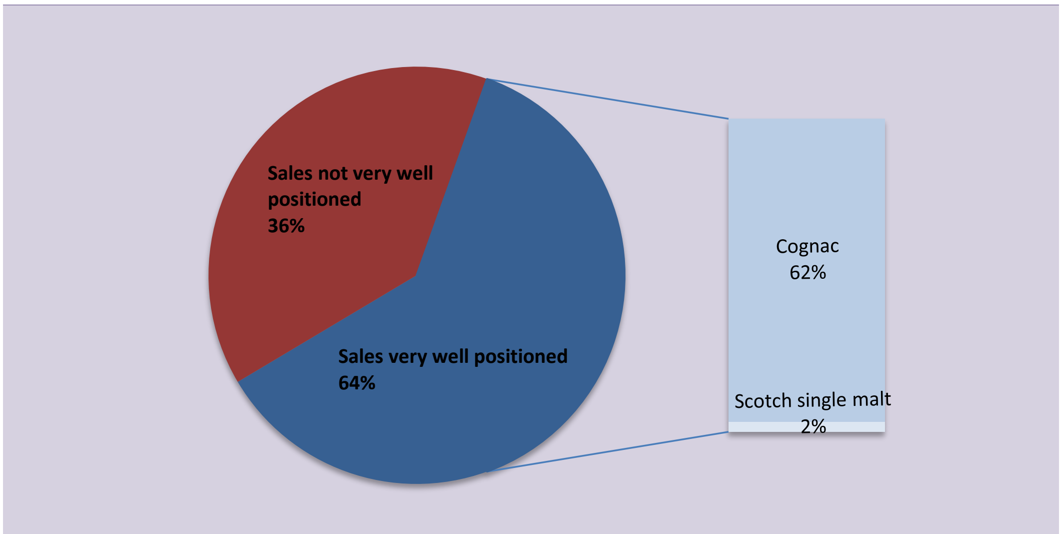
| Simplified Profit & Loss Account (EURm) | 31/03/14 | 31/03/15 | 31/03/16 | 31/03/17e | 31/03/18e | 31/03/19e |
|---|---|---|---|---|---|---|
| Revenues | 1,032 | 965 | 1,051 | 1,076 | 1,145 | 1,227 |
| *Change (%)* | *-13.6%* | *-6.4%* | *8.9%* | *2.5%* | *6.4%* | *7.1%* |
| Gross profit | 618 | 618 | 666 | 707 | 763 | 827 |
| EBITDA | 167 | 178 | 200 | 227 | 250 | 282 |
| EBIT | 150 | 156 | 178 | 206 | 228 | 256 |
| *Change (%)* | *-38.8%* | *3.9%* | *14.4%* | *15.7%* | *10.2%* | *12.6%* |
| Financial results | (26.2) | (29.7) | (27.3) | (23.0) | (17.0) | (16.0) |
| Pre-Tax profits | 119 | 127 | 151 | 183 | 211 | 240 |
| Tax | (45.8) | (33.5) | (44.1) | (56.9) | (65.3) | (74.5) |
| Profits from associates | (10.9) | (0.70) | (4.8) | (0.60) | 0.0 | 0.0 |
| Profit from continuing operations | 62.4 | 92.6 | 103 | 126 | 145 | 166 |
| Net profit (loss) from discontinued operations | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Minority interests | 0.0 | 0.0 | 0.10 | 0.0 | 0.0 | 0.0 |
| Net profit | 62.4 | 92.6 | 103 | 126 | 145 | 166 |
| Restated net profit | 80.2 | 94.6 | 110 | 126 | 145 | 166 |
| *Change (%)* | *-47.1%* | *18.0%* | *16.7%* | *14.1%* | *15.3%* | *14.1%* |
| **Cash Flow Statement (EURm)** | | | | | | |
| Operating cash flows | 110 | 98.8 | 157 | 213 | 236 | 266 |
| Change in working capital | (61.7) | (79.4) | (42.4) | (16.1) | (17.2) | (18.4) |
| Capex, gross | (42.2) | (36.8) | (30.8) | (35.7) | (37.8) | (40.5) |
| Financial investments / tax paid | (108) | (53.0) | (52.8) | (79.9) | (82.3) | (90.5) |
| Dividends | (69.3) | (48.0) | (72.8) | (81.9) | (81.9) | (81.9) |
| Other | (69.4) | (42.8) | 6.0 | (15.0) | (17.0) | (16.0) |
| Net debt | 414 | 467 | 458 | 435 | 401 | 348 |
| Free Cash flow | (43.8) | 7.7 | 75.2 | 97.4 | 115 | 135 |
| **Balance Sheet (EURm)** | | | | | | |
| Tangible fixed assets | 191 | 216 | 223 | 232 | 239 | 244 |
| Intangibles assets | 481 | 491 | 488 | 488 | 488 | 488 |
| Cash & equivalents | 186 | 74.1 | 46.9 | 12.5 | 46.3 | 99.5 |
| Other current assets | 1,443 | 1,375 | 1,407 | 1,300 | 1,299 | 1,370 |
| Other non-current assets | 164 | 183 | 164 | 165 | 165 | 166 |
| Total assets | 2,278 | 2,339 | 2,282 | 2,184 | 2,190 | 2,268 |
| L & ST Debt | 600 | 541 | 505 | 418 | 418 | 418 |
| Others liabilities | 667 | 722 | 663 | 677 | 715 | 759 |
| Shareholders' funds | 1,012 | 1,076 | 1,113 | 1,088 | 1,058 | 1,090 |
| Total Liabilities | 1,267 | 1,262 | 1,168 | 1,096 | 1,133 | 1,177 |
| Capital employed | 1,390 | 1,532 | 1,552 | 1,477 | 1,416 | 1,401 |
| **Ratios** | | | | | | |
| Gross margin | 59.77 | 64.05 | 63.37 | 65.70 | 66.60 | 67.45 |
| Current operating margin | 14.56 | 16.16 | 16.98 | 19.18 | 19.88 | 20.89 |
| Tax rate | 38.46 | 26.42 | 29.13 | 31.00 | 31.00 | 31.00 |
| Net margin | 7.77 | 17.96 | 10.51 | 11.70 | 12.69 | 13.51 |
| ROE (after tax) | 7.93 | 8.79 | 9.92 | 11.58 | 13.74 | 15.21 |
| ROCE (after tax) | 17.10 | 15.60 | 16.50 | 17.30 | 18.00 | 18.30 |
| Gearing | 40.86 | 43.35 | 41.16 | 39.94 | 37.90 | 31.89 |
| Pay out ratio | 52.60 | 80.10 | 75.99 | 64.98 | 56.35 | 49.38 |
| Number of shares, diluted (Thousand) | 49,312 | 48,683 | 48,683 | 51,167 | 51,167 | 51,167 |
| **Data per Share (EUR)** | | | | | | |
| Diluted EPS | 1.27 | 1.91 | 2.11 | 2.46 | 2.84 | 3.24 |
| Diluted restated EPS | 1.63 | 1.95 | 2.27 | 2.46 | 2.84 | 3.24 |
| *% change* | *-47.4%* | *19.9%* | *16.3%* | *8.6%* | *15.3%* | *14.1%* |
| BVPS | 20.52 | 22.11 | 22.87 | 21.26 | 20.67 | 21.31 |
| CFPS | 2.23 | 2.03 | 3.23 | 4.17 | 4.61 | 5.20 |
| FCF | (0.89) | 0.16 | 1.54 | 1.90 | 2.26 | 2.64 |
| Dividend Total | 1.27 | 1.53 | 1.60 | 1.60 | 1.60 | 1.60 |
| o/w Special Dividends | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

*Source: Company Data; Bryan, Garnier & Co ests.*

# 1. 64% of sales are well-positioned

**Based on our forecasts, 64% of Rémy Cointreau's sales are aligned with the tastes of the Millennial generation, i.e. mainly cognac (62% of sales) but also, to a lesser extent, single-malt scotch (2%).** The group's other categories remain interesting and some are posting strong performances although the attraction they hold for Generation Y seems, in our view, less obvious.

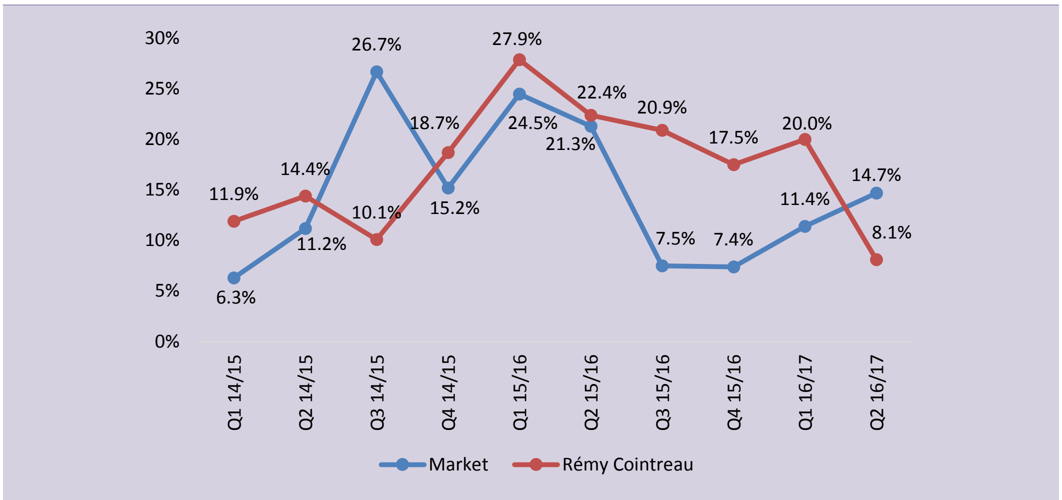
**Fig. 1: The Rémy Cointreau portfolio (% of group sales)**




*Source: Rémy Cointreau, Bryan, Garnier & Co*

**The United States, which account for 40% of the group's cognac sales, are posting very robust growth. The country's consumption has changed from being emblematic of a community to a generational symbol.** Thus, Afro-Americans who used to represent 60% of cognac consumers now account for no more than one third, Caucasians and Latino-Americans constituting the remaining two thirds. In the United States, Rémy Cointreau has astutely repositioned itself in the high-end qualities (VSOP and XO), enabling it to virtually-consistently outperform the cognac market over the past two years, the recent slowdown being explained by retailer destocking following the price rises at the beginning of the year.

**Fig. 2: Cognac depletions in value: Rémy Cointreau vs the US market**

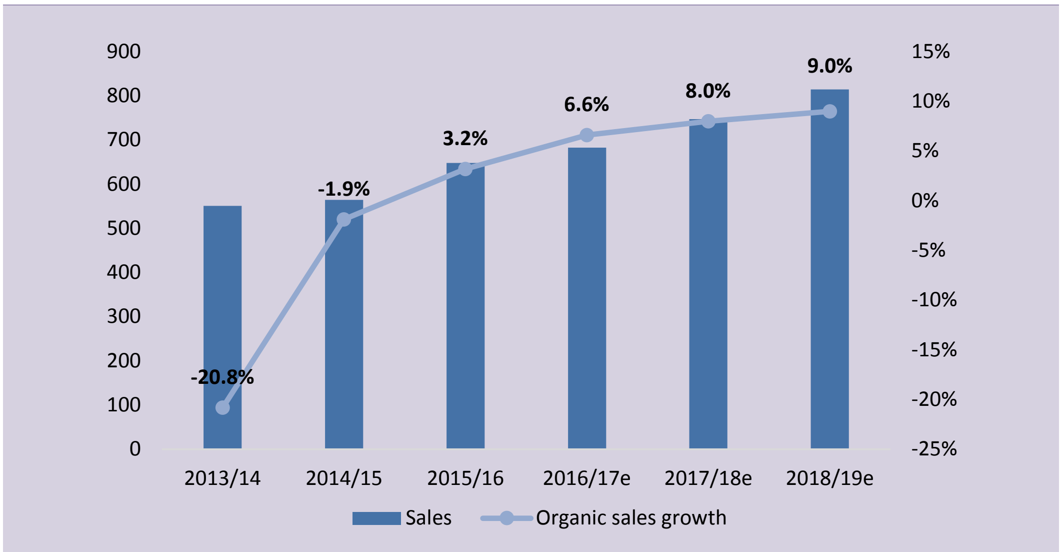



*Source: Rémy Cointreau, Bryan, Garnier & Co.*

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 sharp 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 group has also benefited from its 'One Life/Live Them' marketing campaign showcasing the Chinese star Huang Xioming. 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 sales and depletions (value), remains unchanged.

**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 significant acceleration on the 2015/16 level (+3.2%).

**Fig. 1: Sales forecasts**




*Source: Rémy Cointreau, Bryan, Garnier & Co*

# 2. A strategic plan on the right track

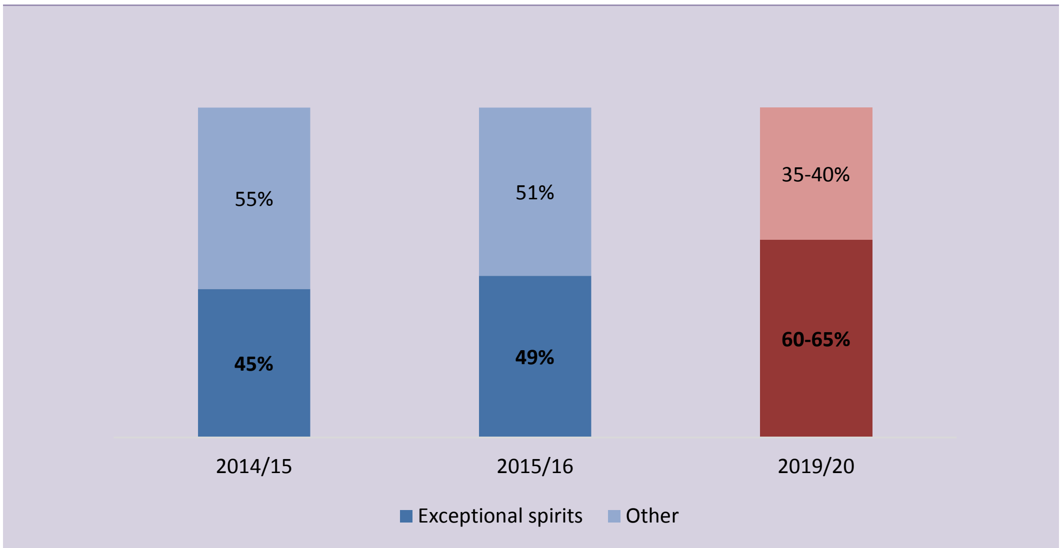
In its strategic plan unveiled in June 2015, Rémy Cointreau stated its goal of becoming the leader in the exceptional spirits segment, i.e. a bottle price of over USD50. Most of the brands satisfy this criterion.

**Fig. 2: The group's portfolio**


*Source: Rémy Cointreau*

The group aims to generate 60% to 65% of sales in exceptional spirits by 2019/20 and we are confident in its ability to achieve this target. **2015/16 may effectively be deemed to represent a first successful step in this direction,** in that their proportion of sales progressed by 400bps in one year to 49%.

**Fig. 3: Percentage of exceptional spirits in the group's sales**




*Source: Rémy Cointreau, Bryan, Garnier & Co*

**To achieve its objective, the group is mainly focusing on improving the price/mix of its existing portfolio.** Concretely, it is increasing prices, upping its investment in products which qualify as 'exceptional spirits' and launching new products in the over-USD50 price bracket.

- One of the priorities for the **cognac portfolio** is to develop the intermediary category whose price is above that of VOSPs but below that of XOs. Club in China and 1738 in the United States have thus benefited from a major marketing campaign. Louis XIII must also regain its pre-2012 status. For this purpose, a geographical diversification is under way. There are opportunities outside China, in the United States, Canada, Russia, India, etc. To seize them, the group will need to recruit influencers from amongst HNWIs (13 million globally). Innovation is also important. The company has launched the miniature (5cl priced at EUR500) and special editions like the Odyssée d'Un Roi. Note that the VS volumes are now residual (mainly in Russia).
- Within the **Liqueurs & Spirits division**, the group is massively investing in the Bruichladdich products (Bruichladdich/Port Charlotte/Octomore/The Botanist) which may be considered to be 'exceptional'. It has also launched premium versions of the existing brands: Mount Gay Black Barrel, Mount Gay XO, Cointreau Blood Orange, Saint-Rémy XO, and Metaxa Angel's Treasure. In parallel, it has increased the price of Mount Gay Eclipse in the United States from USD15 to USD25 in two years.

**Adjustments to the product portfolio should also enable Rémy Cointreau to increase the proportion of exceptional spirits.** In October 2015, the group sold the Izarra brand before establishing a JV with Bols for the Passoa brand in September 2016. This passion fruit-based liqueur, which represents around 1.5% of the group's sales should be deconsolidated at the end of 2016. We do not see more liqueur and spirits brand disposals but other distribution contracts could be terminated. The group has already ended its US distribution agreement with Edrington whiske(y)s in 2014/15, and EPI champagnes in the United States in 2015/16 and in France, the Benelux and Travel Retail in 2016/17…In 2015/16, the Partner Brands division contributed only 12% of the group's sales against 24% two years previously. The remaining contracts are modest in size (primarily William Grant & Sons' and Russian Standard's brands). Having made no acquisitions since Bruichladdich in 2012, this October Rémy Cointreau announced plans to purchase the Domaine des Hautes Glaces, an organic whisky manufactured using renewable energy and sold at a bottle price of between EUR65 and EUR150. The group has always said that it is interested in a champagne brand but we have argued that whisk(e)ys, tequilas and mezcals might be potential targets.

# 3. Forecasts

## Fig. 4: Sales

| *EURm* | 2014/15 | 2015/2016 | 2016/17e | 2017/18e | 2018/19e |
|---|---|---|---|---|---|
| **Group** | | | | | |
| **Sales** | **1032** | **1051** | **1076** | **1145** | **1227** |
| % reported | -6.4% | 8.9% | 2.5% | 6.4% | 7.1% |
| % FX and perimeter | -7.0% | 8.5% | -1.3% | 0.2% | 0.0% |
| **% organic** | **0.6%** | **0.3%** | **3.7%** | **6.2%** | **7.1%** |
| **Rémy Martin** | | | | | |
| **Sales** | **565** | **648** | **683** | **748** | **815** |
| % reported | 2.5% | 14.7% | 5.4% | 9.5% | 9.0% |
| **% organic** | **-1.9%** | **3.2%** | **6.6%** | **8.0%** | **9.0%** |
| **Liqueurs & Spirits** | | | | | |
| **Sales** | **263** | **274** | **281** | **284** | **295** |
| % reported | 10.8% | 4.1% | 2.8% | 0.8% | 4.0% |
| **% organic** | **7.2%** | **-1.5%** | **4.8%** | **4.0%** | **4.0%** |
| **Partner Brands** | | | | | |
| **Sales** | **137** | **129** | **112** | **114** | **117** |
| % reported | -43.5% | -6.0% | -12.8% | 1.1% | 3.0% |
| **% organic** | **-1.0%** | **-8.1%** | **-13.0%** | **0.3%** | **3.0%** |

## Fig. 5: Current operating result

| *EURm* | 2014/15 | 2015/2016 | 2016/17e | 2017/18e | 2018/19e |
|---|---|---|---|---|---|
| **Group** | | | | | |
| **EBIT** | **156** | **178** | **206** | **228** | **256** |
| Margin | 16.2% | 17.0% | 19.2% | 19.9% | 20.9% |
| Change in bps | 160 | 82 | 220 | 70 | 102 |
| **Rémy Martin** | | | | | |
| **EBIT** | **117** | **140** | **162** | **180** | **203** |
| Margin | 20.8% | 21.6% | 23.7% | 24.1% | 24.9% |
| Change in bps | -197 | 78 | 217 | 32 | 88 |
| **Liqueurs & Spirits** | | | | | |
| **EBIT** | **52** | **48** | **54** | **57** | **63** |
| Margin | 19.7% | 17.6% | 19.2% | 20.2% | 21.2% |
| Change in bps | 406 | -212 | 162 | 103 | 97 |
| **Partner Brands** | | | | | |
| **EBIT** | **7** | **6** | **6** | **6** | **6** |
| Margin | 5.3% | 4.6% | 5.2% | 5.1% | 5.1% |
| Change in bps | 174 | -67 | 57 | -12 | 0 |
| **Holding company costs** | | | | | |
| **EBIT** | **-21** | **-15** | **-15** | **-15** | **-15** |
| % of sales | -2.1% | -1.5% | -1.4% | -1.3% | -1.3% |

*Source of all tabs: Rémy Cointreau, Bryan, Garnier & Co*

# 4. Buy; FV: EUR84

Fig. 6: DCF (1/2)

| *EURm* | 2016/17e | 2017/18e | 2018/19e | 2019/20e | 2020/21e | 2021/22e | 2022/23e | 2023/24e | 2024/25e | 2025/26e |
|---|---|---|---|---|---|---|---|---|---|---|
| **Sales** | **1076** | **1145** | **1227** | **1319** | **1424** | **1520** | **1605** | **1676** | **1730** | **1765** |
| % change | 2.5% | 6.4% | 7.1% | 7.5% | 7.9% | 6.8% | 5.6% | 4.4% | 3.2% | 2.0% |
| **EBIT** | **206** | **228** | **256** | **282** | **312** | **333** | **351** | **367** | **379** | **386** |
| EBIT margin | 19.2% | 19.9% | 20.9% | 21.4% | 21.9% | 21.9% | 21.9% | 21.9% | 21.9% | 21.9% |
| -Income taxes | -57 | -65 | -74 | -79 | -87 | -93 | -98 | -103 | -106 | -108 |
| +Depreciation | 20 | 23 | 26 | 29 | 34 | 38 | 42 | 46 | 50 | 53 |
| as % of sales | 1.9% | 2.0% | 2.1% | 2.2% | 2.4% | 2.5% | 2.6% | 2.8% | 2.9% | 3.0% |
| + Change in WC | -16 | -17 | -18 | -20 | -21 | -23 | -24 | -25 | -26 | -26 |
| as % of sales | -1.5% | -1.5% | -1.5% | -1.5% | -1.5% | -1.5% | -1.5% | -1.5% | -1.5% | -1.5% |
| **Operating cash flows** | **154** | **168** | **189** | **213** | **237** | **255** | **271** | **285** | **297** | **305** |
| -Capex | -35.7 | -37.8 | -40.5 | -42.9 | -45.6 | -47.9 | -49.8 | -51.1 | -51.9 | -52.1 |
| as % of sales | -3.3% | -3.3% | -3.3% | -3.3% | -3.2% | -3.2% | -3.1% | -3.1% | -3.0% | -3.0% |
| **Free cash flow** | **118** | **130** | **149** | **170** | **191** | **207** | **221** | **234** | **245** | **253** |
| Discount coefficient | 0.94 | 0.89 | 0.83 | 0.78 | 0.74 | 0.69 | 0.65 | 0.62 | 0.58 | 0.55 |
| **Discounted FCF** | **111** | **115** | **124** | **133** | **141** | **144** | **145** | **144** | **142** | **138** |

Fig. 7: DCF (2/2)

| | |
|---|---|
| Sum of discounted cash flows | 1337 |
| +Terminal Value | 3300 |
| -Net debt | 458 |
| -Provisions | 36 |
| -Minorities | 1 |
| +Financial assets | 135 |
| **Equity Value** | **4276** |
| Number of shares (m) | 51.2 |
| **Fair value (EUR)** | **84** |

*Source of all charts: Bryan, Garnier & Co*

BRYAN, GARNIER & CO

# INDEPENDENT RESEARCH UPDATE

23rd November 2016

Food & Beverages

# Campari

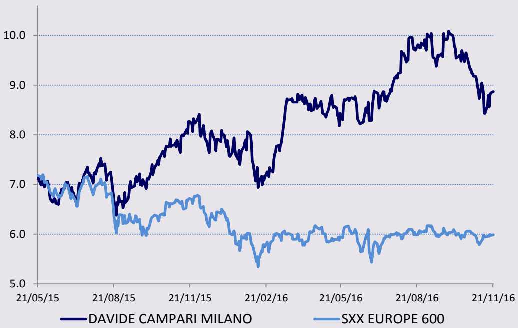
## Italian specialties

**Fair Value EUR10,7** (price EUR8.87) **BUY**

| | |
|---|---|
| Bloomberg | CPR IM |
| Reuters | CPR.MI |
| 12-month High / Low (EUR) | 10.1 / 6.9 |
| Market capitalisation (EURm) | 5,152 |
| Enterprise Value (BG estimates EURm) | 6,453 |
| Avg. 6m daily volume ('000 shares) | 1 209 |
| Free Float | 49.0% |
| 3y EPS CAGR | 15.4% |
| Gearing (12/15) | 47% |
| Dividend yield (12/16e) | 1.01% |

| YE December | 12/15 | 12/16e | 12/17e | 12/18e |
|---|---|---|---|---|
| Revenue (EURm) | 1,657 | 1,730 | 1,917 | 2,020 |
| EBIT (EURm) | 332.70 | 355.23 | 410.04 | 442.37 |
| Basic EPS (EUR) | 0.32 | 0.35 | 0.45 | 0.49 |
| Diluted EPS (EUR) | 0.32 | 0.35 | 0.45 | 0.49 |
| EV/Sales | 3.61x | 3.73x | 3.27x | 3.00x |
| EV/EBITDA | 15.7x | 15.9x | 13.4x | 12.1x |
| EV/EBIT | 18.0x | 18.2x | 15.3x | 13.7x |
| P/E | 27.6x | 25.0x | 19.5x | 18.0x |
| ROCE | 7.0 | 6.7 | 10.3 | 11.1 |

*Price and data as at close of 21st November*





**Campari remains one of our favourite spirits companies. Not only does the group benefit from a portfolio closely aligned with the tastes of Generation Y but its financial position could also enable new acquisitions as of 2017. We maintain our Buy recommendation and our Fair Value of EUR10.7.**

■ **A well-positioned portfolio.** We calculate that 39% of Campari's sales are aligned with the tastes of the Millennial generation. The latter has been responsible for the revival in bitters which represent 30% of the Italian company's sales, with Campari and Aperol the two flagship brands. Their sales increased by a respective 6.1% and 11.8% in 2015 and gained momentum over the first nine months of 2016, with respective growth of 8.1% and 19.3%. Furthermore, Campari is the only company to own a bourbon of significant size (7% of total sales), giving it a key advantage in the United States. Wild Turkey posted 7.3% sales growth in the US over nine months, broadly in line with 2015 (+7.6%), but significantly above the growth for the broader spirits market (+4%).

■ **Other acquisitions are in the pipeline.** Campari's strategy has always been to generate half its growth via acquisitions. We think the group does not want to exceed a net debt/EBITDA ratio of 3.5x and is thus currently somewhat constrained by the acquisition of SPML. On our forecasts, net debt should reach EUR1,302m at the end of 2016, i.e. a net debt/EBITDA ratio of 3.2x. The firepower increases in 2017 and 2018, by which time we calculate that Campari will be able to acquire a target with maximum sales of EUR100m in the first year and EUR300m in the second.

**Buy; Fair Value: EUR10.7.** We maintain our Buy recommendation and our Fair Value of EUR10.7. In the past three months, the stock has underperformed the DJ Stoxx by 9% as it was penalized by sector rotation. At the day before yesterday's close, it is trading at 15.3x 2017e EV/EBIT, a 8% discount to its peer group.

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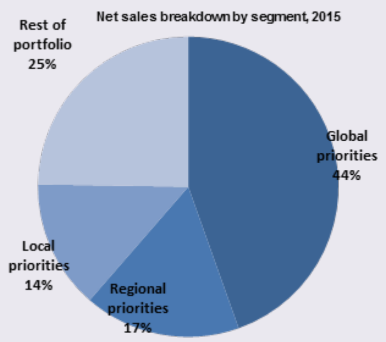
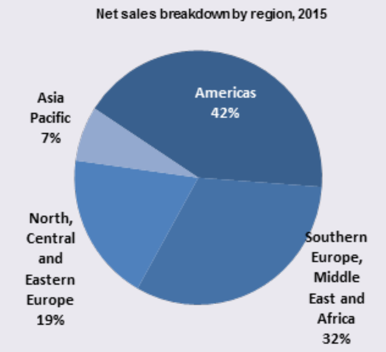



### Company description

Campari was founded in 1860 and today is the sixth-largest player worldwide in the spirits industry. The Group's portfolio, with over 50 brands, includes spirits, the core business, wines and soft drinks. Internationally-renowned brands include Aperol, Appleton, Campari, Cinzano, SKYY Vodka and Wild Turkey.

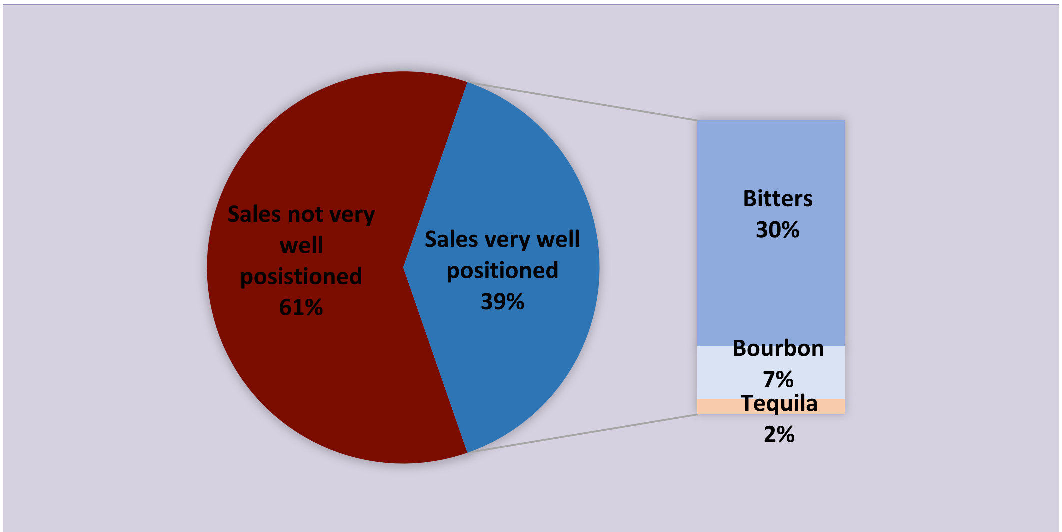
| **Simplified Profit & Loss Account (€m)** | **2013** | **2014** | **2015** | **2016e** | **2017e** | **2018e** |
|---|---|---|---|---|---|---|
| Net revenues | 1,524 | 1,560 | 1,657 | 1,730 | 1,917 | 2,020 |
| *Change (%)* | *13.7%* | *2.4%* | *6.2%* | *4.4%* | *10.8%* | *5.4%* |
| Gross profit after distribution costs | 810 | 832 | 917 | 993 | 1,104 | 1,167 |
| Contribution after A&P | 561 | 571 | 631 | 684 | 765 | 810 |
| EBITDA | 339 | 338 | 380 | 407 | 468 | 503 |
| Result from recurring operations | 300 | 298 | 333 | 355 | 410 | 442 |
| *Change (%)* | *-1.6%* | *-0.5%* | *11.6%* | *6.8%* | *15.4%* | *7.9%* |
| Net financial income (charges) | (58.9) | (60.3) | (60.0) | (83.0) | (35.0) | (35.0) |
| Profit before taxes and non-controlling interests | 230 | 194 | 249 | 272 | 375 | 407 |
| Tax | (79.8) | (64.6) | (73.4) | (73.3) | (113) | (122) |
| Net profit | 151 | 130 | 176 | 171 | 263 | 285 |
| Minority interests | (0.60) | (0.60) | (0.60) | 0.0 | 0.0 | 0.0 |
| Group net profit | 150 | 129 | 175 | 171 | 263 | 285 |
| *Change (%)* | *-4.3%* | *-13.9%* | *36.0%* | *-2.5%* | *53.6%* | *8.6%* |
| **Cash Flow Statement (€m)** | | | | | | |
| Operating cash flows | 257 | 290 | 315 | 334 | 389 | 426 |
| Change in working capital | (36.0) | (6.9) | (9.6) | (23.5) | (15.3) | (10.7) |
| Capex, net | (58.9) | (47.9) | (49.1) | (49.1) | (57.5) | (60.6) |
| Financial investments, net | (55.9) | (57.5) | (56.3) | (83.0) | (35.0) | (35.0) |
| Dividends | (39.8) | (46.1) | (45.7) | (52.0) | (52.0) | (57.8) |
| Other | (49.1) | (21.3) | (24.5) | (130) | (50.0) | (50.0) |
| Net debt | 853 | 978 | 826 | 1,302 | 1,122 | 911 |
| Free Cash flow | 106 | 178 | 200 | 178 | 282 | 319 |
| **Balance Sheet (€m)** | | | | | | |
| Tangible fixed assets | 397 | 436 | 445 | 446 | 442 | 434 |
| Intangibles assets | 1,582 | 1,872 | 1,932 | 1,932 | 1,932 | 1,932 |
| Cash & equivalents | 444 | 231 | 844 | 339 | 518 | 558 |
| current assets | 1,258 | 1,088 | 1,746 | 1,276 | 1,501 | 1,576 |
| Other assets | 65.3 | 119 | 101 | 1,109 | 1,109 | 1,109 |
| Total assets | 3,303 | 3,515 | 4,224 | 4,763 | 4,984 | 5,052 |
| L & ST Debt | 1,342 | 1,267 | 1,781 | 2,319 | 2,319 | 2,147 |
| Others liabilities | 564 | 667 | 687 | 575 | 677 | 712 |
| Shareholders' funds | 1,396 | 1,580 | 1,746 | 1,869 | 1,988 | 2,193 |
| Total Liabilities | 1,906 | 1,933 | 2,468 | 2,894 | 2,996 | 2,859 |
| Capital employed | 2,120 | 2,444 | 2,510 | 2,533 | 2,548 | 2,559 |
| **Ratios** | | | | | | |
| Gross margin | 53.17 | 53.31 | 55.35 | 57.41 | 57.60 | 57.80 |
| A&P as % of sales | 16.35 | 16.72 | 17.28 | 17.90 | 17.70 | 17.70 |
| Contribution after A&P as % of sales | 36.82 | 36.60 | 38.07 | 39.51 | 39.90 | 40.10 |
| Result from recurring operations | 19.66 | 19.12 | 20.08 | 20.53 | 21.39 | 21.90 |
| Tax rate | 34.65 | 38.35 | 29.43 | 26.91 | 30.00 | 30.00 |
| Net margin | 9.84 | 8.27 | 10.59 | 9.88 | 13.70 | 14.12 |
| ROE (after tax) | 10.78 | 8.20 | 10.08 | 9.15 | 13.21 | 13.00 |
| ROCE (after tax) | 7.10 | 5.30 | 7.01 | 6.75 | 10.30 | 11.14 |
| Gearing | 61.08 | 61.93 | 47.31 | 69.64 | 56.45 | 41.52 |
| Pay out ratio | 32.00 | 30.17 | 28.00 | 25.37 | 22.02 | 20.27 |
| Number of shares, diluted | 590,855 | 582,346 | 578,055 | 578,055 | 578,055 | 578,055 |
| **Data per Share (€)** | | | | | | |
| Basic EPS | 0.26 | 0.27 | 0.32 | 0.35 | 0.45 | 0.49 |
| Diluted EPS | 0.25 | 0.27 | 0.32 | 0.35 | 0.45 | 0.49 |
| *% change* | *-7.4%* | *6.1%* | *21.2%* | *10.4%* | *28.0%* | *8.6%* |
| BVPS | 2.36 | 2.71 | 3.02 | 3.23 | 3.44 | 3.79 |
| Operating cash flows | 0.43 | 0.50 | 0.54 | 0.58 | 0.67 | 0.74 |
| Free Cash Flow | 0.18 | 0.31 | 0.35 | 0.31 | 0.49 | 0.55 |
| Net dividend | 0.08 | 0.08 | 0.09 | 0.09 | 0.10 | 0.10 |

*Source: Company Data; Bryan, Garnier & Co ests.*

# 1. 39% of the portfolio is well-positioned

**We calculate that 39% of Campari's sales are aligned with the tastes of the Millennial generation.** The latter has been responsible for the revival in bitters which represent 30% of the Italian company's sales. This generation also favours bourbon and tequila which account for 7% and 2% of sales, respectively.

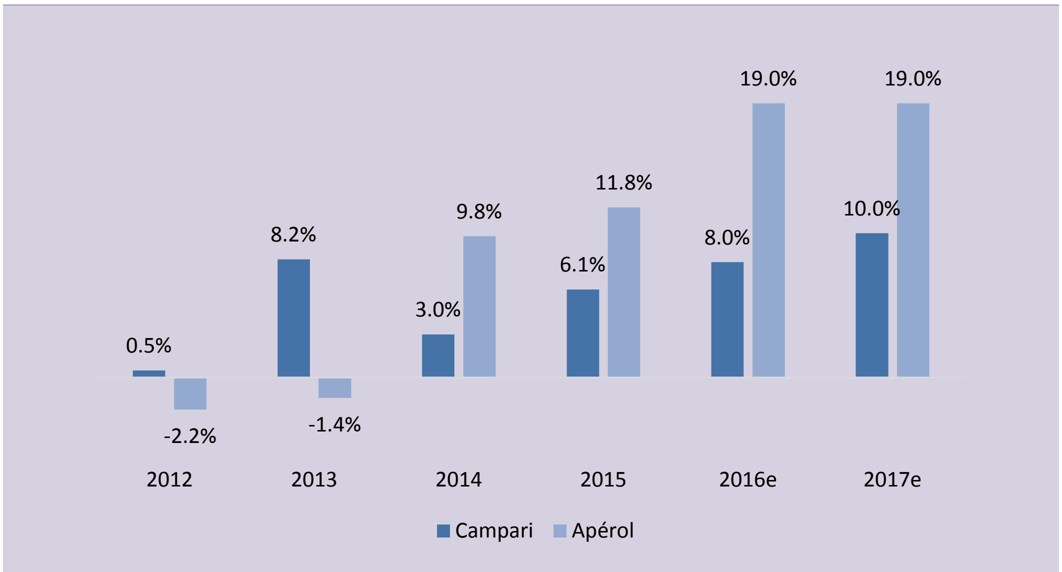
**Fig. 1: The Campari portfolio (% of group sales)**




*Source: Campari, Bryan, Garnier & Co*

**Campari generates 30% of its sales in bitters,** where Campari and Aperol are the flagship brands, each representing 10% of sales. Their sales grew by a respective 6.1% and 11.8% in 2015, momentum then building during the first nine months of 2016 with respective growth of 8.1% and 19.3%.

**Fig. 2: Organic sales growth for Campari and Aperol**



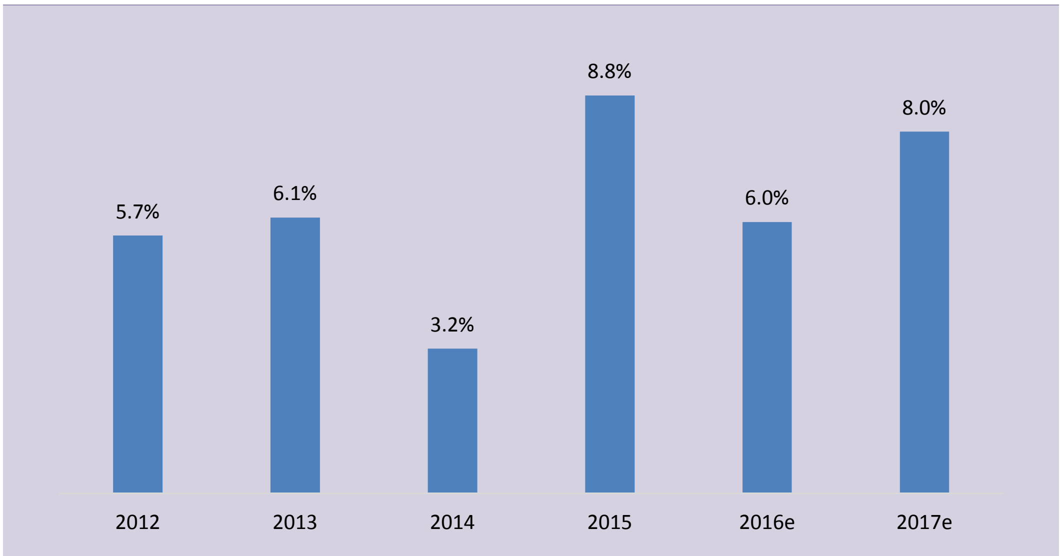
*Source: Campari, Bryan, Garnier & Co*

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 growth of 2.9% and 4.8%.

Campari and Aperol are also growing exponentially 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 this country. 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.

**Campari is also the only company in our sample with a bourbon brand of significant size (7% of its total sales), giving it an advantage in the key US market.** Its Wild Turkey brand posted sales growth of 7.3% over the first nine months in the US, broadly in line with 2015 (+7.6%) but well above that of the broader spirits market (+4%). At global level, our forecasts show the brand's sales increasing by 6% in 2016 and 8% in 2017 on an organic basis.

**Fig. 3: Organic sales growth for Wild Turkey**




*Source: Campari, Bryan, Garnier & Co*

**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.

# 2. Other acquisitions in the pipeline

**Campari's strategy has always been to generate half its growth via acquisitions, the latest being SPML in March 2016**. The main aim of this acquisition was to increase the proportion of US sales to 25% of total sales from 22%. This transaction is accretive, adding 70bps to Campari's 2015 EBITDA margin.

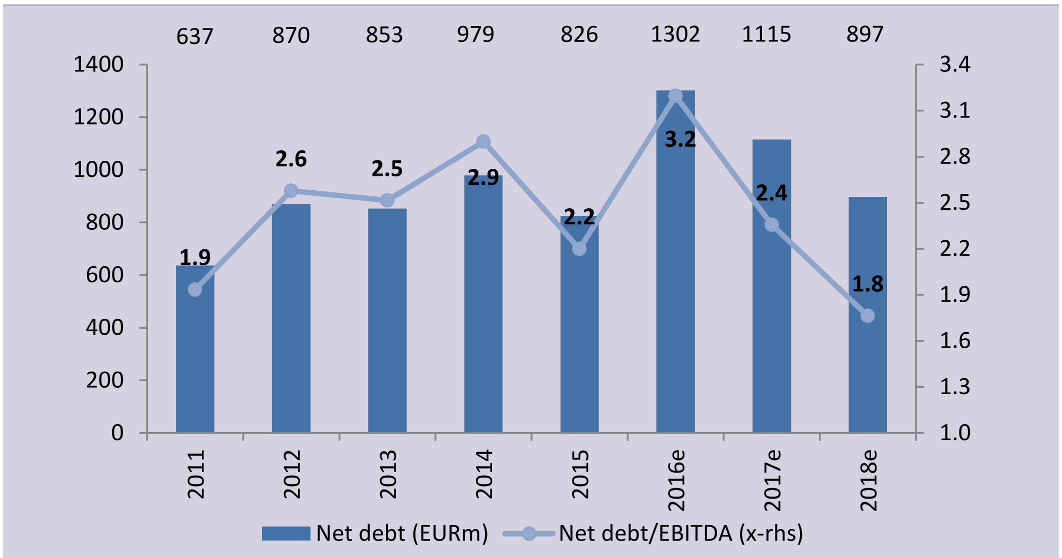
**Fig. 4: The acquisitions and their objectives**

| Year | Target | Rationale |
|---|---|---|
| 2001 | Skyy Spirits | Exposure to the US and to the vodka category |
| 2003 | Barbero 1891 (Aperol) | Exposure to a medium-alcoholic content spirit (Aperol) |
| 2005 | Glen Grant, Braemar brands, Old Smuggler | Exposure to the whisk(e)y category |
| 2007 | Cabo Wabo Tequila | Strengthened presence in the US and exposure to tequila |
| 2008 | Destiladora San Nicolas | Access to the Mexican market |
| 2009 | Wild Turkey | Presence in the bourbon category and basis for its own distribution platform in Australia |
| 2010 | Carolans, Frangelico, Irish Mist | Strengthened presence in the US |
| 2011 | Sagatiba | Exposure to cachaça and Brazil |
| 2012 | Lascelles deMercado | Exposure to rum |
| 2014 | Forty Creek Distillery | Exposure to Canadian whisky |
| 2014 | Fratelli Averna | Increased critical mass in Central Europe |
| 2016 | SPML | Increased critical mass and exposure to on-trade in the US |

*Source: Campari, Bryan, Garnier & Co*

**We think Campari does not want to exceed a net debt/EBITDA ratio of 3.5x, meaning that the company is somewhat constrained at present by the acquisition of SPML**. On our forecasts, net debt should reach EUR1,302m at the end of 2016, i.e. a net debt/EBITDA ratio of 3.2x. This figure should then fall to 2.4x in 2017, enabling Campari to resume an active acquisition strategy.

**Fig. 5: Campari's net debt**




*Source: Campari, Bryan, Garnier & Co*

The following simulation, which does not take into account any synergies or acquisitions in the wine and non-alcoholic beverage segments, shows that Campari is able not to exceed a net debt/EBITDA ratio of 3.5x on scenarios 1 and 2 in 2017 and scenarios 1, 2, 3 and 4 in 2018. **The Group can thus acquire a target with maximum sales of EUR100m in the first year and EUR300m in the second.**

**Fig. 6: Simulation of Campari's debt capacity**

| *EURm* | Scenario 1 | Scenario 2 | Scenario 3 | Scenario 4 | Scenario 5 |
|---|---|---|---|---|---|
| Assumption of sales | 50 | 100 | 200 | 300 | 400 |
| Average EBITDA margin | 25% | 25% | 25% | 25% | 25% |
| EBITDA | 12.5 | 25 | 50 | 75 | 100 |
| | | | **2017e** | | |
| Sector's average 2016e EV/sales | | | 3.8x | | |
| EV of the target | 190 | 380 | 760 | 1140 | 1520 |
| Net debt (EV of the target + Campari's net debt) | 1305 | 1495 | 1875 | 2255 | 2635 |
| Consolidated EBITDA | 486 | 498 | 523 | 548 | 573 |
| **Net debt/EBITDA (x)** | **2.7** | **3.0** | **3.6** | **4.1** | **4.6** |
| | | | **2018e** | | |
| Sector's average 2017e EV/sales | | | 3.5x | | |
| EV of the target | 175 | 350 | 700 | 1050 | 1400 |
| Net debt (EV of the target + Campari's net debt) | 1072 | 1247 | 1597 | 1947 | 2297 |
| Consolidated EBITDA | 522 | 534 | 559 | 584 | 609 |
| **Net debt/EBITDA (x)** | **2.1** | **2.3** | **2.9** | **3.3** | **3.8** |

*Source: Campari, Bryan, Garnier & Co*

What could be the targets? Campari has always sought to purchase brands in one of the two following categories:

- Hidden gems, i.e. brands which have been around for a long time but which have seen insufficient investment from their current owners.
- Rising stars which are seeing very strong growth but have yet to achieve their full potential, whether in terms of geographical coverage or brand recognition.

# 3. Forecasts

Our forecasts look for organic sales growth of 5.4% in 2016 following a 3% progression in 2015. This acceleration will be underpinned by the priority global brands whose sales are expected to increase by 8.5% in 2016 (+6.1% in 2015). SMPL has been consolidated since July 2016.

**Fig. 7: Sales**

| *EURm* | **2015** | **2016e** | **2017e** | **2018e** |
|---|---|---|---|---|
| **Group** | | | | |
| **Sales** | **1657** | **1730** | **1917** | **2020** |
| % reported | 6.2% | 4.4% | 10.8% | 5.4% |
| % perimeter | -1.0% | 2.0% | 4.3% | 0.0% |
| % FX | 4.1% | -2.9% | 1.1% | 0.0% |
| **% organic** | **3.0%** | **5.4%** | **5.4%** | **5.4%** |
| **Americas** | | | | |
| **Sales** | **702** | **721** | **811** | **853** |
| % reported | 14.3% | 2.8% | 12.5% | 5.2% |
| **% organic** | **7.0%** | **3.2%** | **4.7%** | **5.0%** |
| **Southern Europe, Middle East and Africa** | | | | |
| **Sales** | **525** | **542** | **594** | **625** |
| % reported | 4.0% | 3.2% | 9.6% | 5.2% |
| **% organic** | **1.9%** | **3.7%** | **4.5%** | **5.2%** |
| **North, Central and Eastern Europe** | | | | |
| **Sales** | **314** | **347** | **379** | **401** |
| % reported | -5.6% | 10.5% | 9.2% | 5.8% |
| **% organic** | **-3.7%** | **13.0%** | **8.0%** | **6.0%** |
| **Asia Pacific** | | | | |
| **Sales** | **116** | **120** | **133** | **141** |
| % reported | 7.2% | 3.7% | 10.8% | 6.0% |
| **% organic** | **6.4%** | **5.4%** | **6.0%** | **6.0%** |

*Source: Campari, Bryan, Garnier & Co*

**The margin progression over the next three years should be driven by a positive mix coming from the stronger growth contributed by the priority global brands** whose gross margin is approaching 70% compared with 55% for the group average. In H2 2016 and H1 2017, this positive mix should be partially offset by an increase in advertising and especially overhead costs, linked to the establishment of a subsidiary in South Africa and the bolstering of commercial capacity in the on-trade in the United States.

**Fig. 8: Current operating result**

| *EURm* | 2015 | 2016e | 2017e | 2018e |
|---|---|---|---|---|
| **Group** | | | | |
| **EBIT** | **333** | **355** | **410** | **442** |
| % reported | 11.6% | 6.8% | 15.5% | 7.8% |
| **Margin** | **20.1%** | **20.5%** | **21.4%** | **21.9%** |
| Variation in bps | 97 | 45 | 86 | 51 |
| **Americas** | | | | |
| **EBIT** | **135** | **135** | **160** | **173** |
| % reported | 33.3% | -0.6% | 18.5% | 8.1% |
| **Margin** | **19.3%** | **18.7%** | **19.8%** | **20.4%** |
| Variation in bps | 280 | -64 | 118 | 57 |
| **Southern Europe, Middle East and Africa** | | | | |
| **EBIT** | **100** | **108** | **125** | **136** |
| % reported | 2.5% | 8.6% | 15.6% | 8.5% |
| **Margin** | **18.9%** | **19.9%** | **21.0%** | **21.7%** |
| Variation in bps | -30 | 99 | 106 | 66 |
| **North, Central and Eastern Europe** | | | | |
| **EBIT** | **82** | **99** | **110** | **117** |
| % reported | -4.4% | 21.7% | 10.4% | 7.0% |
| **Margin** | **26.0%** | **28.6%** | **28.9%** | **29.1%** |
| Variation in bps | 30 | 262 | 26 | 27 |
| **Asia Pacific** | | | | |
| **EBIT** | **16** | **13** | **15** | **16** |
| % reported | 13.4% | -17.5% | 13.2% | 8.0% |
| **Margin** | **13.9%** | **11.0%** | **11.2%** | **11.4%** |
| Variation in bps | 80 | -283 | 20 | 16 |

*Source: Campari, Bryan, Garnier & Co*

# 4. Valuation

**Fig. 9: DCF (1/2)**

| *EURm* | 2017e | 2018e | 2019e | 2020e | 2021e | 2022e | 2023e | 2024e | 2025e | 2026e |
|---|---|---|---|---|---|---|---|---|---|---|
| **Sales** | **1 917** | **2 020** | **2 128** | **2 242** | **2 363** | **2 473** | **2 572** | **2 658** | **2 728** | **2 781** |
| % change | 12.1% | 5.4% | 5.4% | 5.4% | 5.4% | 4.7% | 4.0% | 3.3% | 2.6% | 2.0% |
| **EBIT** | **410** | **442** | **472** | **504** | **538** | **564** | **586** | **606** | **622** | **634** |
| EBIT margin | 21.4% | 21.9% | 22.2% | 22.5% | 22.8% | 22.8% | 22.8% | 22.8% | 22.8% | 22.8% |
| -income taxes | -114 | -124 | -128 | -136 | -145 | -152 | -158 | -164 | -168 | -171 |
| +depreciation | 58 | 61 | 65 | 68 | 72 | 75 | 78 | 81 | 83 | 84 |
| as % of sales | 3.0% | 3.0% | 3.0% | 3.0% | 3.0% | 3.0% | 3.0% | 3.0% | 3.0% | 3.0% |
| +change in WC | -12 | -10 | -21 | -22 | -24 | -25 | -26 | -27 | -27 | -28 |
| as % of sales | -0.6% | -0.5% | -1.0% | -1.0% | -1.0% | -1.0% | -1.0% | -1.0% | -1.0% | -1.0% |
| **Operating cash flows** | **342** | **369** | **388** | **414** | **441** | **462** | **480** | **496** | **509** | **519** |
| -capex | -58 | -61 | -65 | -68 | -72 | -75 | -78 | -81 | -83 | -84 |
| as % of sales | -3.0% | -3.0% | -3.0% | -3.0% | -3.0% | -3.0% | -3.0% | -3.0% | -3.0% | -3.0% |
| **Free cash flow** | **284** | **308** | **323** | **346** | **369** | **387** | **402** | **416** | **427** | **435** |
| Discount coefficient | 0.94 | 0.88 | 0.82 | 0.77 | 0.72 | 0.68 | 0.64 | 0.60 | 0.56 | 0.52 |
| **Discounted FCF** | **266** | **270** | **266** | **267** | **267** | **262** | **256** | **248** | **238** | **228** |

**Fig. 10: DCF (2/2)**

| | |
|---|---|
| Sum of discounted cash flows | 2 568 |
| +Terminal Value | 4952 |
| +Financial assets | 10 |
| -Net debt | -1 302 |
| -Minorities | -0.3 |
| -Provisions | -22 |
| **Equity Value** | **6 206** |
| Number of shares (m) | 578 |
| **Fair Value (EUR)** | **10.7** |

*Source of all tabs: Campari, Bryan, Garnier & Co*

BRYAN, GARNIER & CO

# INDEPENDENT RESEARCH UPDATE

23rd November 2016

Food & Beverages

# Pernod Ricard

## Getting better!

**Fair Value EUR115** (price EUR101.80) **BUY**

| | |
|---|---|
| Bloomberg | RI FP |
| Reuters | PERP.PA |
| 12-month High / Low (EUR) | 110.3 / 91.6 |
| Market capitalisation (EURm) | 27,020 |
| Enterprise Value (BG estimates EURm) | 35,304 |
| Avg. 6m daily volume ('000 shares) | 458.8 |
| Free Float | 79.4% |
| 3y EPS CAGR | 7.7% |
| Gearing (06/16) | 65% |
| Dividend yield (06/17e) | 1.99% |

| YE June | 06/16 | 06/17e | 06/18e | 06/19e |
|---|---|---|---|---|
| Revenue (EURm) | 8,682 | 8,899 | 9,253 | 9,673 |
| EBIT (EURm) | 2,277 | 2,390 | 2,517 | 2,655 |
| Basic EPS (EUR) | 5.20 | 5.60 | 6.06 | 6.49 |
| Diluted EPS (EUR) | 5.20 | 5.60 | 6.05 | 6.49 |
| EV/Sales | 4.12x | 3.97x | 3.76x | 3.55x |
| EV/EBITDA | 14.3x | 13.5x | 12.7x | 11.8x |
| EV/EBIT | 15.7x | 14.8x | 13.8x | 12.9x |
| P/E | 19.6x | 18.2x | 16.8x | 15.7x |
| ROCE | 6.7 | 11.5 | 11.8 | 12.1 |



**Organic sales growth is expected to accelerate in 2016/17 thanks to a pick-up in China and Europe while momentum in the United States should remain strong. We maintain our Buy recommendation and our Fair Value of EUR115.**

- **A pick-up in China and Europe.** Chinese sales were down by only 2% in 2014/15 before posting a 9% decline in 2015/16. This deterioration was mainly due to whisk(e)ys which continued to post double-digit falls while Martell cognac was just slightly negative thanks to a normalisation in private consumption, before returning to positive territory in Q1 2016/17 (+3%). In our view, Pernod Ricard should manage to stabilise its sales in China this year. Europe is also showing signs of an improvement. We are forecasting organic sales growth of 2% in 2016/17 in the region, an acceleration relative to 2015/16 (+1.1%), driven by Eastern Europe, and specifically Russia, and France which should not be impacted by a negative technical effect this year.

- **A solid performance in the United States.** Sales in the US were up by 4% in 2015/16, having been flat in 2014/15. This growth rate is expected to continue in 2016/17. The Irish whiskey Jameson and single-malt scotch The Glenlivet, accounting for a respective 25% and 7% of sales in the United States, remain the main growth drivers. These two brands saw their sell-outs increase by 23% and 9% last year. Although remaining in negative territory, the Absolut brand is showing signs of an improvement, value depletions having declined by only 2% in 2015/16 following a 4% fall in 2014/15.

**Buy. Fair Value: EUR115.** The stock has underperformed the DJ Stoxx by 7% in the past month. At yesterday's close, it is trading at 14.8x 2016/17e EV/EBIT, a 11% discount to the peer group average. We maintain our Buy recommendation which was upgraded on November 18th. Our Fair Value remains unchanged at EUR115.

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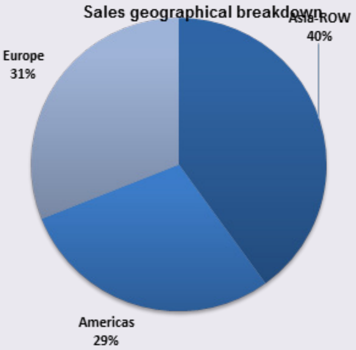
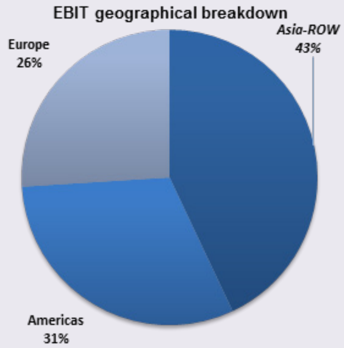



## Company description

Pernod Ricard was formed in 1975 from the merger of two French anis groups (Pernod and Ricard). Through organic development and various acquisitions (Seagram in 2001, Allied Domecq in 2005, V&S in 2008), Pernod Ricard has now become the second largest wine and spirits group worldwide. The company commands a global 18% share behind Diageo (28%). The group's strategy is based on three pillars: decentralization, premiumisation and innovation.

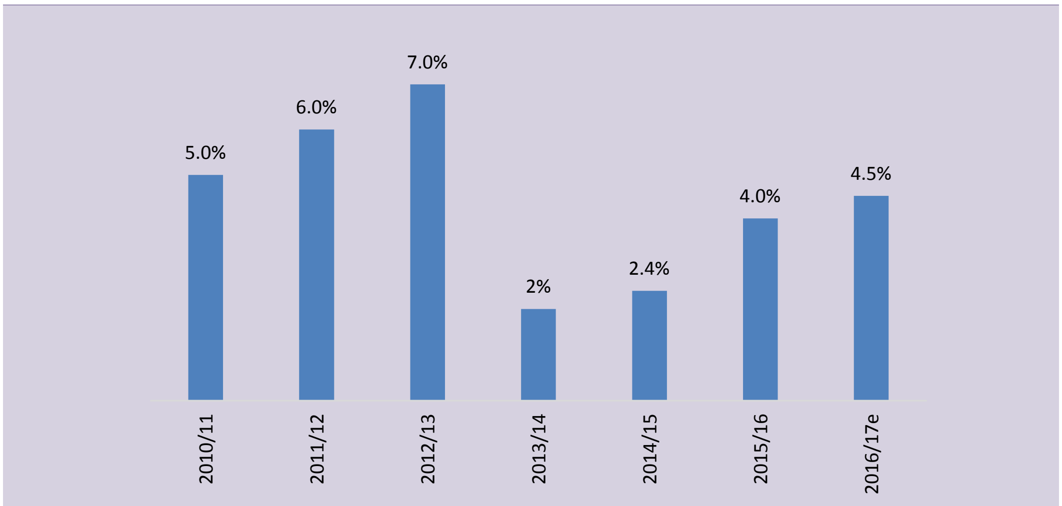
| **Simplified Profit & Loss Account (EURm)** | **30/06/14** | **30/06/15** | **30/06/16** | **30/06/17e** | **30/06/18e** | **30/06/19e** |
|---|---|---|---|---|---|---|
| Revenues | 7,945 | 8,558 | 8,682 | 8,899 | 9,253 | 9,673 |
| *Change (%)* | *-7.3%* | *7.7%* | *1.4%* | *2.5%* | *4.0%* | *4.5%* |
| Gross Profit | 4,987 | 5,296 | 5,339 | 5,464 | 5,691 | 5,997 |
| Contribution after A&P | 3,484 | 3,453 | 3,473 | 3,577 | 3,729 | 3,937 |
| Adjusted EBITDA | 2,421 | 2,456 | 2,494 | 2,612 | 2,748 | 2,897 |
| Recurring EBIT | 2,056 | 2,238 | 2,277 | 2,390 | 2,517 | 2,655 |
| *Change (%)* | *-7.8%* | *8.9%* | *1.7%* | *5.0%* | *5.3%* | *5.5%* |
| Financial results | (485) | (489) | (432) | (390) | (355) | (340) |
| Pre-Tax profits | 1,332 | 1,100 | 1,663 | 1,900 | 2,062 | 2,215 |
| Tax | (305) | (221) | (409) | (457) | (498) | (536) |
| Minority interests / Discontinued operations | (11.0) | (18.0) | (20.0) | (21.0) | (21.0) | (21.0) |
| Net profit group share | 1,016 | 861 | 1,234 | 1,421 | 1,543 | 1,658 |
| Restated net profit group share | 1,185 | 1,329 | 1,380 | 1,486 | 1,608 | 1,723 |
| *Change (%)* | *-3.4%* | *12.2%* | *3.8%* | *7.7%* | *8.2%* | *7.1%* |
| **Cash Flow Statement (EURm)** | | | | | | |
| Operating cash flows | 2,263 | 2,466 | 2,529 | 2,590 | 2,711 | 2,878 |
| Change in working capital | 319 | 192 | 211 | 128 | 164 | 225 |
| Capex, net | 274 | 313 | 337 | 311 | 278 | 290 |
| Financial investments / tax paid | 831 | 807 | 781 | 847 | 853 | 876 |
| Dividends | 448 | 461 | 497 | 499 | 538 | 579 |
| Other(s) | 351 | (913) | (260) | 27.0 | 0.0 | 0.0 |
| Net debt | 8,352 | 9,020 | 8,715 | 8,284 | 7,806 | 7,298 |
| Free Cash flow | 839 | 1,154 | 1,200 | 1,304 | 1,417 | 1,487 |
| **Balance Sheet (EURm)** | | | | | | |
| Tangible fixed assets | 2,593 | 2,933 | 3,233 | 3,334 | 3,436 | 3,538 |
| Intangibles assets | 16,449 | 17,706 | 17,572 | 17,923 | 18,282 | 18,648 |
| Cash & equivalents | 503 | 595 | 577 | 124 | 602 | 1,110 |
| current assets | 6,646 | 7,419 | 7,282 | 7,010 | 7,719 | 8,540 |
| Other assets | 1,928 | 2,339 | 2,511 | 2,480 | 2,455 | 2,431 |
| Total assets | 27,616 | 30,397 | 30,598 | 30,747 | 31,892 | 33,156 |
| L & ST Debt | 8,893 | 9,510 | 9,362 | 8,638 | 8,638 | 8,633 |
| Others liabilities | 6,945 | 7,600 | 7,730 | 7,897 | 8,080 | 8,287 |
| Shareholders' funds | 11,778 | 13,288 | 13,506 | 14,212 | 15,174 | 16,236 |
| Total Liabilities | 15,838 | 17,110 | 17,092 | 16,535 | 16,718 | 16,919 |
| Capital employed | 23,491 | 25,446 | 25,479 | 26,059 | 26,684 | 27,376 |
| **Ratios** | | | | | | |
| Gross profit Margin | 62.77 | 62.52 | 61.14 | 61.88 | 62.06 | 60.77 |
| A&P as % of sales | 18.92 | 18.99 | 19.00 | 18.70 | 18.70 | 18.80 |
| Contribution after A&P as % of sales | 43.85 | 42.90 | 42.50 | 42.70 | 42.80 | 43.20 |
| Recurring operating margin | 25.88 | 26.15 | 26.23 | 26.85 | 27.20 | 27.45 |
| Effective tax rate | 22.90 | 20.09 | 24.59 | 24.08 | 24.15 | 24.21 |
| Underlying tax rate | 25.80 | (24.40) | (24.50) | 25.00 | 25.00 | 25.00 |
| Net margin group share | 12.79 | 10.06 | 14.21 | 15.97 | 16.68 | 17.14 |
| ROE (after tax) | 8.72 | 6.61 | 9.28 | 10.15 | 10.31 | 10.34 |
| ROCE (after tax) | 11.01 | 6.65 | 6.75 | 11.46 | 11.79 | 12.12 |
| Gearing | 70.92 | 67.88 | 64.53 | 59.26 | 52.35 | 45.77 |
| Pay out ratio | 36.79 | 36.07 | 36.19 | 36.19 | 36.00 | 136 |
| Number of shares, diluted | 265,817 | 266,230 | 265,633 | 265,633 | 265,633 | 265,633 |
| **Data per Share (EUr)** | | | | | | |
| Restated basic EPS | 4.50 | 5.03 | 5.20 | 5.60 | 6.06 | 6.49 |
| Restated diluted EPS | 4.46 | 4.99 | 5.20 | 5.60 | 6.05 | 6.49 |
| *% change* | *-3.2%* | *11.9%* | *4.1%* | *7.7%* | *8.2%* | *7.1%* |
| BVPS | 44.31 | 49.91 | 50.84 | 53.50 | 57.12 | 61.12 |
| Operating cash flows | 8.51 | 9.26 | 9.52 | 9.75 | 10.21 | 10.84 |
| FCF | 3.16 | 4.33 | 4.52 | 4.91 | 5.33 | 5.60 |
| Net dividend | 1.64 | 1.80 | 1.88 | 2.03 | 2.18 | 8.83 |

*Source: Company Data; Bryan, Garnier & Co ests.*

# 1. Sales up by 4.5% this year in the Americas

**Based on our estimates, Pernod Ricard's sales in the Americas should grow by 4.5% in 2016/17**, a modest acceleration relative to 2015/16 (+4%).

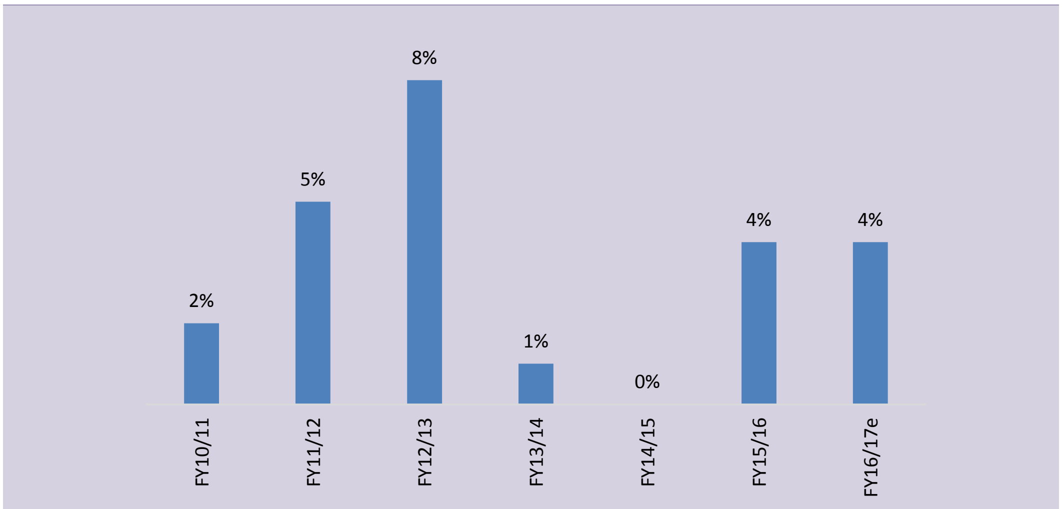
**Fig. 1: Organic sales growth in the Americas**




*Source: Pernod Ricard, Bryan, Garnier & Co*

**Pernod Ricard has redoubled its efforts to win market share in the United States which contribute 67% of the region's sales.** In particular, the group has tripled the size of its dedicated sales force, increased advertising expenditure on brands and priority states, and made changes to commercial and marketing structures. **Sales thus grew by 4% in 2015/16, having remained stable in 2014/15. This growth rate is expected to continue for the year to come.**

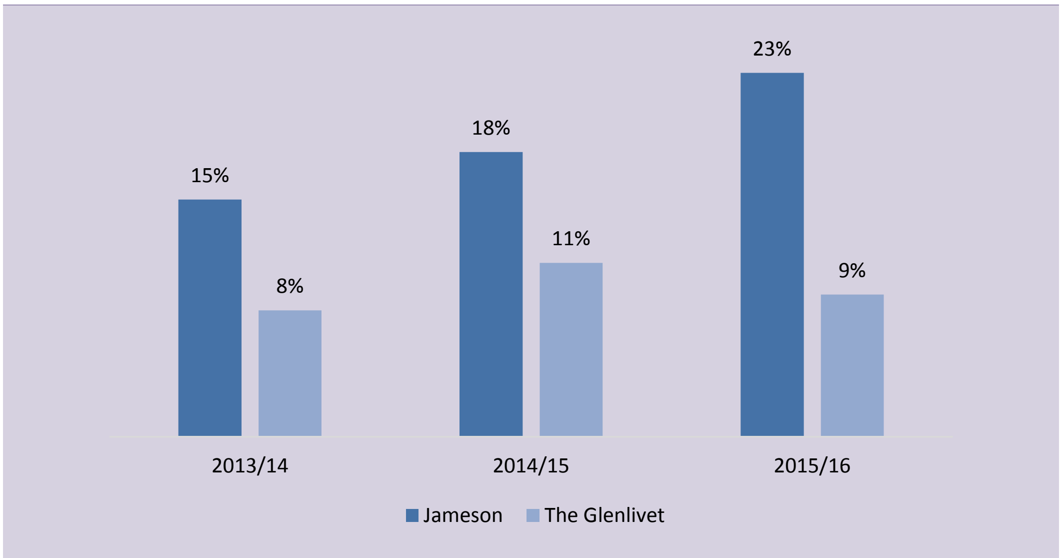
**Fig. 2: Organic sales growth in the United States**




*Source: Pernod Ricard, Bryan, Garnier & Co*

**Irish whiskey Jameson and single-malt scotch The Glenlivet, accounting for a respective 25% and 7% of the company's sales in the United States, remain the main growth drivers.** These two brands saw their sell-out progress by a respective 23% and 9% last year.

**Fig. 3: Sell-out for Jameson and The Glenlivet in the United States**




*Source: Nielsen*

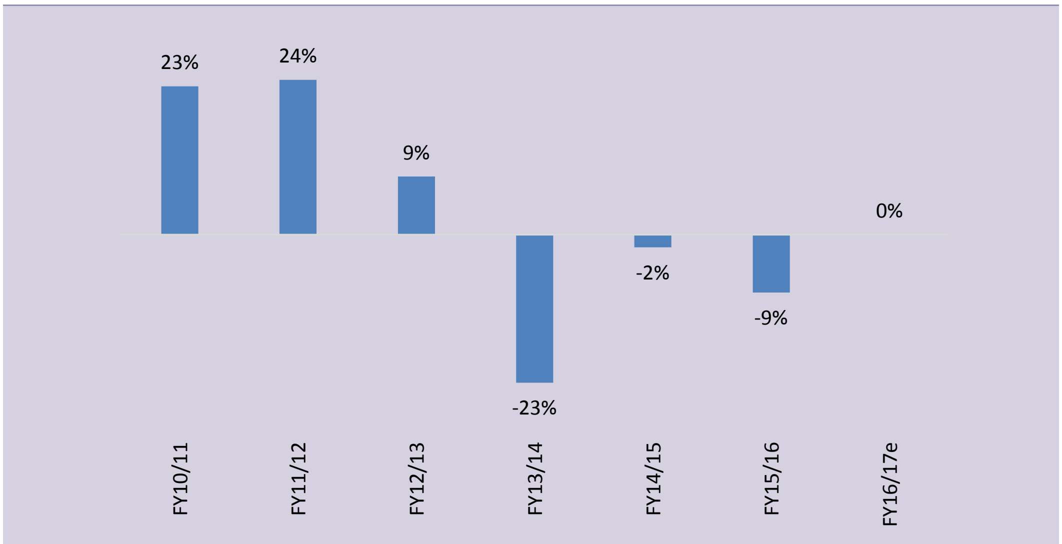
**Absolut is showing signs of an improvement but remains in negative territory. Depletions declined by 2% in 2015/16 after -4% in 2014/15.** This is the result of measures taken by the group: renegotiation of two distribution contracts, packaging changes, refocusing of the advertising campaigns around the notion of authenticity, reduction in the number of flavours, increased advertising expenditure, price reductions and expansion into super premium via Absolut Elyx. Pernod Ricard has reiterated its goal of stabilising Absolut in the medium term.

# 2. Asia-ROW: organic growth of 1.5% in 2016/17

## 2.1. An improvement in China…

**China, which represents 9% of Pernod Ricard's total sales, is showing signs of a pick-up.** After the implementation of the anti-extravagance policy in this country, Pernod Ricard was the first to experience an end to destocking in 2013/14. Its sales fell 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 show double-digit declines while Martell cognac was just slightly down thanks to a normalisation in private consumption, before returning to positive territory in Q1 2016/17 (+3%). At present, the performance remains driven by Noblige although Cordon Bleu is showing signs of an improvement. **In our view, Pernod Ricard should manage to stabilise its sales in China in 2016/17.**

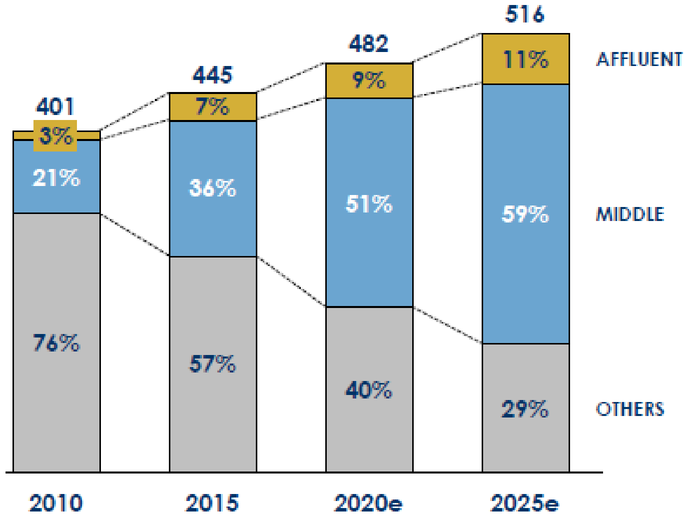
**Fig. 4: Organic sales growth in China**




*Source: Pernod Ricard, Bryan, Garnier & Co*

The group is intensifying its investment in the premium brands in its Chinese portfolio, namely Absolut, Ballantine's Finest and Jameson. In terms of channel, it is looking to reduce its exposure to very high-end bars/discos and traditional karaoke bars, and to increase the proportion of sales generated in off-trade, Western-style bars and restaurants. **This strategy is in response to a normalisation of the Chinese market, implying a reduction in the weight of super premium and prestige and a corresponding increase in premium resulting from the rise of the middle class.**

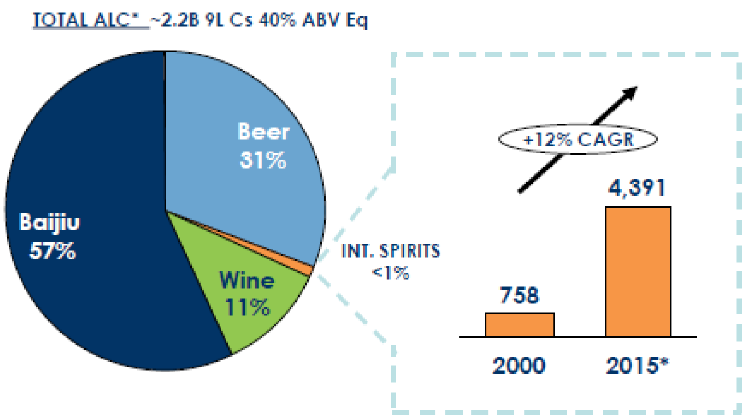
**Fig. 5: Chinese households (in millions)**




*Source: HIS Global Insight*

**Pernod Ricard's portfolio diversification** in terms of categories should enable the group to benefit from an increase in the consumption of international spirits in China where they currently represent no more than 1% of volumes. The group also has an **expanded distribution system,** with 100% penetration in tier 3 cities and 50% in tier four. We think that these two advantages together with a strategy focused on premium will enable the group to return to a 5% growth rate in the medium term.

**Fig. 6: Penetration of international spirits**

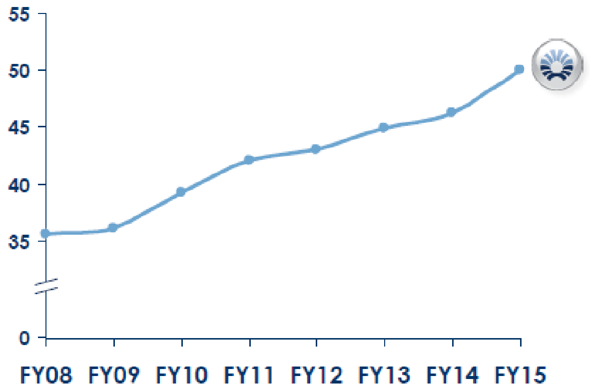



*Source: Pernod Ricard*

## 2.2. …which offset a slowdown in India

Pernod Ricard's portfolio is 90% composed of Indian whisk(e)ys which were acquired during the purchase of the Seagram operations, the remaining 10% coming from the Top 14 spirits. The group enjoys a dominant position in India with a market share in value approaching 50% in 2015 against 36% seven years ago.

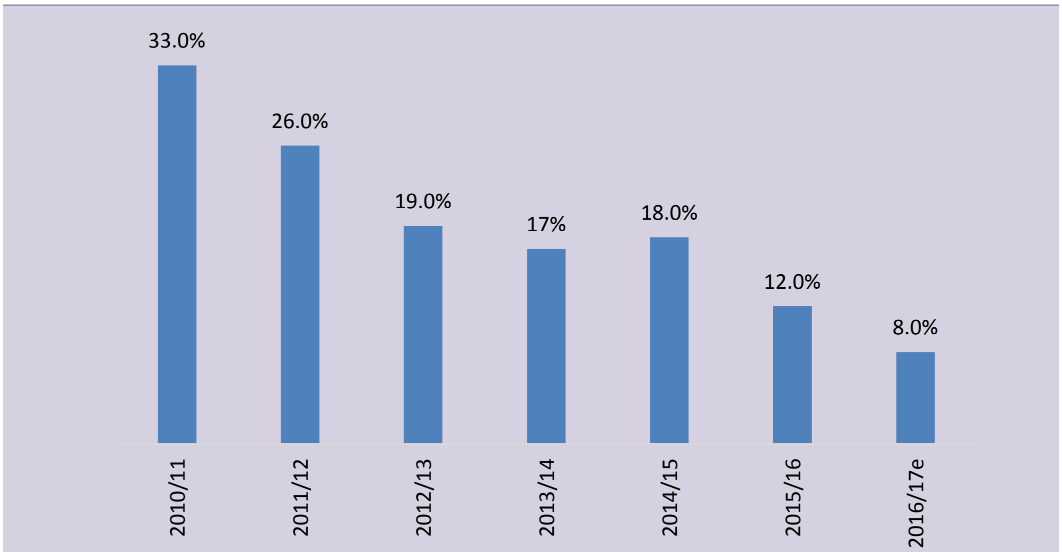
**Fig. 7: Trend in Pernod Ricard's market share in value**




*Source: Pernod Ricard*

**Sales in India (10% of total sales) grew by only 8% in Q1 2016/17, representing a deceleration relative to 2015/16 (+12%). The company has said that this growth rate is expected to hold good for the rest of the year.** The environment is deteriorating: tax increases in Maharastra, change of distributor in the Punjab and the introduction of a ban on alcohol in Bihar. Besides, the group faced a supply disruption during the Diwali celebration at the end of October 2016.

**Fig. 8: Organic sales growth in India**

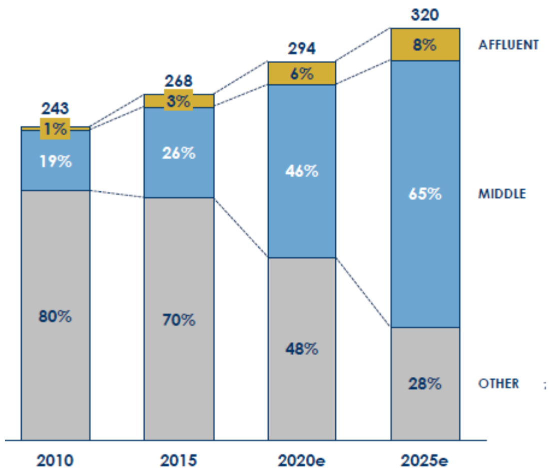



*Source: Pernod Ricard, Bryan, Garnier & Co*

In the longer term, the company should return to double-digit growth in India. The market fundamentals are very solid:

- A young population. In India, the age profile is very favourable to spirits consumption with more than half of the Indian population aged less than 26 years.
- The rise of the middle class. According to IHS Global Insight, middle class householders should represent 65% of the total in 2025 compared with 26% currently.

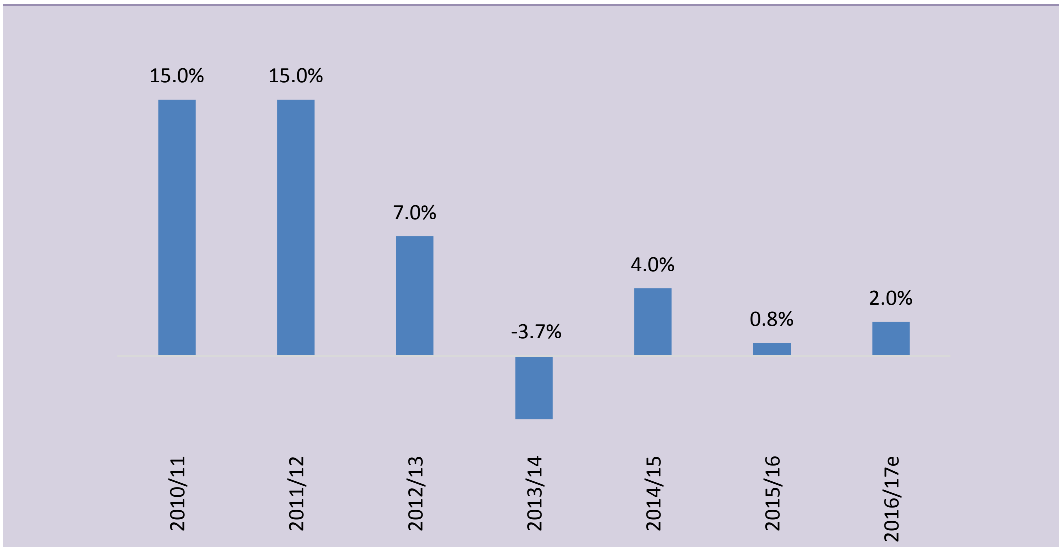
**Fig. 9: Indian households (in millions)**




*Source: HIS Global Insight*

**The pick-up in China should offset the slowdown in India and, to a lesser extent, that of Africa/Middle East. We are thus forecasting organic sales growth for the Asia-ROW region of 2% in 2016/17 after +0.8% last year.**

**Fig. 10: Organic sales growth in the Asia-ROW region**

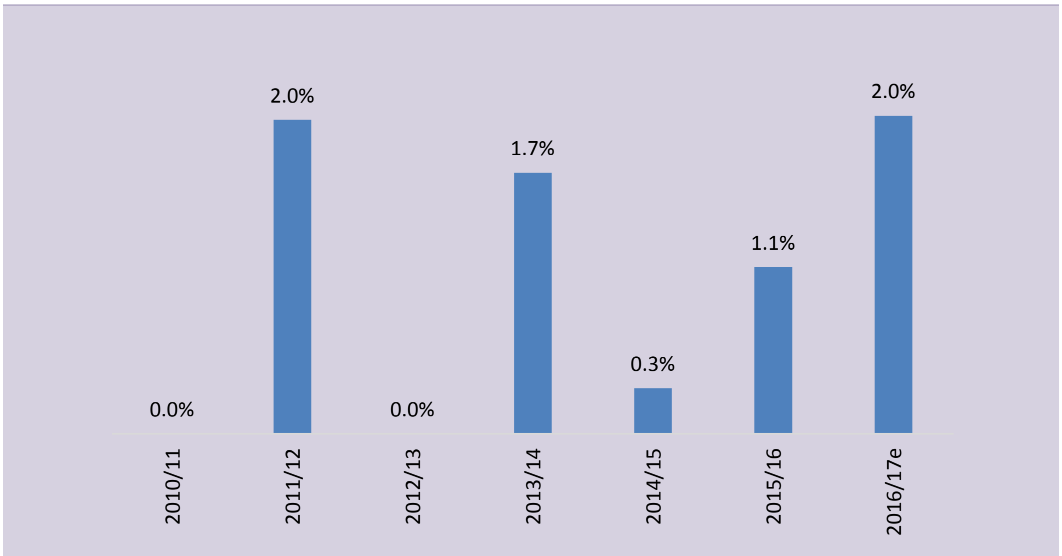



*Source: Pernod Ricard, Bryan, Garnier & Co*

# 3. Europe growing 2% in 2016/17

**Europe is also showing signs of an improvement. We are forecasting organic sales growth of 2% for the region in 2016/17. This represents an acceleration relative to 2015/16 (+1.1%) enabled by Eastern Europe and France.**

**Fig. 11: Organic sales growth in Europe**




*Source: Pernod Ricard, Bryan, Garnier & Co*

Sales in Eastern Europe increased by 5% in 2015/16 and are expected to accelerate in 2016/17 thanks, notably, to Russia. Destocking came to an end in the country last year and spirits consumption is now showing signs of a recovery. In Poland, the situation is more mixed but the group is managing to regain market share. Eastern Europe constitutes a real medium-term growth relay in view of the low penetration rates for Western spirits.

Western Europe posted flat sales in 2015/16. Momentum has improved in all countries across the region, with the exception of France where the environment remains difficult given the pressure from retailers. Sales in the country fell by 7% in 2015/16 but would have been flat without the impact of the merging of the Pernod and Ricard IT systems. Spain turned in a particularly impressive performance last year with sales progressing by +8% after +2% in 2014/15. The intelligence of the company's strategy during the crisis with, notably, the maintenance of advertising expenditure, enabled it to become the leader in Spain with a market share of 24%. We expect an improving performance in Western Europe in 2016/17 thanks to the lack of negative technical effect in France.

# 4. Forecasts

**We are forecasting organic sales growth of 2.7% in 2016/17, an acceleration on the 2015/16 level (+1.8%). Our estimates factor in 1/ positive signs in China which are offsetting the slowdown in India and Africa/Middle East, 2/ continued strong growth in the United States and 3/ an improvement in the Europe region.**

**Fig. 12: Sales**

| *EURm* | 2015/16 | 2016/17e | 2017/18e | 2018/19e |
|---|---|---|---|---|
| **GROUP** | | | | |
| **Sales** | **8 682** | **8 899** | **9 253** | **9 673** |
| Reported variation | 1.4% | 2.5% | 4.0% | 4.5% |
| **Organic variation** | **1.8%** | **2.7%** | **3.4%** | **4.5%** |
| External variation | -0.6% | 0.0% | 0.1% | 0.0% |
| FX variation | 0.3% | -0.2% | 0.5% | 0.0% |
| **Asia-ROW** | | | | |
| **Sales** | **3 496** | **3 579** | **3 711** | **3 896** |
| Reported variation | 1.5% | 2.4% | 3.7% | 5.0% |
| **Organic variation** | **0.8%** | **2.0%** | **3.0%** | **5.0%** |
| **Americas** | | | | |
| **Sales** | **2 475** | **2 561** | **2 710** | **2 859** |
| Reported variation | 3.9% | 3.5% | 5.8% | 5.5% |
| **Organic variation** | **4.0%** | **4.5%** | **5.0%** | **5.5%** |
| **Europe** | | | | |
| **Sales** | **2 710** | **2 758** | **2 832** | **2 917** |
| Reported variation | -0.8% | 1.8% | 2.7% | 3.0% |
| **Organic variation** | **1.1%** | **2.0%** | **2.5%** | **3.0%** |

*Source: Pernod Ricard, Bryan, Garnier & Co*

**We are forecasting a 3.3% organic increase in the current operating profit this year, a figure in the middle of the guidance provided by the company (2%-4%). The first effects of the cost-saving programme (EUR200m of which half is expected to be reinvested) should offset the negative mix arising from the stronger growth in India relative to China.**

### Fig. 13: Current operating result

| *EURm* | 2015/16 | 2016/17e | 2017/18e | 2018/19e |
|---|---|---|---|---|
| **GROUP** | | | | |
| **EBIT** | **2277** | **2390** | **2517** | **2655** |
| Reported variation | 1.7% | 5.0% | 5.3% | 5.5% |
| Organic variation | 2.1% | 3.3% | 4.5% | 5.5% |
| External variation | -0.6% | 0.0% | 0.1% | 0.0% |
| FX variation | 0.3% | 1.6% | 0.8% | 0.0% |
| **Margin** | **26.2%** | **26.9%** | **27.2%** | **27.4%** |
| Variation in bp | 7 | 63 | 34 | 25 |
| **Asia-ROW** | | | | |
| **EBIT** | **983** | **1023** | **1074** | **1138** |
| Reported variation | -1.6% | 4.1% | 5.0% | 6.0% |
| Organic variation | -2.4% | 1.9% | 4.0% | 6.0% |
| **Margin** | **28.1%** | **28.6%** | **28.9%** | **29.2%** |
| Variation in bp | -87 | 47 | 35 | 28 |
| **Americas** | | | | |
| **EBIT** | **706** | **756** | **807** | **855** |
| Reported variation | 11.7% | 7.1% | 6.7% | 6.0% |
| Organic variation | 4.4% | 5.2% | 5.5% | 6.0% |
| **Margin** | **28.5%** | **29.5%** | **29.8%** | **29.9%** |
| Variation in bp | 198 | 99 | 25 | 14 |
| **Europe** | | | | |
| **EBIT** | **588** | **611** | **636** | **662** |
| Reported variation | -3.1% | 3.9% | 4.2% | 4.0% |
| Organic variation | 6.9% | 3.4% | 4.0% | 4.0% |
| **Margin** | **21.7%** | **22.1%** | **22.5%** | **22.7%** |
| Variation in bp | -53 | 45 | 32 | 22 |

*Source: Pernod Ricard, Bryan, Garnier & Co*

# 5. Valuation

Fig. 14: DCF (1/2)

| *EURm* | 2016/17e | 2017/18e | 2018/19e | 2019/20e | 2020/21e | 2021/22e | 2022/23e | 2023/24e | 2024/25e | 2025/26e |
|---|---|---|---|---|---|---|---|---|---|---|
| **Sales** | **8 899** | **9 253** | **9 673** | **10 140** | **10 661** | **11 142** | **11 576** | **11 955** | **12 272** | **12 522** |
| % reported | 2.5% | 4.0% | 4.5% | 4.8% | 5.1% | 4.5% | 3.9% | 3.3% | 2.7% | 2.0% |
| **EBIT** | **2 390** | **2 517** | **2 655** | **2 804** | **2 948** | **3 081** | **3 201** | **3 305** | **3 393** | **3 462** |
| EBIT margin | 26.9% | 27.2% | 27.4% | 27.6% | 27.6% | 27.6% | 27.6% | 27.6% | 27.6% | 27.6% |
| -Income taxes | -457 | -498 | -536 | -608 | -640 | -668 | -695 | -717 | -736 | -751 |
| +Depreciation | 222 | 231 | 242 | 261 | 281 | 302 | 322 | 341 | 358 | 374 |
| +Change in WC | -128 | -164 | -225 | -236 | -248 | -259 | -269 | -278 | -286 | -291 |
| as % of sales | -1.4% | -1.8% | -2.3% | -2.3% | -2.3% | -2.3% | -2.3% | -2.3% | -2.3% | -2.3% |
| **Operating cash flows** | **2 027** | **2 086** | **2 135** | **2 220** | **2 341** | **2 455** | **2 558** | **2 651** | **2 729** | **2 794** |
| -Capex | -311 | -278 | -290 | -304 | -320 | -334 | -347 | -359 | -368 | -376 |
| as % of sales | -3.5% | -3.0% | -3.0% | -3.0% | -3.0% | -3.0% | -3.0% | -3.0% | -3.0% | -3.0% |
| **Free cash flows** | **1 716** | **1 808** | **1 845** | **1 916** | **2 021** | **2 120** | **2 211** | **2 292** | **2 361** | **2 418** |
| Discount coefficient | 0.94 | 0.87 | 0.82 | 0.77 | 0.72 | 0.67 | 0.63 | 0.59 | 0.55 | 0.51 |
| **Discounted FCF** | **1 605** | **1 582** | **1 510** | **1 466** | **1 447** | **1 420** | **1 385** | **1 342** | **1 293** | **1 239** |

Fig. 15: DCF (2/2)

| | |
|---|---|
| Sum of discounted cash flows | 14 289 |
| +Terminal Value | 25 187 |
| +Financial assets | 721 |
| -Net debt | -8 716 |
| -Provisions | -589 |
| -Minorities | -169 |
| **Equity Value** | **30 723** |
| Number of shares (m) | 266 |
| **Fair Value** | **115** |

*Source of all tabs: Pernod Ricard, Bryan, Garnier & Co*

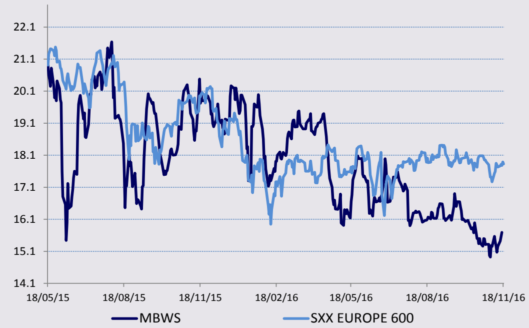
# INDEPENDENT RESEARCH

23rd November 2016

Food & Beverages

| | |
|---|---|
| Bloomberg | MBWS FP |
| Reuters | MBWS.PA |
| 12-month High / Low (EUR) | 20.3 / 14.9 |
| Market capitalisation (EURm) | 444 |
| Enterprise Value (BG estimates EURm) | -23,372 |
| Avg. 6m daily volume ('000 shares) | 56.10 |
| Free Float | 100% |
| 3y EPS CAGR | 94.3% |
| Gearing (12/15) | -35% |
| Dividend yields (12/16e) | NM |

| YE December | 12/15 | 12/16e | 12/17e | 12/18e |
|---|---|---|---|---|
| Revenue (EURm) | 451,050 | 441,262 | 458,404 | 479,628 |
| EBIT(EURm) | 5,093 | 11,649 | 27,229 | 51,512 |
| Basic EPS (EUR) | 0.22 | -0.19 | 0.65 | 1.52 |
| Diluted EPS (EUR) | 0.21 | -0.19 | 0.65 | 1.52 |
| EV/Sales | NS | NS | NS | NS |
| EV/EBITDA | NS | NS | NS | NS |
| EV/EBIT | NS | NS | NS | NS |
| P/E | 75.8x | NS | 24.2x | 10.3x |
| ROCE | 6.9 | -1.3 | -1.5 | -1.5 |




# MBWS

## A change in the equity story

**Fair Value EUR17.1** (price EUR15.69)

**NEUTRAL**
**Coverage initiated**

**The restructuring of MBWS is now complete with the exit from the business continuation plan in July 2016. 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.**

- An end to restructuring. The history of MBWS is marked by disagreements between shareholders, issues surrounding the level of indebtedness notably linked to the acquisition of Marie Brizard in 2006 and, lastly, a legal proceeding launched in 2012 which was to culminate in a EUR532m debt for equity swap. However, the normalisation process is now complete and, having been rebaptised Marie Brizard Wine & Spirits, the company has a new Executive Committee and Board of Directors. Its shareholder structure has stabilised and the continuation plan has been completed.

- The growth story is less convincing. We are forecasting 2018 sales of EUR480m, in line with the guidance (EUR450-EUR500m) but only thanks to the retention of the wholesale operations in Poland which had initially been slated for divestment. In our view, the organic performance for 2016-18 will not be enough for MBWS to achieve its objectives. The group is behind schedule in France and its targets in the United States, Spain and Poland are very ambitious. We are forecasting EBITDA of just EUR58m in 2018 versus the guidance of EUR67-EUR75m. We are confident on the rationalization and optimization components and their ability to generate a respective EUR3.5m and EUR25m but the weaker-than-expected growth is likely to represent an EBITDA shortfall of EUR9m.

- Limited upside. After a re-rating in 2014 and 2015, the shares have fallen by 22% in absolute terms since the beginning of the year due to the stock warrant exchange offer and uncertainties regarding the growth outlook. Our DCF-based valuation derives a Fair Value of EUR17.1, which points to 9% upside potential. We are initiating coverage with a Neutral recommendation

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**Sector Analyst Team:**
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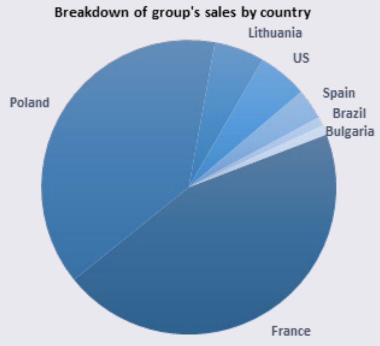
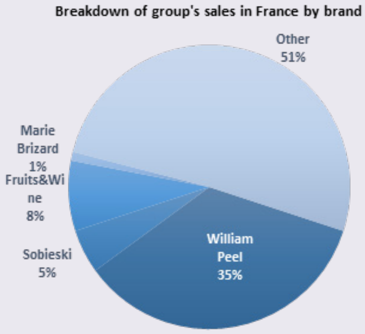



## Company description

MBWS is a French wines and spirits group which is mainly exposed to France (45% of sales) and Poland ( 39% of sales). Its portfolio is made up of around thirty brands but four of them generate 46% of sales (Marie, Brizard, Sobieski, William Peel and Fruits & Wines)

| **Simplified Profit & Loss Account (EURm)** | **2013** | **2014** | **2015** | **2016e** | **2017e** | **2018e** |
|---|---|---|---|---|---|---|
| Revenues | 539,566 | 466,678 | 451,050 | 441,262 | 458,404 | 479,628 |
| *Change (%)* | *-2.1%* | *-13.5%* | *-3.3%* | *-2.2%* | *3.9%* | *4.6%* |
| Adjusted EBITDA | 0.0 | 5,146 | 11,219 | 18,224 | 33,555 | 58,179 |
| Recurring EBIT | 279 | 997 | 5,093 | 11,649 | 27,229 | 51,512 |
| *Change (%)* | *-%* | *257%* | *411%* | *129%* | *134%* | *89.2%* |
| Financial results | 226,170 | (4,224) | (6,416) | (17,130) | (561) | (17,691) |
| Pre-Tax profits | 190,432 | (18,183) | (960) | (6,042) | 19,539 | 44,127 |
| Exceptionals | (36,017) | (14,956) | 365 | 0.0 | 0.0 | 0.0 |
| Tax | (272) | (44.0) | 7,891 | 2,000 | 0.0 | 0.0 |
| Minority interests | 207 | 897 | 1,084 | 1,171 | 1,264 | 1,366 |
| Net profit | 190,467 | (18,228) | 6,931 | (4,042) | 19,539 | 44,127 |
| Restated group net profit | 226,277 | (4,168) | 5,484 | (5,212) | 18,274 | 42,761 |
| *Change (%)* | *-%* | *-102%* | *-%* | *-195%* | *-%* | *134%* |
| **Cash Flow Statement (EURm)** | | | | | | |
| NOPAT | 279 | 999 | (36,770) | 7,793 | 27,229 | 51,512 |
| Depreciation | NM | NM | NM | NM | NM | NM |
| Change in working capital | 27,091 | 21,149 | 1,118 | 2,164 | 5,568 | 6,075 |
| Capex, net | 16,645 | (4,370) | (9,017) | (8,825) | (9,168) | (9,593) |
| Dividends | 106 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | (57,148) | 10,797 | 56,900 | 62,800 | (6,000) | (22,000) |
| Net debt | (22,400) | (41,549) | (70,960) | (23,817) | (50,614) | (86,200) |
| Free Cash flow | 64,032 | 30,153 | (44,974) | 9,957 | 32,797 | 57,587 |
| **Balance Sheet (EURm)** | | | | | | |
| Tangible fixed assets | 51,653 | 42,922 | 51,929 | 56,137 | 55,333 | 54,152 |
| Intangibles assets | 141,886 | 140,832 | 135,198 | 137,902 | 138,513 | 139,136 |
| Cash & equivalents | 36,470 | 77,184 | 89,112 | 83,469 | 110,266 | 145,853 |
| current assets | 291,697 | 223,613 | 188,319 | 185,304 | 182,663 | 180,096 |
| Other assets | 11,353 | 4,844 | 2,410 | 5,770 | 5,885 | 6,003 |
| Total assets | 533,059 | 489,395 | 466,968 | 468,582 | 492,660 | 525,239 |
| L & ST Debt | 0.0 | 148,454 | 125,416 | 202,773 | 229,571 | 265,158 |
| Others liabilities | 311,674 | 142,544 | 146,551 | 34,505 | 11,958 | (19,302) |
| Shareholders' funds | 221,385 | 199,514 | 204,334 | 231,304 | 251,132 | 279,384 |
| Total Liabilities | 533,059 | 490,512 | 476,301 | 468,582 | 492,660 | 525,239 |
| Capital employed | 363,780 | 295,846 | 286,335 | 291,084 | 285,322 | 278,689 |
| **Ratios** | | | | | | |
| EBITDA margin | 0.0 | 1.10 | 2.49 | 4.13 | 7.32 | 12.13 |
| Recurring EBIT margin | 0.17 | 0.68 | 3.20 | 2.64 | 5.94 | 10.74 |
| Tax rate | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Restated group net profit margin | 41.94 | (0.89) | 1.22 | (1.18) | 3.99 | 8.92 |
| ROE (after tax) | NM | NM | NM | NM | NM | NM |
| Net debt / EBITDA | NM | 17.60 | 6.89 | (1.31) | (1.51) | (1.48) |
| Gearing | (10.12) | (20.83) | (34.73) | (10.30) | (20.15) | (30.85) |
| Pay out ratio | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Number of shares, diluted | 25,027 | 32,429 | 26,506 | 27,739 | 28,187 | 28,187 |
| **Data per Share (EUR)** | | | | | | |
| Diluted EPS | 7.60 | (0.59) | 0.22 | (0.19) | 0.65 | 1.52 |
| Restated diluted EPS | 9.04 | (0.13) | 0.21 | (0.19) | 0.65 | 1.52 |
| *% change* | *-%* | *-101%* | *-%* | *-191%* | *-%* | *134%* |
| BVPS | 8.45 | 5.82 | 7.26 | 7.98 | 8.55 | 9.56 |
| FCF | 2.56 | 0.93 | (1.70) | 0.36 | 1.16 | 2.04 |
| Net dividend | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

*Source: Company Data; Bryan, Garnier & Co ests.*

# Table of contents

# 1. Investment Case

*Why the interest now?*

## The reason for writing now

The MBWS restructuring is now complete with the exit from the continuation plan in July 2016. The company is henceforth embarking on a new chapter – one of growth – which promises to be more difficult. France is behind schedule and our 2018 sales forecasts for the United States, Spain and Poland are below the guidance given for these three countries. Only the abandoned divestment plan for the Polish wholesale operations will enable MBWS to achieve its target of group's sales between EUR450m and EUR500m.

*Cheap or Expensive?*

## Valuation

After a re-rating in 2014 and 2015, the shares have fallen by nigh-on 22% in absolute terms since the beginning of the year given the stock warrant exchange offer and uncertainties regarding the growth outlook. Despite this, our DCF-derived Fair Value of EUR17.1 points to 9% upside potential.

*When will I start making money?*

## Catalysts

The update on the strategic plan on 12 December should be an opportunity to provide more detail on the growth component of the BIG 2.0 plan and to announce that the plan to divest the Polish wholesale operations has been abandoned.

*What's the value added?*

## Difference from consensus

We are forecasting 2018 sales of EUR480m, 14% above the market consensus and in line with the company's guidance (EUR450-EUR500m). Our base case scenario is that the group will not divest its Polish wholesale operations, explaining this difference with the consensus. However, our EBITDA forecast is EUR58m, i.e. 10% below the consensus. We are confident in the rationalization and optimization components and their ability to generate a respective EUR3.5m and EUR25m but the weaker-than-expected growth is likely to represent an EBITDA shortfall of EUR9m.

*Could I lose money?*

## Risks to our investment case

Governance issues are likely to emerge given the presence in the share capital of a number of industrial players (Diana Holding, Castel and La Martiniquaise) with potentially divergent interests. Inversely, our estimates could prove to be too cautious if the market conditions, particularly in France and Poland, were to show a material improvement.

# 2. Atypical positioning

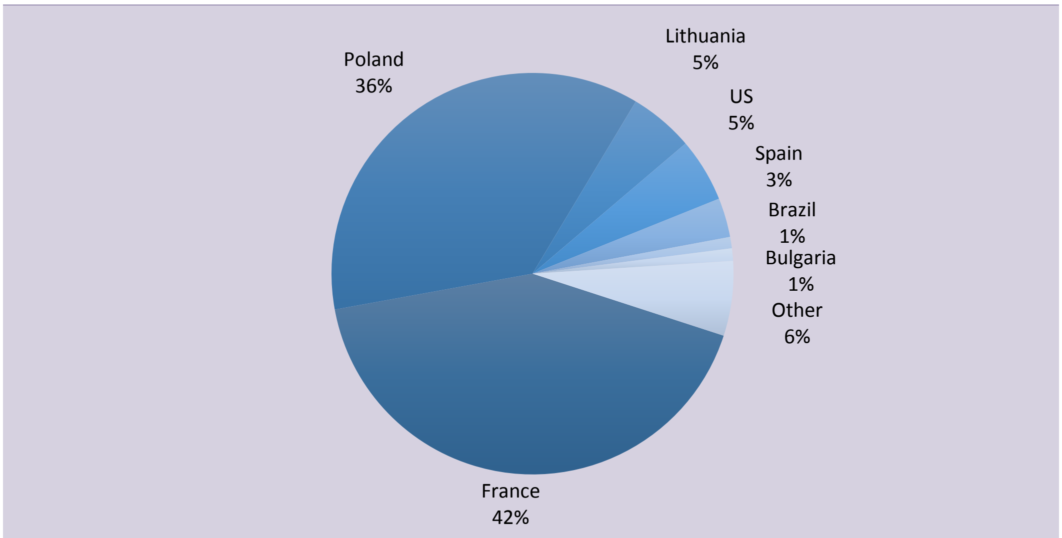
The group is a local player which is mainly exposed to France and Poland (2.1). Its portfolio is highly diversified in terms of categories and comprises some thirty brands, four of which contribute 46% of sales according to our estimates (2.2). The 'standard' price positioning is not shared by other listed companies (2.3).

## 2.1. A local player

France and Poland combined represent 78% of the group's sales

**The group is mainly present in France (42% of sales) and Poland (36% of sales),** the other geographical exposures being Lithuania (6%), the United States (5%), Spain (3%), Brazil (1%) and Bulgaria (1%).

**Fig. 1: Breakdown of sales by country**




*Source: Marie Brizard Wine & Spirits*

## 2.2. A highly-diversified portfolio

The four pillar brands: 46% of sales according to our estimates

**The Marie Brizard portfolio comprises some thirty brands belonging to diverse categories: vodka, whiskey, port, pastis, gin, tequila, wines, liqueurs, absinthe, cachaça, etc.** The company demarcates four pillar brands which represent 46% of sales according to our estimates.

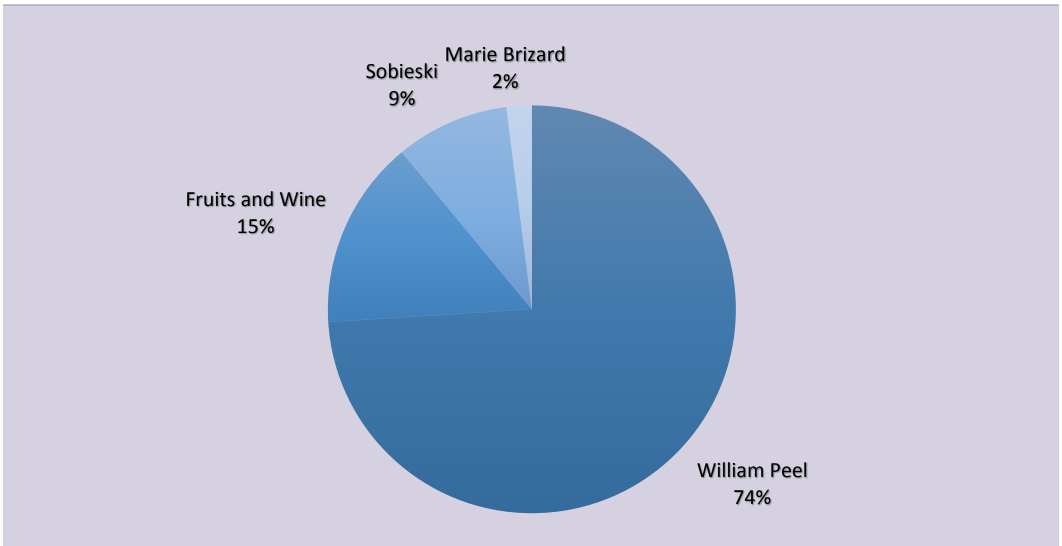
**Fig. 2: The four pillar brands**


*Source: Marie Brizard Wine & Spirits*

William Peel: 74% of pillar brand sales

**The blended scotch brand William Peel is the most important in terms of weight,** accounting for 74% of pillar brand sales, followed by Fruits and Wine aromatised wines (15%), Sobieski vodka (9%) and Marie Brizard liqueurs (2%).

**Fig. 3: Breakdown of pillar brand sales, 2015**




*Source: Marie Brizard Wine & Spirits*

The geographical diversification of pillar brand sales is low

**The pillar brands are not present in all the group's key markets,** with William Peel and Fruits and Wines mainly sold in France, the latter country representing a respective 95% and 98% of their sales. Sobieski is mainly exposed to the United States (45% of sales) and Marie Brizard to Spain (50% of sales).

**Fig. 4: Breakdown of William Peel sales, 2015**

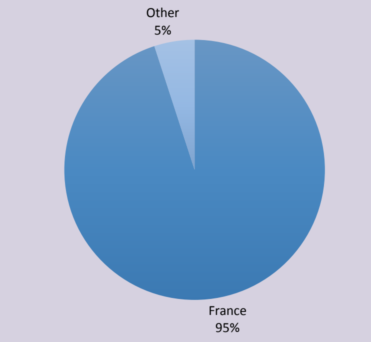



**Fig. 5: Breakdown of Fruits and Wines sales, 2015**

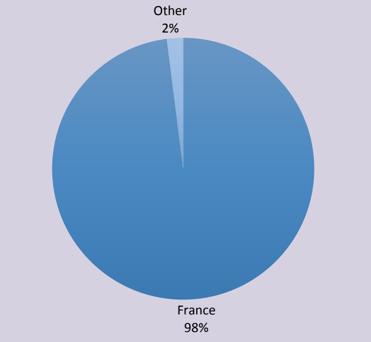



**Fig. 6: Breakdown of Sobieski sales, 2015**

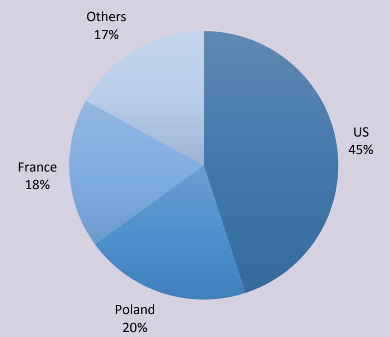
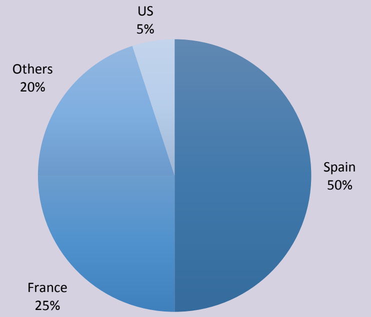



**Fig. 7: Breakdown of Marie Brizard sales, 2015**




*Source: Marie Brizard Wine & Spirits, Bryan, Garnier & Co*

Gautier cognac


*Source: Marie Brizard Wine & Spirits*

**The expansion of the pillar brands into new geographies is a key objective of the strategic plan. William Peel** has thus been launched in Lithuania, Bulgaria, Spain, Brazil and Poland. **Fruits & Wines** has been the subject of a successful launch in Canada, Poland and Spain and should now be rolled in the United States, Japan and the United Kingdom. The priority for **Marie Brizard** is expansion outside Spain with a focus on the United States, Asia-Pacific and Duty Free. The international diversification of the brand should be facilitated by the regrouping of the liqueur brands under one umbrella (e.g. Dubar by Marie Brizard and Marie Brizard by Dubar). The aim for **Sobieski** is to increase its weight in the United States, notably by concentrating the advertising spend on nine key States. The group is looking to achieve a market share of 10% in the imported vodka segment (i.e. its current market share in Michigan). **Gautier cognac,** which is destined to become the fifth pillar brand, was the subject of a global re-launch in 2016 and should now be rolled out in France, the United Kingdom, Canada, the United States and Duty Free. The brand should thus double its volumes and reach the million bottle mark, thereby becoming the 10th best-selling cognac worldwide compared with 20th position currently. In our view, the July 2015 sale by Suntory of the Royer cognac for a price approaching EUR100m has encouraged MBWS to develop Gautier which, despite suffering from a past lack of investment, has nonetheless twice been voted the 'World's Best Cognac'.

**Fig. 8: Strategic plan objectives for the pillar brands**

| | |
|---|---|
| **William Peel** | Launch in Lithuania, Bulgaria, Spain, Brazil, Poland |
| **Fruits and Wines** | Launch in Canada, Poland, Spain, United States, Japan and the UK |
| **Marie Brizard** | Focus on the US, Asia Pacific and Duty Free |
| **Sobieski** | Increase the weight of the US as % of the brand's sales |
| **Gautier** | Launch in France, the UK, Canada, the US and Duty Free |

*Source: Marie Brizard Wine & Spirits*

**The remainder of the portfolio breaks down into branded wines** (MonCigale, Eclat du Rhône, Domaine Menada, Tcherga, Bodega Marques del Puerto, etc.), **private labels** (vodka, wines) **and secondary spirits** (Old Lady's gin, Porto Pitters, Berger pastis, Gautier cognac, San José tequila, etc.).

## 2.3. Standard positioning

The low margins in 'standard' discourage the global leaders from positioning themselves in this segment

**Marie Brizard is mainly positioned in the standard segment (91% of its sales and 87% of volumes), which is not common to the listed companies.** This segment represents only 47% of Diageo and Pernod Ricard sales and 24% at Rémy Cointreau. These global leaders are very unlikely to increase their exposure to the standard segment in view of its low level of profitability, the EBITDA margin standing at around 15% versus 26% for premium.

**Fig. 9: Breakdown of sales (in value) by price segment**

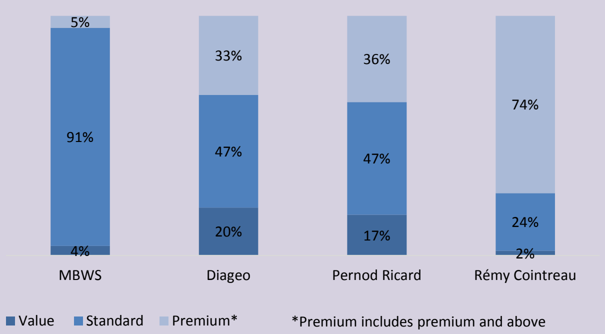
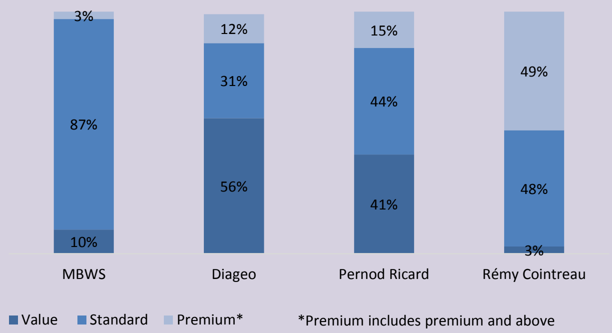


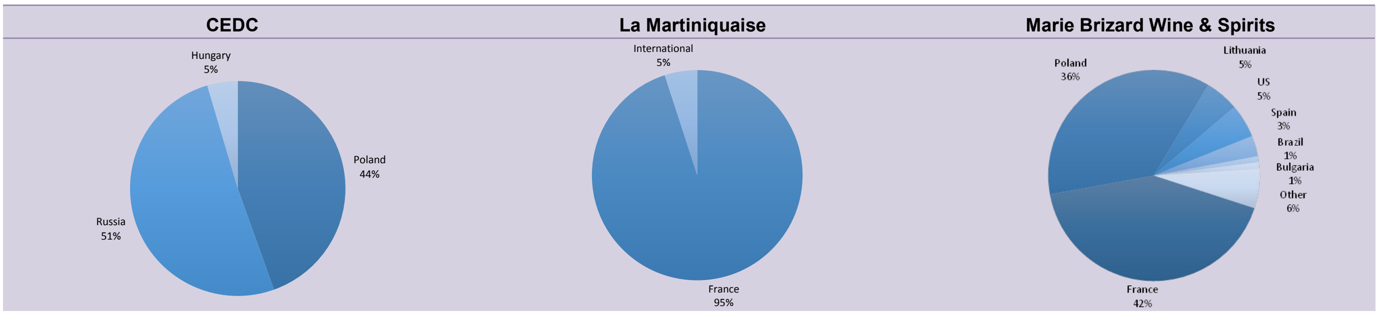

**Fig. 10: Breakdown of sales (in volume) by price segment**




*Source: IWSR*

**The geographical diversification of the other standard segment players is lower than that of MBWS.** CEDC operates only in Russia (51% of sales), Poland (44%) and Hungary (5%). Based on our estimates, La Martiniquaise is unlikely to generate more than 5% of its sales outside France.

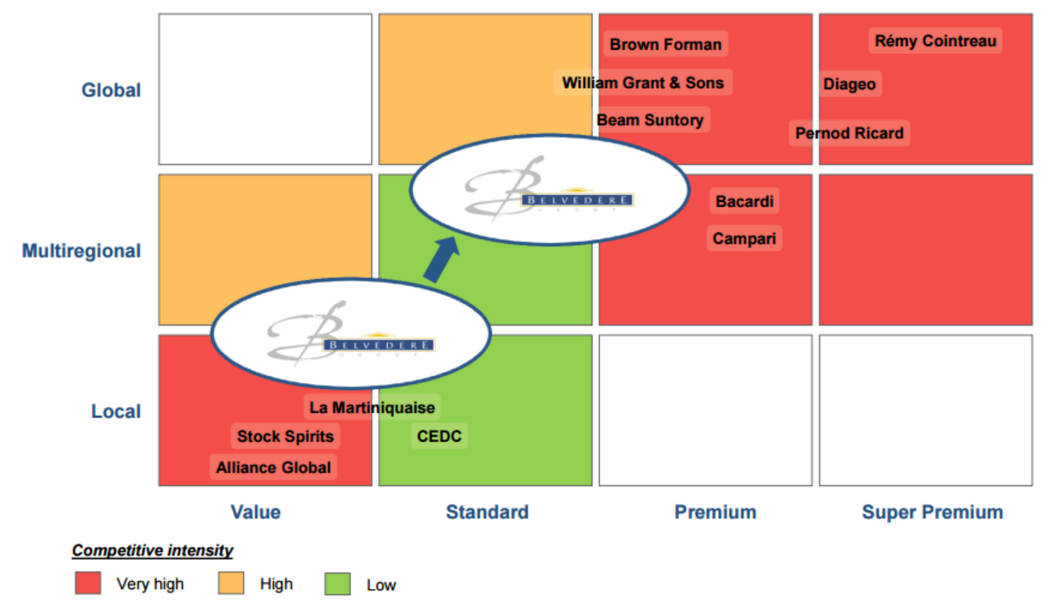
**Fig. 11: Geographical sales breakdown for the groups with standard exposure**




*Source: Companies, Bryan, Garnier & Co*

**MBWS is not aiming to become a 'premium' player,** this segment being considered too competitive and too costly. **Something resembling a move up market is nonetheless under way via** 1/ the launch of premium formats of existing brands (notably Sobieski and William Peel), 2/ an increase in exposure to the more profitable on-trade channel (cafés, hotels and restaurants) channel and 3/ a growth acceleration for the higher-margin pillar brands.

**Fig. 12: Positioning of Marie Brizard (ex-Belvédère)**




*Source: Marie Brizard Wine & Spirits*

# 3. The normalisation process now over

The company has had a troubled history (3.1), marked by disagreements between shareholders, issues surrounding the high level of indebtedness linked to the Marie Brizard acquisition in 2006 and, lastly, a legal proceeding launched in 2012 which was to culminate in a EUR532m debt for equity swap. However, the normalisation process is now over (3.2) and, having been rebaptised Marie Brizard Wine & Spirits, the company has a new Executive Committee and Board of Directors. Its shareholder structure has been stabilised and the business continuation plan completed.

## 3.1. A turbulent history

In 1991 in Beaune, Mssrs. Jacques Rouvroy and Krzystof Trylinski founded Euro Agro, a company specialised in the design and manufacturing of high-end bottles for vodka. Having been renamed Belvédère, the company was listed for trading on the stock market in 1997. **As of the 2000s, the two founders modified the strategy to include alcoholic beverage manufacturing in order to secure the end-to-end value chain. A number of acquisitions then ensued (wines and spirits) in Poland, Bulgaria and Lithuania.** Belvédère vodka was subsequently sold to LVMH in 2001.

The company Belvédère then embarked on a quest for a partner willing to back its external growth strategy. **Thus, in 2003, a conglomerate based in Trinidad & Togabo, CL Finance, entered the Belvédère share capital** by acquiring a 21% stake then continuing to add to its shareholding in the ensuing years. In 2005, CL Finance announced plans to bid for Belvédère, only to change its mind when **Mssrs. Jacques Rouvroy and Krzystof Trylinski opted to purchase Marie Brizard**, their aim being to diversify the categories in their portfolio (brands: Marie Brizard, William Peel whisky, Gautier cognac Moncigale wines), expand into Western Europe and distribute Marie Brizard products in Eastern Europe.

The acquisition of Marie Brizard in 2006 saw Belvédère's net debt/EBITDA ratio soar to 11x

**After the acquisition of Marie Brizard, the net debt/EBITDA ratio soared to 11x. CL Finance supported the transaction but finally proceeded to launch a bid, culminating in ownership of 68% of the Belvédère share capital.** The separation of the conglomerate and its historic shareholders, Mssrs. Jacques Rouvroy and Krzystof Trylinski, then become effective, the two men terminating their shareholder pact in early 2007.

In June 2007, CL Finance agreed to sell its shareholding in return for EUR345m, 4.8% of the share capital then being transferred to Orangina (purchaser of the Pulco and Sirop Sport brands) which agreed to hold the shares for a three-month period. Since it had not found another investor at the end of this period, Belvédère was obliged to buy back these shares. The group also had to undertake the purchase of the shares owned by V&S since the purchase of the Florida Distillers Company.

In 2012 a legal proceeding was launched, culminating in a EUR532m debt for equity swap

**The company then owned more than 10% of its own share capital, contravening one of the clauses in the agreement with the OBSAR (bonds with redeemable warrants) and FRN debt holders who had helped finance the Marie Brizard acquisition in 2006.** The latter then demanded the reimbursement of EUR473m, a sum that Belvédère was unable to pay. In 2008, the senior executives launched a business continuation plan scheduling the reimbursement of the debt over a ten-year period but Belvédère suspended its payments to creditors. **In 2013, agreement was reached on a EUR532m debt for equity swap.**

## 3.2. Significant progress

Having been rebaptised Marie Brizard Wine & Spirits, the company appointed a new Executive Committee and Board of Directors. The shareholder register has been stabilised and the business continuation plan is complete.

### 3.2.1. A new Executive Committee and Board of Directors

A Board of Directors chaired by an independent director

Five of the 11 members of the Board of Directors are independent: Mr Herault, Ms. Benqué, Ms. Mondollot, Mr. Ghiot and Mr. de Belair. **The Board of Directors has made a commitment to the Board remaining chaired by an independent director and this post has been occupied by Mr. Benoit Hérault since 2014.** He contributed to the appointment of **Mr. Jean-Noël Reynaud** in April 2014.

Mr. Raynaud was previously Deputy Managing Director of Lactalis Europe. He has experience of Eastern Europe (Coca-Cola beverages Ukraine, Lorenz Bahlsen Snack world) and of the spirits industry (14 years at Rémy Cointreau). **He has a solid restructuring track record, having headed up Rémy Cointreau's operations in Latin America/Central Europe and Bahlsen in Central Europe.** In 2014, Mr, Reynaud notably focused on establishing a new management team including professionals with strong industry or organisational reputations. Financial control and human resources have been completely reorganised.

Jean-Noël Reynaud: a CEO recognised for his restructuring skills

**Senior executive remuneration is mostly tied to the success of the strategic plan,** with 480,000 stock options having been distributed to 26 senior executives, of which 110,000 to Mr. Reynaud. Each stock option confers the right to purchase one share at a price of EUR10.64. Most of the stock options may not be exercised before 2018 and a number of performance criteria must be met.

The founders no longer occupy functions within the company, Mr. Trylinksi having stepped down as Chairman of the Board of Directors in September 2014.

### 3.2.2. A stabilised shareholder structure

**In September 2014, Diana Holding acquired 5.8% of the Marie Brizard share capital.** Diana Holding is the leading wine producer and the seventh-largest industrial company in Morocco, realising 3 billion dirhams of sales (EUR280m) and, since April 2014, headed by Ms. Rita Maria Zniber, the wife of the founded Brahim Zniber.

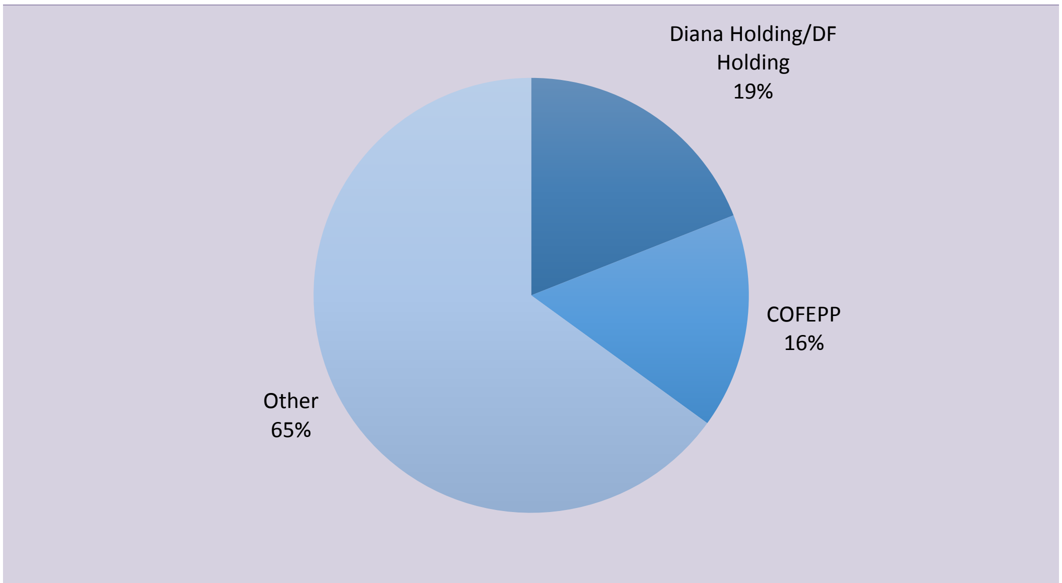
A shareholder structure comprising three wine and spirits industry players

**In May 2015, the company DF Holding controlled by the Castel family acquired a 5.7% stake in Marie Brizard before declaring that it was acting in concert with Diana Holding.** In our view, the arrival of DF Holding in the MBWS share capital was mainly motivated by a wish to assist Diana Holding, the Castel and Zniber families maintaining close relations.

In June 2015, the two shareholders called for the resignation of four independent Board directors, a proposal that was rejected by the shareholders at the General Shareholders' Meeting. The meeting was held after the acquisition of **5.1% of the capital of MBWS by the company COFEPP, controlled by the Cayard family. The latter heads up La Martiniquaise**, the number two player in the French spirits industry whose sales are estimated at EUR1bn. Its key products are the Scotch whisky Label 5, a competitor to William Peel in France with an 11% market share, and Poliakov vodka, the leader in France with a market share of 37%. The group is also present in the rum market with its Old Nick and Saint James brands given the merger with Bardinet in 2009. Mr. Jean-Pierre Cayard has said that he has no plans to take control of Marie Brizard but rather to work on potential partnerships in terms of procurement and industrial processes.

**Diana Holding and DF Holding currently own 19% of the share capital and COFEPP 16%.**

**Fig. 13: Shareholder breakdown**




*Source: Marie Brizard Wine & Spirits*

Over the long-term, development in Africa and in specialised retail chains in France (Nicolas, Le Repaire de Bacchus)

**The development of MBWS in Africa should be facilitated by the presence of Diana Holding and Castel in the share capital. In France, the group could gain access to the specialised retail chains, Nicolas and Le Repaire de Bacchus.** Nicolas, which numbers some 500 stores in France, is owned by the Castel group. It is difficult to envisage brands like Sobieski and William Peel, which are not difficult to find in supermarkets, being sold in this specialised, premium network but the positioning of the Marie Brizard liqueur and Gautier cognac could be a good fit. La Martiniquaise owns the La Repaire de Bacchus chain (around 30 stores in France) through which MBWS could market its wines.

### 3.2.3. Exiting the business continuation plan

**The business continuation plan had been expected to be concluded in 2020** once MBWS had finished reimbursing its creditors. It did not prevent the development of the company but did constitute **a brake on the day-to-day management** since numerous decisions needed to be approved by the Dijon Commercial Court. Furthermore, it made it **impossible to distribute dividends or make acquisitions, while damaging MBWS's reputation** with banking institutions, suppliers and local authorities.

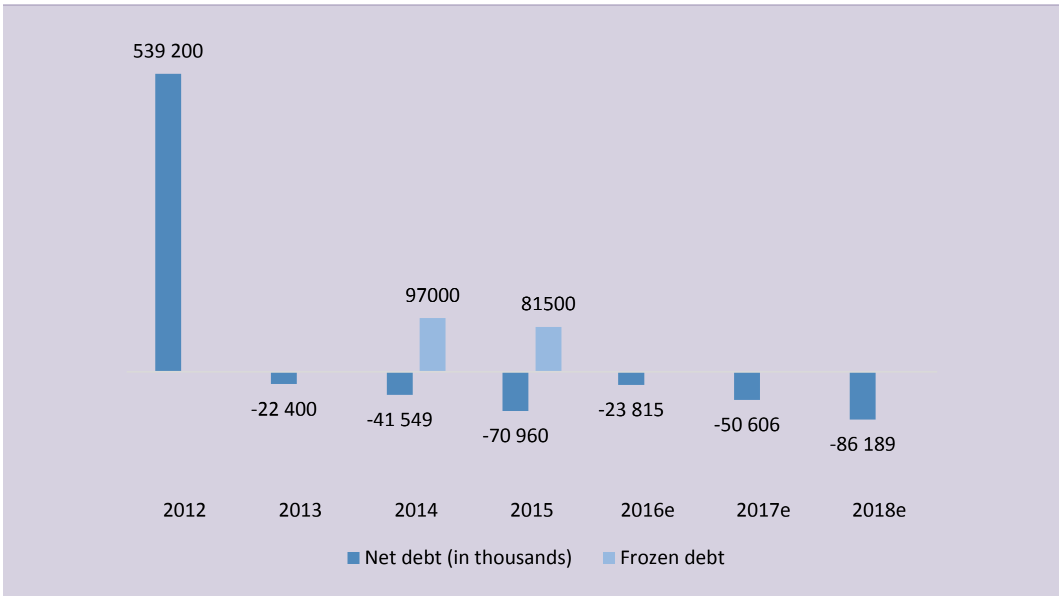
The normalisation of the group was concluded with the exit from the business continuation plan in July 2016

In October 2015, an agreement was reached ending the dispute between MBWS and the French tax authorities concerning the deductibility of the interest charge on the FRN debt. By virtue of this agreement, the group obtained tax relief of EUR20.4m and, in return, agreed to **begin the process of early exit from the business continuation plan of its French subsidiary Marie Brizard Wine & Spirits France. This exit was confirmed in March 2016, preceeding the group's full exit from the continuation plan in July of the same year,** enabled by the settlement of the last significant dispute (between MBWS and the company Chamarré) and the reimbursement of the frozen debt, i.e. EUR81.5m at the end of 2015. **The last stage in the normalisation of the group had been concluded.**

**To finance the reimbursement of the frozen debt, Marie Brizard contracted a bank loan for the sum of EUR62.5m in May 2015 and launched a stock warrant exchange offer.** Concretely, the bank issued BSA 2016s to replace the BSA 2004s, BSA 2006s, BSA Actionnaires 1, BSA Actionnaires 2 and BSA OS previously in issue. The holders had until the end of March 2016 to exercise their BSA 2016s at a price of EUR20 and obtain, in exchange, one new Marie Brizard Wine & Spirits share with a BSAR 2023 attached whose exercise price is EUR25. After 31 March 2016, they reserved the right to subscribe for one Marie Brizard Wine & Spirits share at EUR20 until the end of 2016, but without the option of obtaining a BSA 2023. **This transaction led to the issuance of 1.8m new shares (i.e. dilution of 6.8% and a 70% success rate) and cash proceeds of EUR36m. 1.6 million BSAR 2023s were issued,** potentially leading to 5.8% dilution in future.

**The group is now in a much stronger financial position. At the end of 2016, the group should have EUR24m of cash** following the reimbursement of the EUR81.5m of frozen debt, the EUR36m of cash proceeds from the stock warrant exchange offer (BSAs) and the proceeds on real estate sales in Poland (estimated at EUR12m) which should be received in H2 2016.

**Fig. 14: Trend in net debt**




*Source: MBWS, Bryan, Garnier & Co*

Acquiring exposure to rum is a priority objective

**MBWS thus has the financial resources to make acquisitions,** which it is prioritising over dividends. We understand that the group would like to acquire the rum brand it currently lacks in that rum is the number three category after whisk(e)y and pastis in its leading market, France. The attraction would also be to dispose of as comprehensive an offer as possible for distributors at global level. **A rum from the French overseas territories would be the option of choice,** in terms of both taste (French consumers are familiar with it) and fiscal advantage. Since rums from the French overseas territories benefit from a 50% exemption from excise duties, their price is very competitive.

The group envisages adopting an asset light model and thus does not consider the need for a distillery to be attached to the brand as a condition precedent to the negotiations.

### 3.2.4. Other aspects of the normalisation process

- In July 2014, Marie Brizard Wine & Spirits exited the Euronext Paris Special Compartment and returned to Compartment B. The stock was included in the EnterNext PEA-PME 150 index.

- The 2014 accounts were approved without qualification for the first time in six years by Mazars and Renart Guion et Associés.

- The group implemented a process involving the daily tracking of sales, WCR, financial liquidity and a quarterly budget review.

- The accounting policy is now conservative. Taxes are currently included in sales (in line with industry practice) and are now based on volumes sold as opposed to volumes produced. Sales in the United States are net of commercial discounts and other benefits.

- In June 2015, the group changed its name to Marie Brizard Wine & Spirits in order mark a break with Belvédère's troubled history and avoid any confusion with the vodka now owned by LVMH.

- The financial disclosure is more detailed and easier to read. MBWS now supplies the breakdown of its organic growth by country.

# 4. Sluggish growth

We are forecasting 2018 sales of EUR480m which is in line with the guidance (EUR450m-EUR500m) but only thanks to the retention of the wholesale operations in Poland. In our view, the organic performance over 2016-18 will not enable MBWS to reach its objectives. The group is behind schedule in France and its targets in the United States, Spain and Poland are very ambitious (4.1). We expect EBITDA of only EUR58m in 2018 versus the guidance of EUR67m-EUR75m. We are confident of the rationalization and optimization components and their ability to generate a respective EUR3.5m and EUR25m but the weaker-than-expected growth is likely to represent an EBITDA shortfall of EUR9m (4.2).

## 4.1. Sales of EUR480m in 2018

**In November 2015, Marie Brizard Wine & Spirits gave an update on its strategic plan for the 2015-18 period,** originally unveiled in December 2014. All the financial targets were revised upwards. In terms of sales, the group is currently targeting between EUR450m and EUR500m, compared with between EUR420m and EUR460m previously. A breakdown by country was disclosed.

**Fig. 15: 2018 par pays**

| | Guidance | BG estimate |
|---|---|---|
| **Group** | EUR450-500 | 480 |
| **France** | >EUR200m | 196 |
| **Poland_core** | >EUR100m | 84 |
| **United States** | >EUR50m | 30 |
| **Lithuania** | >EUR25m | 24 |
| **Spain** | >EUR25m | 18 |

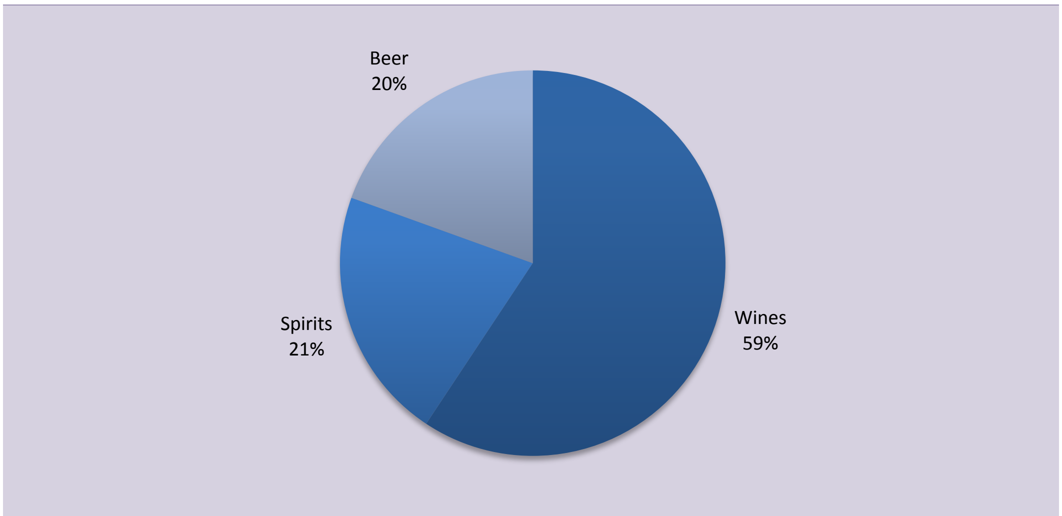
*Source: Marie Brizard Wine & Spirits*

**Our sales forecast for 2018 is EUR480m. This is in line with the guidance (EUR450m-EUR500m) but only thanks to the conservation of the wholesale operations in Poland. In our view, the organic performance over 2015-18 is unlikely to enable MBWS to achieve its objectives. The group is behind schedule in France and its targets in the United States, Spain and Poland are very ambitious.**

### 4.1.1. A disappointing performance in France

**MBWS's sales in France are equally split between spirits and wines.** The latter represent 59% of the market (in volume) ahead of spirits and (21%) beer (20%).

**Fig. 16: Breakdown of alcoholic beverage consumption in France in volume, 2015**




*Source: French Spirits Federation*

The number one brand in France is William Peel (35% of sales)

France is the leading whisk(e)y market in the world. The catetory represents 39% of alcoholic beverage volumes consumed in the country. **35% of MBWS sales in France is generated by its whiskey William Peel.** Fruits and Wines and Sobieski represent a respective 8% and 5% of French sales.

**Fig. 17: Breakdown of spirits consumption in France in volume, 2015**

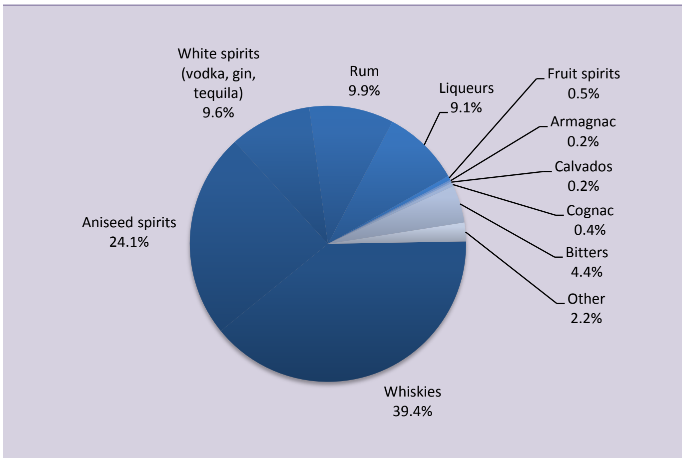
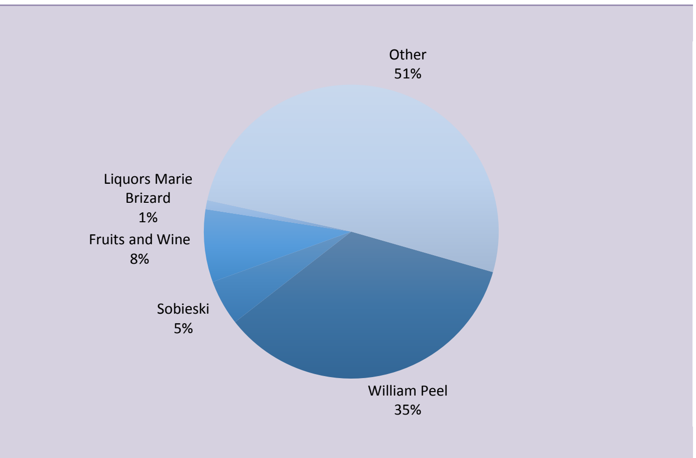



**Fig. 18: Breakdown of MBWS sales in France by brand, 2015**




*Source: French Spirits Federation Marie Brizard Wine & Spirits*

The French market is characterised by significant price elasticity, explained by the fact that it is dominated by the standard segment (42% of the market). In the update to its strategic plan in December 2015, the company indicated that the latter should realise 57% of the market growth (in volume) over the next four years. **The group is thus rather well positioned,** enabling it to acquire a dominant position despite the low level of past investment. **It is number three in wines and spirits** behind **Pernod Ricard and La Martiniquaise.** In whisk(e)y, it is number one with William Peel which has a 24.5% market share in volume and is considered as a flagship product by the large retailers. Fruits & Wines is also the number one in aromatised wines, its market share standing at 29.6%. The brand was launched in 2010 to meet the demand for inexpensive ready-to-drink beverages with a low alcohol content. The deceleration in the aromatised wines market is partially offset by automatic distribution gains (ending of the distribution of small brands). Sobieski has reached second position in the French vodka market (market share: 14.7%) behind Poliakov, which was one of the objectives of the BIG 2018 plan unveiled in December 2014. The group has also inherited powerful niche brands in France. It is thus number one in tequila with San José (market share: 42%) and the number three in gin with Old Lady's (market share: 5%). The group continues to outperform relative to competitors with its brands William Peel and Sobieski making market share gains of 90bps and 310bps respectively in the first nine months of the year.

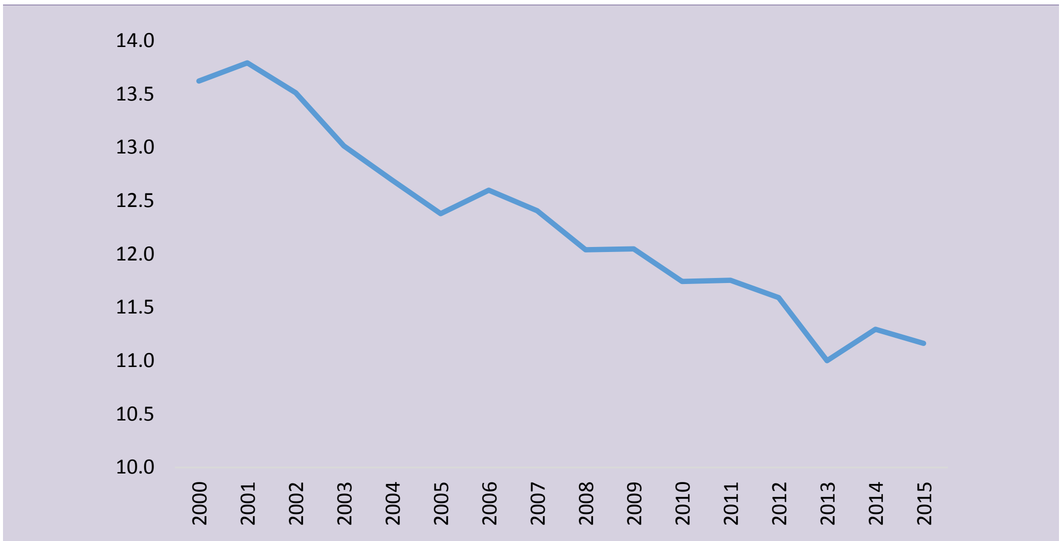
MBWS is n°1 in whiskey, flavoured wines and tequila, and n°2 in vodka

**The aim is to generate sales of EUR200m** in France by 2018, driven by 1/ **a 50% increase in advertising expenditure** between 2015 and 2018, and particularly advertising dedicated to the strategic brands, 2/ **innovation** notably via the launch of premium formats of William Peel (William Peel Double Maturation) and Sobieski (Sobieski Estate), 3/ **the progressive revitalisation of second-line brands** like San José (creation of a premix, etc.) and Old Lady's and 4/ **the development of the CHR** (cafés, hotels, restaurants) channel with Marie Brizard, Sobieski and Gautier.

**However, the group delivered a disappointing performance in 2015 and 9M 2016 in a difficult market. Since the early 2000s, alcohol sales in France have fallen by 18%** to 11.2 litres of pure alcohol per capita in 2015.

An 18% fall in alcohol volumes between 2000 and 2015

**Fig. 19: Alcohol sales (in volume) per capita in France in 2015**

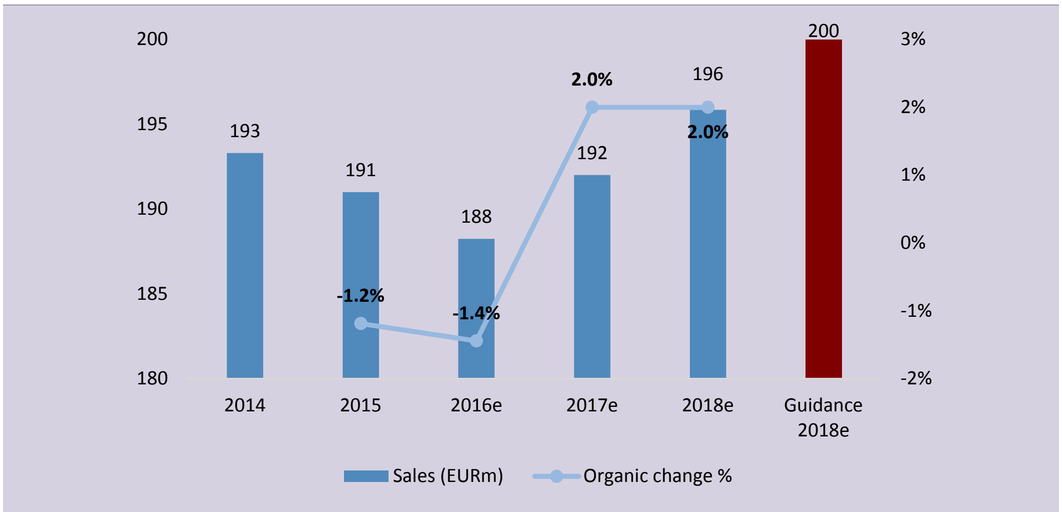



*Source: INSEE*

**The power gained by the large retailers is having a very negative impact on the activity of spirits companies.** Three mergers between purchasing groups took place in 2014: Système U and Auchan in September, Intermarché and Casino in October, and Carrefour and Cora/Match in December. According to Kantar Worldpanel, 92% of the sales of mass market and self-service chilled products now come from the four leading French purchasing groups. **In addition to these difficult market conditions, in 2015 the group fell behind schedule on the implementation of the strategic plan.** The new commercial structure for the on-trade channel only become effective as of Q1 2016 given the significant slowdown in this channel in the wake of the November 2015 terrorist attacks. In the second quarter, sales were penalised by unfavourable weather conditions which had a material impact on the sale of Fruits and Wines rosé wines and private labels (the latter accounting for 38% of sales in the country).

**According to our forecasts and on an organic basis, sales are likely to decline by 1.4% in 2016 before increasing by 2% in 2017 and 2018. This is relatively optimistic considering the past performance (-1.2% in 2015 and -2.8% in 9M 2016) and the market trends and, despite this, we derive a sales figure of EUR196m in 2018, slightly below the group's guidance (>EUR200m).**

**Fig. 20: France: sales (EURm)**




*Source: Marie Brizard Wine & Spirits*

Krupnik

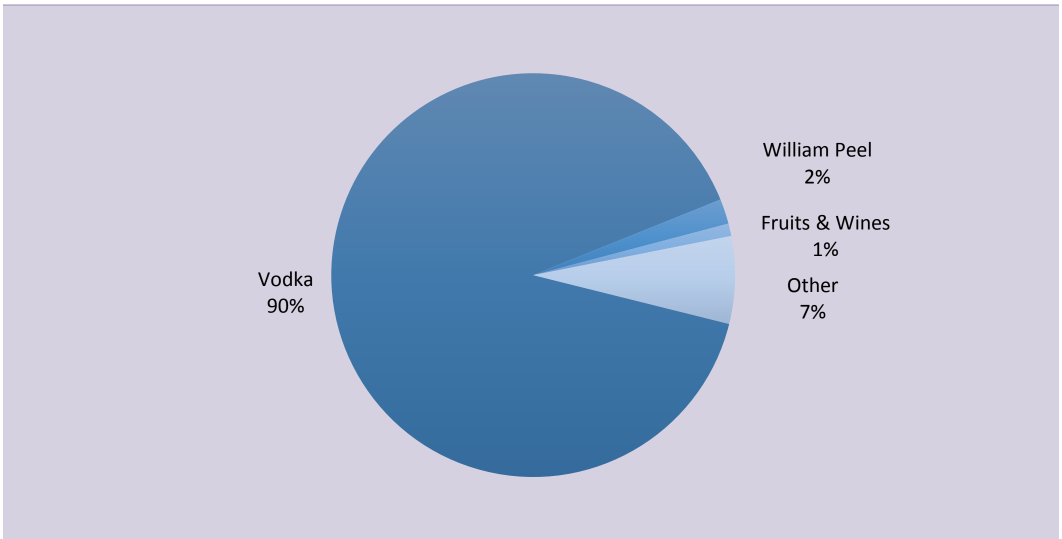
*Source: Marie Brizard Wine & Spirits*

## 4.1.2. Very ambitious guidance for Poland, Spain and the United States

In 2015, the non-core activities contributed 60% of sales in Poland. They currently comprise only wholesale activities, the retail operations having been sold to Carrefour in May 2015. They generate sales of under EUR10m but a zero operating result.

**In Poland, vodka ranks number two in terms of alcoholic beverage consumption after beer and is the leader in the spirits segment,** accounting for 73% of the spirits market in value (78% of volumes). **MBWS generates 90% of its Polish sales from vodka, most of which from Krupnik (75% of sales).** The remainder comes from Sobieski, Biala Dama, and Starogardzka. This portfolio enables the company to cover all the price segments (value, standard, premium, super premium).

**Fig. 21: Breakdown of MBWS sales in Poland, 2015**

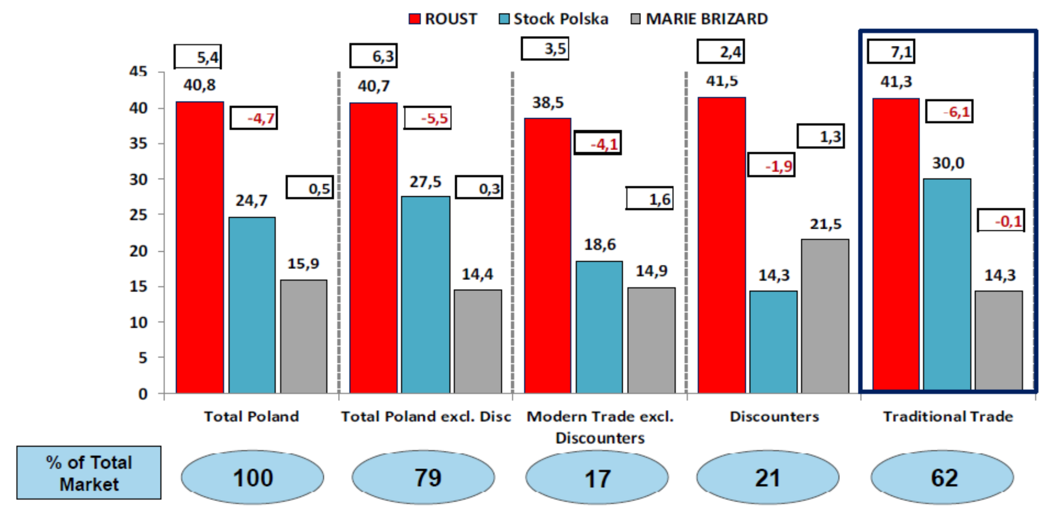



*Source: Marie Brizard Wine & Spirits*

Krupnik is the number three vodka in the Polish market

The standard segment represents 29% of the Polish market and should generate 76% of the volume growth there over the next four years. **The positioning of the group is thus well adapted in Poland and the group is number three in the market.** Its market share in value terms is 16% behind CEDC (41%) and Stock Spirits (25%). Having briefly regained the number two position, the Krupnik vodka brand currently ranks number three behind Zubrowka and GZ Czysta De Luxe. One of the objectives of the strategic plan is to make it the number two vodka brand in Poland.

**Fig. 22: Market share of the main players in the Polish market at end June 2016**

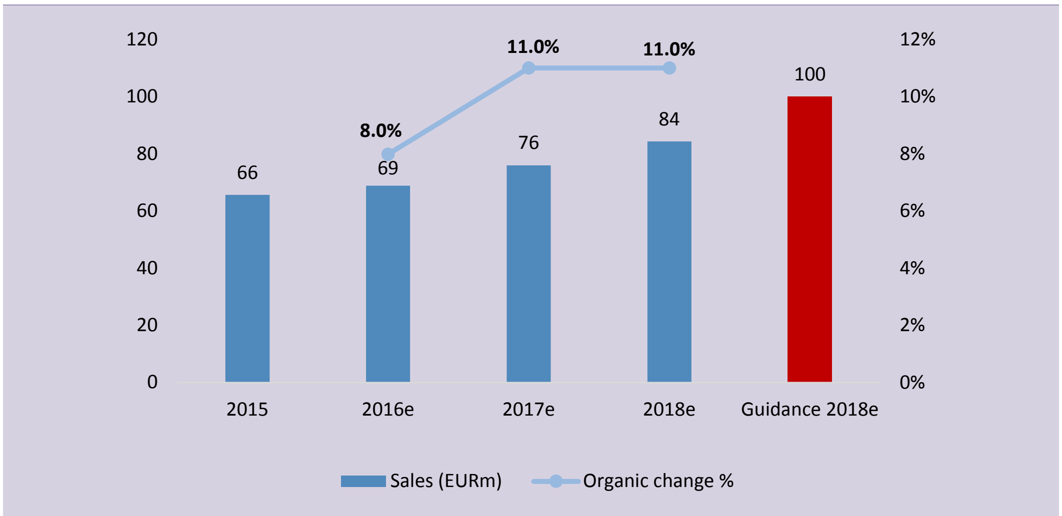



*Source: Roust*

**In Poland, the group is currently targeting more than EUR100m of sales from its core businesses** (>EUR80m previously), i.e. growth of 52% between 2015 and 2018. This performance should be achieved thanks to: **1/ a 50% increase in advertising expenditure between 2015 and 2018**. **2/ the reinforcement of Krupnik distribution and an increase in the proportion of aromatised spirits,** the latter representing 20% of the total vodka volumes sold in Poland but only 7.7% of Krupnik volumes. At present the brand has a 4.5% market share in the aromatised segment. Note that they are accretive for margins given their around 20% lower alcohol content. **3/ the deployment of Fruits and Wines but also of William Peel,** targeting a 10% market share in scotch whisky in 2018 (1.7% currently in volume terms). This is in line with the recent consumption trends marked by a steady decline in vodka sales and growth in those of whiskey and drinks with lower alcohol content like wines, beer and RTDs. **4/ the relaunch of Sobieski in early 2017** with a new bottle design and increased advertising support.

**In Poland, the core business activities posted a 9.7% organic increase in sales for 2015 and 6.1% over the first nine months of 2016,** underpinned by the increased momentum for the pillar brands William Peel and Fruits & Wines and the spectacular growth of aromatised Krupnik. **Assuming that this strong trend continues (+11% in Q4 2016 and in 2017 and 2018), our forecasts show sales for these core business activities reaching EUR84m in 2018, below the group's guidance.**

**FIG. 23: Poland: sales (EURm)**



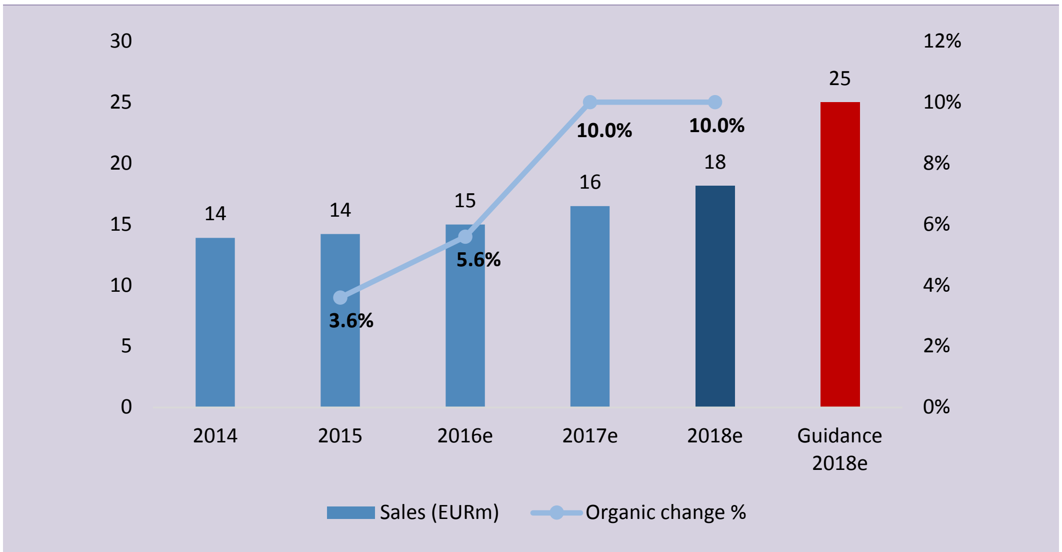

*Source: Marie Brizard Wine & Spirits, Bryan, Garnier & Co*

**In Spain, the aim is to generate 2018 sales of above EUR25m** via 1/ a 200% increase in advertising expenditure between 2015 and 2018, in particular on Marie Brizard, 2/ the development of Shotka and Fruits and Wines, 3/ strengthening relationships with the leading retailers and notably with Mercadona, by the supply of private label 4/ the rejuvenation of the Marques del Puerto brand and 5/ growth in cross-border sales. **In the United States, the group has identified three levers which should enable it to generate sales higher than EUR50m in 2018**: 1/ an 150% increase in advertising expenditure between 2015 and 2018, 2/ repositioning for the Sobieski vodka, notably by developing its Polish image/'craft' credentials, 3/ the launch of a premium format (Sobieski Estate) and of Fruits and Wines, Shotka and Marie Brizard.

**The group's overall performance in these countries is satisfactory.** In **Spain**, the group posted a 3.6% increase in sales for 2015 and 4.3% over the first nine months of 2016, notably thanks to the remodelling of the commercial strategy. **The United States** were impacted by destocking in 2015 and distribution changes (wholesaler mergers) in H1 2016. But sales (on a constant scope and currency basis) increased 3.6% in 9M 2016 after a 3.5% drop last year.

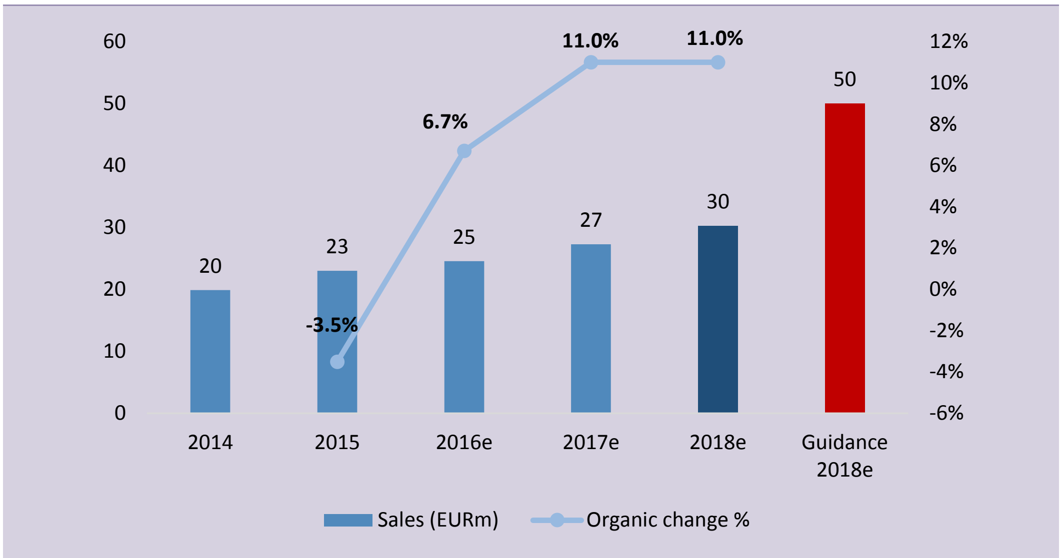
**The group's guidance is, however, overly ambitious. In 2017 and 2018, we are forecasting annual growth of 10% in Spain and 11% in the United States. This is already relatively optimistic considering that the US and Spanish markets are expected to grow by a respective 4% and 5% and, despite this fact, we arrive at sales of only EUR18m in Spain and EUR30m in the United States, well below the targets set by MBWS.**

**Fig. 24: Spain: sales (EURm)**




*Source: Marie Brizard Wine & Spirits*

**Fig. 25: United States: sales (EURm)**




*Source: Marie Brizard Wine & Spirits*

### 4.1.3. Sales forecasts

**We expect MBWS sales to decline by 0.2% over the year (on a constant currency and scope basis), mainly due to a 6.3% fall in the non-core activities** which are in the restructuring process. **The group seems to have abandoned plans to divest the Polish wholesale operations.** The group's profitability is not impacted since they will no longer be loss-making by the end of 2016. The preservation of these operations is mainly for defensive reasons: Mr. Luis Amaral who entered the Stock Spirits share register in May 2016 is the owner of Eurocash, the leading Polish wholesaler. It also facilitates the deployment by MBWS of William Peel and Fruits and Wines in Poland.

**Our 2018 sales forecast stands at EUR480m. This is in line with the guidance (EUR450m-EUR500m) thanks to the retention of the wholesale activities in Poland. In our view, the organic performance in 2016-18 is unlikely to enable MBWS to achieve its objectives. The group has fallen behind schedule in France and its targets in the United States, Spain and Poland are very ambitious.**

**Fig. 26: Sales by division**

| | 2015 | 2016e | 2017e | 2018e |
|---|---|---|---|---|
| **Group** | | | | |
| **Sales (EURm)** | **451** | **441** | **458** | **480** |
| % reported | -3.3% | -2.2% | 3.9% | 4.6% |
| % perimeter | -3.0% | -0.8% | 0.0% | 0.0% |
| % FX | 0.7% | -1.3% | -0.2% | 0.0% |
| **% organic** | **-1.0%** | **-0.2%** | **2.4%** | **4.6%** |
| **France** | | | | |
| **Sales (EURm)** | **191** | **188** | **192** | **196** |
| % reported | -1.2% | -1.4% | 2.0% | 2.0% |
| % perimeter | 0.0% | -0.1% | 0.0% | 0.0% |
| **% organic** | **-1.2%** | **-1.4%** | **2.0%** | **2.0%** |
| **Poland** | | | | |
| **Sales (EURm)** | **66** | **69** | **76** | **84** |
| % reported | | 4.8% | 10.4% | 11.0% |
| % perimeter | | 0.0% | 0.0% | 0.0% |
| % FX | | -3.2% | -0.6% | 0.0% |
| **% organic** | | **8.0%** | **11.0%** | **11.0%** |
| **Lithuania** | | | | |
| **Sales (EURm)** | **23** | **23** | **23** | **24** |
| % reported | 5.2% | 5.2% | 5.0% | 4.9% |
| % perimeter | -2.4% | -1.3% | 0.0% | 3.0% |
| **% organic** | **6.9%** | **-0.4%** | **0.0%** | **3.0%** |
| **US** | | | | |
| **Sales (EURm)** | **23** | **25** | **27** | **30** |

| | | | | |
|---|---|---|---|---|
| % reported | 15.6% | 6.3% | 11.2% | 11.0% |
| % perimeter | 0.0% | -0.4% | 0.0% | 0.0% |
| % FX | 19.1% | -0.4% | 0.2% | 0.0% |
| **% organic** | **-3.5%** | **6.2%** | **11.0%** | **11.0%** |
| **Spain** | | | | |
| **Sales (EURm)** | **14** | **15** | **16** | **18** |
| % reported | 2.2% | 5.6% | 10.0% | 10.0% |
| % perimeter | -1.4% | 0.0% | 0.0% | 0.0% |
| **% organic** | **3.6%** | **5.6%** | **10.0%** | **10.0%** |
| **Brazil** | | | | |
| **Sales (EURm)** | **4** | **4** | **4** | **4** |
| % reported | -19.6% | 1.8% | 2.0% | 4.0% |
| % perimeter | 0.0% | 0.0% | 0.0% | 0.0% |
| % FX | -13.7% | -9.7% | 0.0% | 0.0% |
| **% organic** | **-6%** | **9%** | **2%** | **4%** |
| **Others** | | | | |
| **Sales (EURm)** | **32** | **32** | **33** | **36** |
| % reported | -6.5% | 0.4% | 5.0% | 8.0% |
| % perimeter | -8.3% | -0.3% | 0.0% | 0.0% |
| % FX | 0.0% | -0.3% | 0.0% | 0.0% |
| **% organic** | **1.8%** | **1.0%** | **5.0%** | **8.0%** |
| **Non-core activities** | | | | |
| **Sales (EURm)** | **98** | **86** | **86** | **87** |

*Source: Marie Brizard Wine & Spirits, Bryan, Garnier & Co*

## 4.2. EBITDA of EUR58m in 2018

**During the update to its strategic plan, MBWS revised up its EBITDA guidance for 2018, and is now targeting EUR67m-EUR75m compared with EUR50m-EUR70m previously.** The margin is expected to stand at 15% (vs 12%-15%). The group continues to leverage the three components of the plan, namely growth, optimization and rationalization. Whereas it currently foresees only a EUR3.5m gain from the rationalization of non-strategic assets (EUR6.5m has already been saved), it has upgrded its targets in terms of growth. The resulting additional EBITDA amounts to EUR28m-EUR36m versus EUR20m-EUR30m previously. Optimization efforts should contribute EUR25m.

**Fig. 27: EBITDA targets**

| | BIG 2018 | BIG 2.0 |
|---|---|---|
| **EBITDA** | **50-70** | **67-75** |
| Constituents: | | |
| *Growth* | *20-30* | *28-36* |
| *Optimization* | *20-30* | *25* |
| *Rationalization* | *10* | *3.5* |

*Source: Marie Brizard Wine & Spirits*

**The EUR3.5m increase in EBITDA due to rationalization comes mainly from the restructuring of the wholesale activities in Poland which should materialise in H2 2016.** The group has already abandoned unprofitable contracts and regrouped a number of functions (notably the back office operations). **In terms of optimization, five levers should enable the generation of the additional EUR20m of EBITDA:**

- **Modernisation of the industrial sites**. In 2015, Marie Brizard thus reconfigured the Moncigale logistics networks, modernised the Beaucaire industrial site, transferred part of its liqueurs manufacturing from Bordeaux to Zizurkil and finished adapting the industrial equipment in Lithuania. There had effectively been a real shortfall in efficiency in vodka manufacturing in Eastern Europe, the vodka having been distilled in Lithuania before being rectified in Poland then bottled in Lithuania.

- **A reduction in direct procurement costs.** The procurement contracts for dry and liquid products have been the subject of a first wave of renegotiations. MBWS has also reached an agreement with La Martiniquaise whereby 50% of their scotch procurement will be realised with their shareholder as of 2019 (contracts still apply for 2016-18). Previously the company had secured its procurement of three-year-old whisky (required to obtain the appellation) from brokers. The company does not wish to exceed 50% to be able to preserve the taste of the products and to avoid being too dependent on just one supplier. More savings are possible thanks to the presence of industrial shareholders in the share capital: implementation of a common procurement strategy, concessions on bottling contracts and the securing of port procurement from La Martiniquaise, etc.

- **An improvement in the distribution network.** A reorganization of the export markets is under way, involving a review of distributors, the alignment of practices in key markets and the appointment of senior executives in Asia and in Duty Free. The United States are a priority. MBWS has decided to concentrate its advertising spending on nine key States which account for 50% of its sales while maintaining a distribution network at national level. The company is also seeking to optimize the fixed costs structure via the distribution of third-party brands. A new commercial director has been appointed.

- **Streamlining the operations.** A rationalization of references is under way for all product categories and has already been completed for the Marie Brizard liqueur in France. At present, 1% of this brand's sales is generated by 20% of the references, in line with industry practices, whereas previously this percentage had reached 50%. Since the beginning of the year, some number of recipes have been in the reformulation process, notably for vodka.

- **An improvement in the commercial and industrial strategy.** MBWS has deployed category management tools and commercial and industrial planning in France and Poland. The company also normalised its relationship with the leading retailers in 2015 in France and installed a new inter-cluster transport network in January 2016.

In H1 2016, the group reported a 70% decline in EBITDA given the increase in payroll costs (full effect of the 2015 recruitment) and advertising expenditure, particularly in France (William Peel and Sobieski) but also in Brazil, the EU, Lithuania and Denmark. It has indicated that, over the full year, it expects EBITDA of EUR20m but excluding the impact of IFRS 2 which could reach EUR2m (our forecast: EUR18m). **We are forecasting EBITDA of EUR58m in 2018, below the group's guidance (EUR67m-EUR75m).**

### Fig. 28: EBITDA forecasts

| | 2014 | 2015 | 2016e | 2017e | 2018e | Guidance for 2018 |
|---|---|---|---|---|---|---|
| **EBITDA** | **5** | **11** | **18** | **34** | **58** | **67-75** |
| % reported | 0% | 118% | 62% | 84% | 73% | |
| **Margin** | **1.1%** | **2.5%** | **4.1%** | **7.3%** | **12.1%** | **15%** |
| Variation in bps | | 138 | 164 | 319 | 481 | |

*Source: Bryan, Garnier & Co*

Since our base case scenario is that the group will not divest its wholesale operations in Poland, we are forecasting 2018 sales some 14% above the market expectations. We derive an EBITDA forecast of EUR58m, i.e. 10% below consensus. We are confident on the rationalization and optimization components and on their ability to generate a respective EUR3.5m and EUR25m but the weaker-than-expected growth should represent an EBITDA shortfall of EUR9m. Note that the consensus comprises three contributors.

### Fig. 29: Forecasts versus market consensus

| | 2016e | | 2017e | | 2018e | |
|---|---|---|---|---|---|---|
| | BG | CS | BG | CS | BG | CS |
| Sales | 441 | 438 | 458 | 388 | 480 | 422 |
| *Difference* | *+0.7%* | | *+18.0%* | | *+13.7%* | |
| EBITDA | 18 | 19 | 34 | 37 | 58 | 64 |
| *Difference* | *-5.3%* | | *-8.1%* | | *-9.4%* | |

*Source: Thomson Reuters, Bryan, Garnier & Co*

# 5. Share price performance and valuation

After a re-rating in 2014 and 2015, the shares have fallen by 22% in absolute terms due to the stock warrant exchange offer and uncertainties regarding the growth outlook (5.1). Our DCF-based valuation derives a Fair Value of EUR17.1, which points to 9% upside potential.

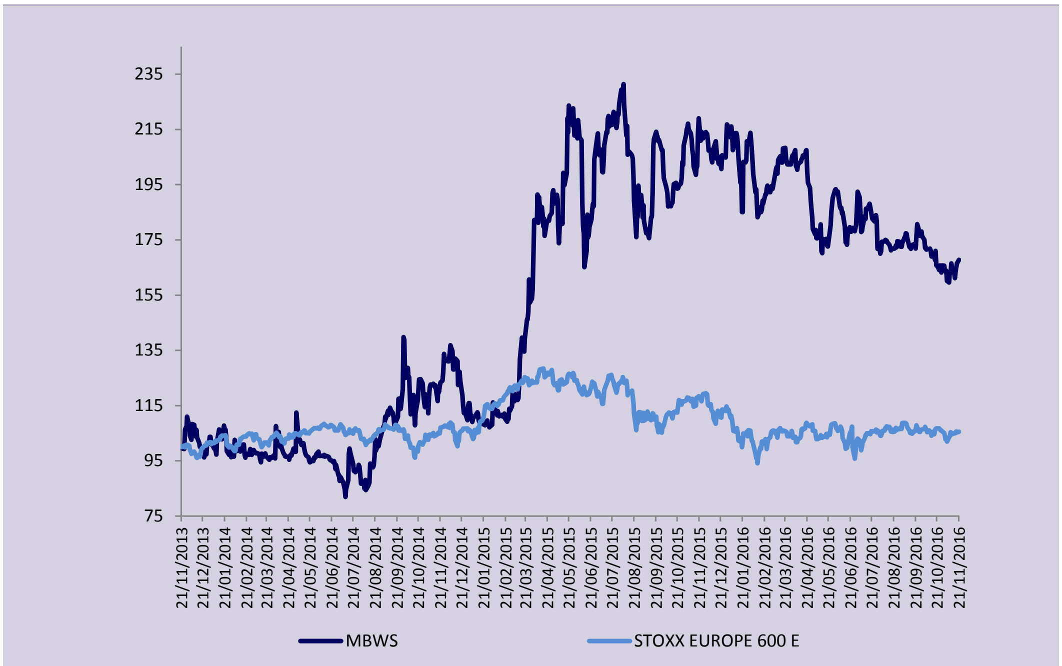
## 5.1. Share price performance

The re-rating of the shares began in September 2014 with the arrival of the new Chief Executive Officer Mr. Reynaud, the unveiling of the first version of the strategic plan in December 2014, the first roadshows with the management and the acquisition of stakes by Diana Holding and Castel which sent a positive signal as to the company's potential value creation. However, since the beginning of 2016, the shares have fallen by 22% in absolute terms. The stock warrant exchange offer in April 2016 led to the issuance of 1.8 million new shares, i.e. dilution of 6.8%. Furthermore, the Q1 and Q2 2016 results were disappointing, prompting uncertainty as to the growth outlook.

**Fig. 30: Absolute performance over the last three years**


*Source: Thomson Reuters*

**Fig. 31: Relative performance over the last three years**




*Source: Thomson Reuters*

## 5.2. Neutral, Fair Value: EUR17.1

Peer group multiples are not relevant in the case of MBWS in that its results over the next few years do not reflect the value of the company. Our DCF-based valuation derives a Fair Value of EUR17.1, based on the following assumptions:

- A WACC of 11.6% resulting from a 11% cost of equity with a risk free rate of 1.6%, a market risk premium of 7% and a beta of 1.3
- A growth rate to perpetuity of 2% as of 2026
- A growth rate of 4.9% and an EBITDA margin of 13.3% in 2021

### Fig. 32: DCF (1/2)

| *EURm* | 2017e | 2018e | 2019e | 2020e | 2021e | 2022e | 2023e | 2024e | 2025e | 2026e | TV |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Sales | 458 372 | 479 594 | 502 278 | 526 537 | 552 494 | 576 526 | 598 260 | 617 343 | 633 455 | 646 313 | 659 239 |
| % change | 3.9% | 4.6% | 4.7% | 4.8% | 4.9% | 4.3% | 3.8% | 3.2% | 2.6% | 2.0% | 2.0% |
| EBITDA | 33 553 | 58 175 | 62 935 | 68 081 | 73 647 | 78 581 | 83 338 | 87 848 | 92 041 | 95 848 | 99 743 |
| Depreciation | -6 417 | -6 714 | -7 383 | -8 109 | -8 895 | -9 686 | -10 470 | -11 236 | -11 972 | -12 668 | -13 383 |
| Recurring EBIT | 27 227 | 51 508 | 55 552 | 59 973 | 64 752 | 68 895 | 72 868 | 76 612 | 80 069 | 83 180 | 86 360 |
| -Taxes | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | -22 454 |
| Tax rate | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | -28.5% |
| **NOPAT** | **27 227** | **51 508** | **55 552** | **59 973** | **64 752** | **68 895** | **72 868** | **76 612** | **80 069** | **83 180** | **63 907** |
| Depreciation | 6 417 | 6 714 | 7 383 | 8 109 | 8 895 | 9 686 | 10 470 | 11 236 | 11 972 | 12 668 | 13 383 |
| +Change in WC | 5 563 | 6 075 | 0 | -2 633 | -5 525 | -8 648 | -11 965 | -12 347 | -12 669 | -12 926 | -13 185 |
| -Capex | -9 167 | -9 592 | -10 046 | -10 531 | -11 050 | -11 531 | -11 965 | -12 347 | -12 669 | -12 926 | -13 185 |
| **FCF** | **30 040** | **54 705** | **52 890** | **54 918** | **57 073** | **58 402** | **59 407** | **63 154** | **66 703** | **69 996** | **50 920** |
| Discount coefficient | 0.90 | 0.80 | 0.72 | 0.64 | 0.58 | 0.52 | 0.46 | 0.42 | 0.37 | 0.33 | |
| **Discounted FCF** | **26 915** | **43 916** | **38 041** | **35 391** | **32 953** | **30 213** | **27 536** | **26 228** | **24 820** | **23 335** | |

### Fig. 33: DCF (2/2)

| | |
|---|---|
| Sum of discounted FCF | 309 347 |
| +Terminal value | 161 425 |
| +Net cash | 23 815 |
| -Minorities | -10 030 |
| -Provisions & Pensions | -14 650 |
| +Financial assets | 5 370 |
| **Equity value** | **475 278** |
| Number of shares (m) | 27 739 |
| **Fair Value (EUR)** | **17.1** |

*Source: Bryan, Garnier & Co*

BRYAN, GARNIER & CO

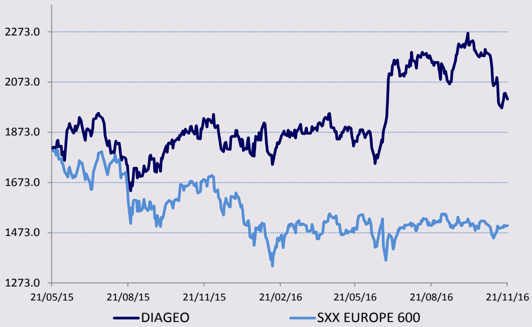
# INDEPENDENT RESEARCH UPDATE

23rd November 2016

Food & Beverages

| | |
|---|---|
| Bloomberg | DGE LN |
| Reuters | DGE.L |
| 12-month High / Low (p) | 2,268 / 1,745 |
| Market capitalisation (GBPm) | 50,448 |
| Enterprise Value (BG estimates GBPm) | 58,168 |
| Avg. 6m daily volume ('000 shares) | 4 948 |
| Free Float | 99.9% |
| 3y EPS CAGR | 11.0% |
| Gearing (06/16) | 17% |
| Dividend yield (06/17e) | 3.10% |

| YE June | 06/16 | 06/17e | 06/18e | 06/19e |
|---|---|---|---|---|
| Revenue (GBPm) | 10,485 | 11,969 | 12,564 | 13,177 |
| EBIT (GBPm) | 3,008 | 3,590 | 3,848 | 4,080 |
| Basic EPS (p) | 89.39 | 103.98 | 113.90 | 122.34 |
| Diluted EPS (p) | 89.04 | 103.57 | 113.45 | 121.86 |
| EV/Sales | 5.63x | 4.86x | 4.58x | 4.30x |
| EV/EBITDA | 17.8x | 14.5x | 13.2x | 12.1x |
| EV/EBIT | 19.6x | 16.2x | 14.9x | 13.9x |
| P/E | 22.5x | 19.4x | 17.7x | 16.5x |
| ROCE | 12.1 | 13.8 | 14.5 | 15.2 |





# Diageo

## An improvement in trajectory

**Fair Value 2150p vs. 2200p** (price 2,005p) **NEUTRAL**

**In our view, the gradual improvement in operating performance is already priced in. We maintain our Neutral recommendation but we adjust downwards our Fair Value to 2,150p due to FX.**

- **A gradual acceleration in growth.** Diageo's sales are expected to increase by 3.5% on an organic basis this year after +2.8% in 2015/16. This reflects a pick-up in the group's main markets excluding the Europe/Russia/Turkey region which is expected to be up by only 2.8%, last year's good performance (+3.9% in 2015/16) having been driven by significant price rises in Russia. The group is expected to continue to under-perform in the United States with our forecasts looking for US sales growth of 3.5% in a market up by 4%. The trading environment also remains difficult in the emerging countries. Africa, Latin America & Caribbean and Asia Pacific are expected to post respective increases of 4%, 3.8% and 4% this year, well below their historic trends.

- **A limited improvement in the EBIT margin.** In 2016/17, the EBIT margin should increase by 120bps at reported level thanks to currency effects but by only 14bps in organic. This should be due to the expenses linked to the GBP500m cost-saving programme to be realised via the implementation of zero-based budgeting, revenue management and efficiency gains at the level of overheads and advertising. The first half should see a 14bp organic decline in the EBIT margin.

**Neutral, Fair Value: 2,150p.** In our view, the improvement in the trajectory is priced in. At the day before yesterday's close, the stock is trading at 16.2x 2016/17e EV/EBIT, a 9% premium to its closest peer Pernod Ricard. We maintain our Neutral recommendation but we adjust downwards our Fair Value to 2,150p due to FX.

**Analyst:**
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**Sector Analyst Team:**
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Loïc Morvan
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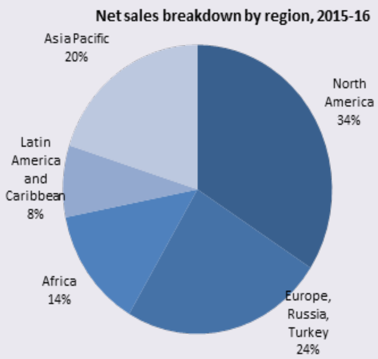
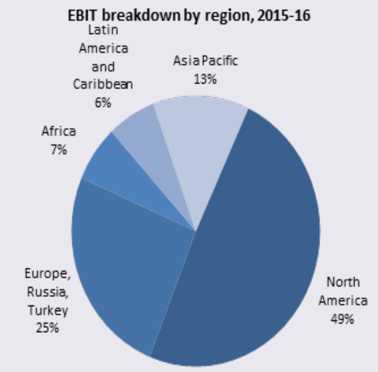



## Company description

Formed in 1997, following the merger of GrandMet and Guinness, Diageo is a global leader in beverage alcohol with an outstanding collection of brands across spirits, beer and wine categories. Headquarted in London, the company is listed on both the London Stock Exchange and the New York Stock Exchange.

| **Simplified Profit & Loss Account (GBPm)** | **30/06/14** | **30/06/15** | **30/06/16** | **30/06/17e** | **30/06/18e** | **30/06/19e** |
|---|---|---|---|---|---|---|
| Net sales | 10,258 | 10,813 | 10,485 | 11,969 | 12,564 | 13,177 |
| *Change (%)* | *-9.2%* | *5.4%* | *-3.0%* | *14.2%* | *5.0%* | *4.9%* |
| *Organic change (%)* | *0.4%* | *0.0%* | *2.8%* | *3.5%* | *4.2%* | *4.9%* |
| Gross profit | 6,252 | 6,228 | 6,234 | 7,229 | 7,614 | 8,011 |
| Adjusted EBITDA | 3,478 | 3,437 | 3,323 | 4,009 | 4,351 | 4,673 |
| Marketing expenses | (1,769) | (1,620) | (1,629) | (1,562) | (1,759) | (1,847) |
| Adjusted EBIT | 3,134 | 3,066 | 3,008 | 3,590 | 3,848 | 4,080 |
| *Change (%)* | *-9.9%* | *-2.2%* | *-1.9%* | *19.3%* | *7.2%* | *6.0%* |
| Financial results | (388) | (412) | (327) | (343) | (280) | (240) |
| Pre-Tax profits | 2,711 | 2,933 | 2,858 | 3,472 | 3,803 | 4,085 |
| Tax | (447) | (466) | (496) | (729) | (799) | (858) |
| Profits from associates | 252 | 175 | 221 | 225 | 235 | 245 |
| Minority interests | (67.0) | 86.0 | 118 | 135 | 148 | 159 |
| Net profit | 2,181 | 2,467 | 2,362 | 2,743 | 3,005 | 3,227 |
| Restated net profit | 2,394 | 2,225 | 2,242 | 2,608 | 2,857 | 3,068 |
| *Change (%)* | *-7.2%* | *-7.1%* | *0.8%* | *16.3%* | *9.5%* | *7.4%* |
| **Cash Flow Statement (GBPm)** | | | | | | |
| Operating cash flows | 2,707 | 2,797 | 2,841 | 3,590 | 3,848 | 4,080 |
| Change in working capital | (597) | 117 | (53.0) | (204) | (204) | (210) |
| Capex, net | (562) | (586) | (449) | (600) | (628) | (659) |
| Financial investments, net | (673) | (722) | (639) | (899) | (906) | (925) |
| Dividends | (1,228) | (1,341) | (1,443) | (1,491) | (1,565) | (1,643) |
| Net debt | 8,850 | 9,527 | 8,635 | 7,720 | 7,071 | 6,235 |
| Free Cash flow | 1,235 | 1,963 | 2,097 | 1,906 | 2,213 | 2,480 |
| **Balance Sheet (GBPm)** | | | | | | |
| Tangible fixed assets | 3,433 | 3,690 | 3,881 | 3,850 | 3,733 | 3,513 |
| Intangibles assets | 7,891 | 11,231 | 12,370 | 12,617 | 12,870 | 13,127 |
| Cash & equivalents | 622 | 472 | 1,089 | (454) | (217) | (341) |
| current assets | 7,469 | 7,670 | 8,852 | 7,987 | 8,619 | 8,902 |
| Other assets | 6,982 | 6,431 | 6,180 | 7,693 | 7,340 | 7,245 |
| Total assets | 22,964 | 25,804 | 28,491 | 27,844 | 28,611 | 28,932 |
| L & ST Debt | 9,214 | 9,838 | 10,129 | 6,505 | 6,093 | 5,133 |
| Others liabilities | 6,160 | 6,710 | 8,182 | 8,778 | 9,091 | 9,413 |
| Shareholders' funds | 7,590 | 9,256 | 10,180 | 12,561 | 13,426 | 14,386 |
| Total Liabilities | 15,374 | 16,548 | 18,311 | 15,283 | 15,184 | 14,546 |
| Capital employed | 15,245 | 18,987 | 20,144 | 20,564 | 20,903 | 21,150 |
| **Ratios** | | | | | | |
| Gross margin | 60.95 | 57.60 | 60.20 | 60.40 | 60.60 | 60.80 |
| Marketing expenses as % of sales | 15.79 | 15.07 | 14.90 | 14.70 | 14.70 | 14.70 |
| Operating margin | 30.55 | 28.35 | 28.69 | 29.99 | 30.63 | 30.97 |
| Effective tax rate | 16.49 | 15.89 | 17.35 | 21.00 | 21.00 | 21.00 |
| Net margin | 21.26 | 22.82 | 22.53 | 22.92 | 23.91 | 24.49 |
| ROE (after tax) | 31.54 | 24.04 | 22.02 | 20.76 | 21.28 | 21.33 |
| ROCE (after tax) | 13.70 | 12.30 | 12.10 | 13.79 | 14.54 | 15.24 |
| Gearing | 17.33 | 18.65 | 16.90 | 15.11 | 13.84 | 12.20 |
| Pay out ratio | 54.36 | 63.80 | 66.49 | 60.02 | 57.53 | 56.24 |
| Number of shares, diluted | 2,517 | 2,517 | 2,518 | 2,518 | 2,518 | 2,518 |
| **Data per Share (GBP)** | | | | | | |
| Basic EPS | 95.53 | 88.82 | 89.39 | 104 | 114 | 122 |
| Diluted EPS | 95.11 | 88.40 | 89.04 | 104 | 113 | 122 |
| *% change* | *-7.2%* | *-7.1%* | *0.7%* | *16.3%* | *9.5%* | *7.4%* |
| BVPS | 302 | 368 | 404 | 499 | 533 | 571 |
| Operating cash flows | 107 | 137 | 133 | 158 | 164 | 176 |
| FCF | 49.07 | 77.99 | 83.28 | 75.70 | 87.90 | 98.49 |
| Net dividend | 51.70 | 56.40 | 59.20 | 62.16 | 65.27 | 68.53 |

*Source: Company Data; Bryan, Garnier & Co ests.*

# 1. A gradual acceleration in growth

**Diageo's sales should increase by 3.5% on an organic basis this year after +2.8% in 2015/16.** This reflects a pick-up in the group's main markets excluding the Europe/Russia/Turkey region where sales are expected to be up by only 2.8%, last year's good performance (+3.9% in 2015/16) having been driven by significant price increases in Russia. The group should continue to under-perform in the United States where our forecasts look for sales growth of 3.5% in a market up by 4%. The trading environment also remains difficult in the emerging countries. Africa, Latin America & Caribbean and Asia Pacific are expected to post respective sales increases of 4%, 3.8% and 4% this year, well below the historic trends.

**Fig. 1: Sales forecasts**

| *GBPm* | 2015/16 | 2016/17e | 2017/18e | 2018/19e |
|---|---|---|---|---|
| **GROUP** | | | | |
| **Sales** | **10 485** | **11 969** | **12 564** | **13 177** |
| Reported variation | -3.0% | 14.2% | 5.0% | 4.9% |
| **Organic variation** | **2.8%** | **3.5%** | **4.2%** | **4.9%** |
| FX variation | -1.6% | 13.3% | 0.8% | 0.0% |
| Perimeter variation | -3.0% | -2.7% | 0.0% | 0.0% |
| **NORTH AMERICA** | | | | |
| **Sales** | **3 565** | **4 152** | **4 385** | **4 582** |
| Reported variation | 3.2% | 16.5% | 5.6% | 4.5% |
| **Organic variation** | **2.8%** | **3.5%** | **4.0%** | **4.5%** |
| **EUROPE** | | | | |
| **Sales** | **2 544** | **2 813** | **2 888** | **2 990** |
| Reported variation | -2.8% | 10.6% | 2.7% | 3.5% |
| **Organic variation** | **3.9%** | **2.8%** | **3.0%** | **3.5%** |
| **AFRICA** | | | | |
| **Sales** | **1 401** | **1 518** | **1 612** | **1 709** |
| Reported variation | -0.8% | 8.3% | 6.2% | 6.0% |
| **Organic variation** | **2.6%** | **4.0%** | **5.0%** | **6.0%** |
| **LATAM** | | | | |
| **Sales** | **863** | **966** | **1 014** | **1 074** |
| Reported variation | -16.3% | 11.9% | 4.9% | 6.0% |
| **Organic variation** | **0.6%** | **3.8%** | **5.0%** | **6.0%** |
| **ASIA-PACIFIC** | | | | |
| **Sales** | **2 076** | **2 485** | **2 629** | **2 787** |
| Reported variation | -6.2% | 19.7% | 5.8% | 6.0% |
| **Organic variation** | **1.5%** | **4.0%** | **5.0%** | **6.0%** |
| **CORPORATE** | | | | |
| **Sales** | **36** | **36** | **36** | **36** |

*Source: Diageo, Bryan, Garnier & Co*

# 2. A limited progression in the current operating margin

**In 2016/17, the EBIT margin is expected to increase by a reported 120bps but by only 14bps on an organic basis. This should be due to the expenses linked to the GBP500m cost-saving programme** to be realised via the implementation of zero-based budgeting, revenue management and efficiency gains at the level of overheads and advertising. The first half is expected to post a 14bp organic decline in the EBIT margin.

### Fig. 2: EBIT forecasts

| *GBPm* | 2015/16 | 2016/17e | 2017/18e | 2018/19e |
|---|---|---|---|---|
| **GROUP** | | | | |
| **EBIT** | **3008** | **3590** | **3848** | **4080** |
| Reported variation | -1.6% | 19.3% | 7.2% | 6.0% |
| **Margin** | **28.7%** | **30.0%** | **30.6%** | **31.0%** |
| Reported variation in bp | 33 | 130 | 64 | 34 |
| Organic variation in bps | 19 | 14 | 58 | 34 |
| **NORTH AMERICA** | | | | |
| **EBIT** | **1551** | **1880** | **2005** | **2116** |
| Reported variation | 7.1% | 21.2% | 6.6% | 5.5% |
| **Margin** | **43.5%** | **45.3%** | **45.7%** | **46.2%** |
| Reported variation in bp | 160 | 179 | 44 | 44 |
| **EUROPE, RUSSIA, TURKEY** | | | | |
| **EBIT** | **801** | **937** | **985** | **1030** |
| Reported variation | -0.4% | 14.3% | 3.7% | 4.5% |
| **Margin** | **31.5%** | **32.6%** | **32.9%** | **33.2%** |
| Reported variation in bp | 76 | 108 | 32 | 32 |
| **AFRICA** | | | | |
| **EBIT** | **212** | **233** | **250** | **267** |
| Reported variation | -33.3% | 9.8% | 7.3% | 7.0% |
| **Margin** | **15.1%** | **15.3%** | **15.5%** | **15.6%** |
| Variation in bp | -734 | 20 | 15 | 15 |
| **LAC** | | | | |
| **EBIT** | **199** | **220** | **231** | **246** |
| Reported variation | -24.3% | 10.5% | 4.9% | 6.5% |
| **Margin** | **23.1%** | **22.8%** | **22.8%** | **22.9%** |
| Variation in bp | -240 | -29 | 0 | 11 |
| **ASIA-PACIFIC** | | | | |
| **EBIT** | **395** | **513** | **559** | **604** |
| Reported variation | 11.0% | 29.9% | 9.0% | 8.0% |
| **Margin** | **19.0%** | **20.7%** | **21.3%** | **21.7%** |
| Variation in bp | 294 | 163 | 63 | 40 |
| **CORPORATE** | | | | |
| **EBIT** | **-150** | **-173** | **-147** | **-147** |

*Source: Diageo, Bryan, Garnier & Co*

# 3. Valuation

### Fig. 3: DCF (1/2)

| *GBPm* | 2016/17e | 2017/18e | 2018/19e | 2019/20e | 2020/21e | 2021/22e | 2022/23e | 2023/24e | 2024/25e | 2025/26e |
|---|---|---|---|---|---|---|---|---|---|---|
| **Sales** | **11 969** | **12 564** | **13 177** | **13 858** | **14 617** | **15 315** | **15 939** | **16 477** | **16 917** | **17 251** |
| % reported | 14.2% | 5.0% | 4.9% | 5.2% | 5.5% | 4.8% | 4.1% | 3.4% | 2.7% | 2.0% |
| **EBIT** | **3 590** | **3 848** | **4 080** | **4 305** | **4 556** | **4 773** | **4 967** | **5 135** | **5 272** | **5 376** |
| EBIT margin | 30.0% | 30.6% | 31.0% | 31.1% | 31.2% | 31.2% | 31.2% | 31.2% | 31.2% | 31.2% |
| -Income taxes | -729 | -799 | -858 | -904 | -957 | -1002 | -1043 | -1078 | -1107 | -1129 |
| +Depreciation | 419 | 503 | 593 | 643 | 699 | 753 | 807 | 857 | 903 | 863 |
| as % of sales | 3.5% | 4.0% | 4.5% | 4.6% | 4.8% | 4.9% | 5.1% | 5.2% | 5.3% | 5.0% |
| +change in WC | -204 | -204 | -210 | -220 | -233 | -244 | -254 | -262 | -269 | -274 |
| as % of sales | 1.7% | 1.6% | 1.6% | 1.6% | 1.6% | 1.6% | 1.6% | 1.6% | 1.6% | 1.6% |
| **Operating cash flows** | **3 076** | **3 349** | **3 606** | **3 824** | **4 065** | **4 281** | **4 477** | **4 651** | **4 799** | **4 836** |
| -Capex | -600 | -628 | -659 | -693 | -731 | -766 | -797 | -824 | -846 | -863 |
| as % of sales | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% |
| **Free cash flows** | **2 476** | **2 720** | **2 947** | **3 131** | **3 334** | **3 515** | **3 680** | **3 828** | **3 954** | **3 973** |
| Discount coefficient | 0.93 | 0.87 | 0.81 | 0.76 | 0.70 | 0.66 | 0.61 | 0.57 | 0.53 | 0.50 |
| **Discounted FCF** | **2 309** | **2 365** | **2 389** | **2 366** | **2 349** | **2 309** | **2 254** | **2 186** | **2 105** | **1 973** |

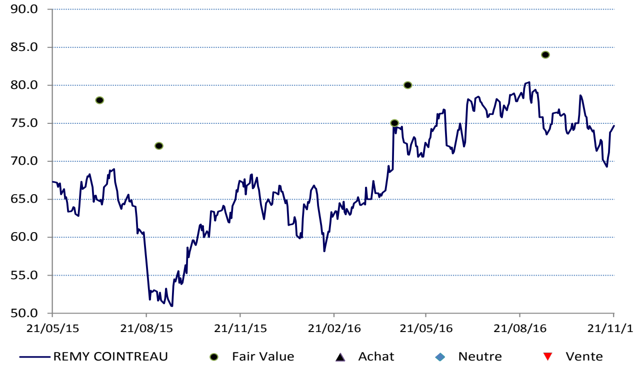
### Fig. 4: DCF (2/2)

| | |
|---|---|
| Sum of discounted cash flows | 22 605 |
| +Terminal Value | 38 728 |
| +Financial assets | 3 443 |
| -Net debt | -8 635 |
| -Minorities | -1 650 |
| -Provisions | -390 |
| **Equity Value** | **54 101** |
| Number of shares | 2518 |
| **Fair Value** | **2150** |

*Source of all tabs: Diageo, Bryan, Garnier & Co*

# Price Chart and Rating History

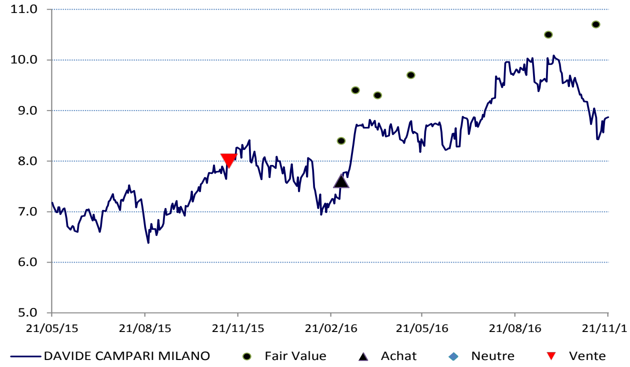
## Rémy Cointreau




| Ratings Date | Ratings | Price |
|---|---|---|
| 23/03/15 | BUY | EUR68.98 |
| 02/10/14 | NEUTRAL | EUR55.49 |
| 27/03/14 | BUY | EUR58.79 |

| Target Price Date | Target price |
|---|---|
| 15/09/16 | EUR84 |
| 03/05/16 | EUR80 |
| 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 |

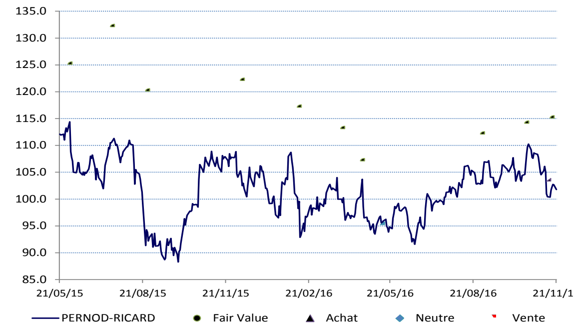
## Campari




| Ratings Date | Ratings | Price |
|---|---|---|
| 02/03/16 | BUY | EUR7.51 |
| 12/11/15 | SELL | EUR8 |
| 17/09/14 | NEUTRAL | EUR5.8 |

| Target Price Date | Target price |
|---|---|
| 09/11/16 | EUR10.7 |
| 23/09/16 | EUR10.5 |
| 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%

# Research Disclosure Legend

| | | | |
|---|---|---|---|
| 1 | Bryan Garnier shareholding in Issuer | Bryan Garnier & Co Limited or another company in its group (together, the "Bryan Garnier Group") has a shareholding that, individually or combined, exceeds 5% of the paid up and issued share capital of a company that is the subject of this Report (the "Issuer"). | No |
| 2 | Issuer shareholding in Bryan Garnier | The Issuer has a shareholding that exceeds 5% of the paid up and issued share capital of one or more members of the Bryan Garnier Group. | No |
| 3 | Financial interest | A member of the Bryan Garnier Group holds one or more financial interests in relation to the Issuer which are significant in relation to this report | No |
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