BRYAN, GARNIER & CO

INDEPENDENT RESEARCH UPDATE

23rd November 2016

Food & Beverages

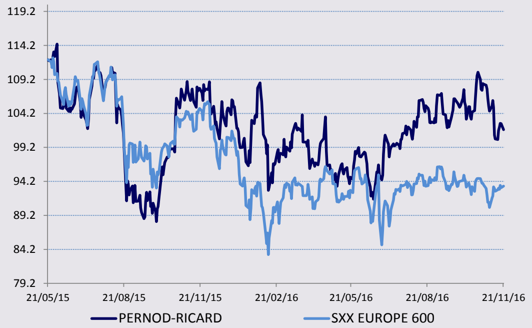
Pernod Ricard

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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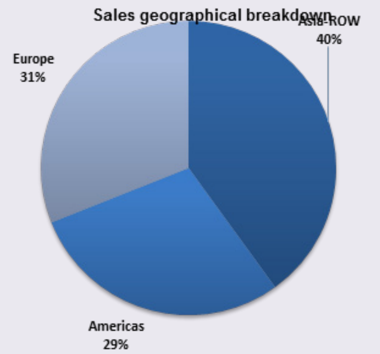
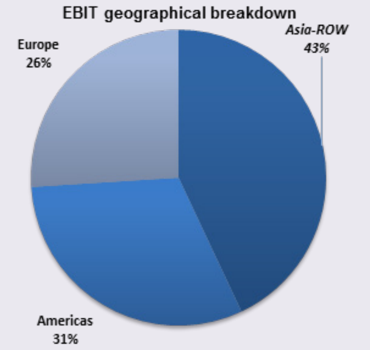




Company description

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.

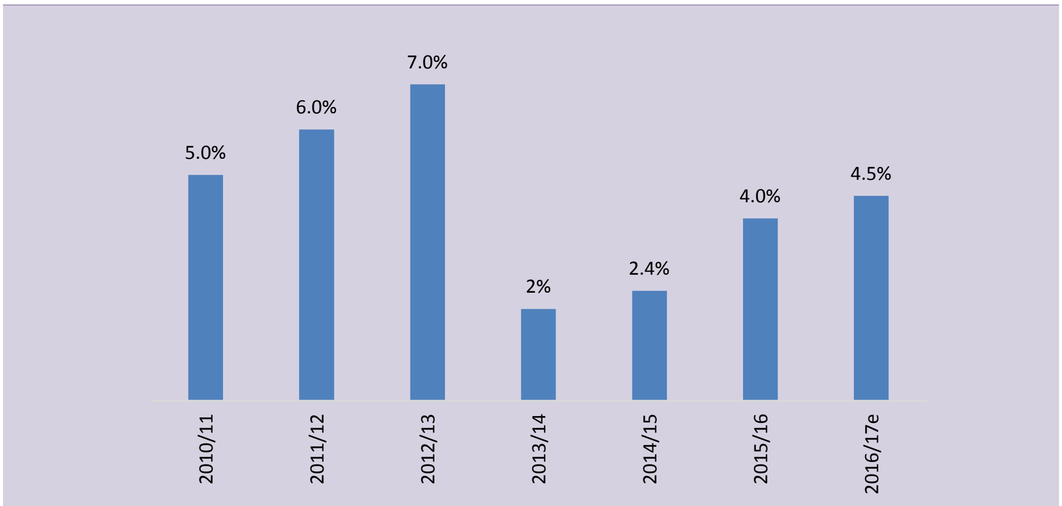
Simplified Profit & Loss Account (EURm)	**30/06/14**	**30/06/15**	**30/06/16**	**30/06/17e**	**30/06/18e**	**30/06/19e**
Revenues	7,945	8,558	8,682	8,899	9,253	9,673
Change (%)	*-7.3%*	*7.7%*	*1.4%*	*2.5%*	*4.0%*	*4.5%*
Gross Profit	4,987	5,296	5,339	5,464	5,691	5,997
Contribution after A&P	3,484	3,453	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%).

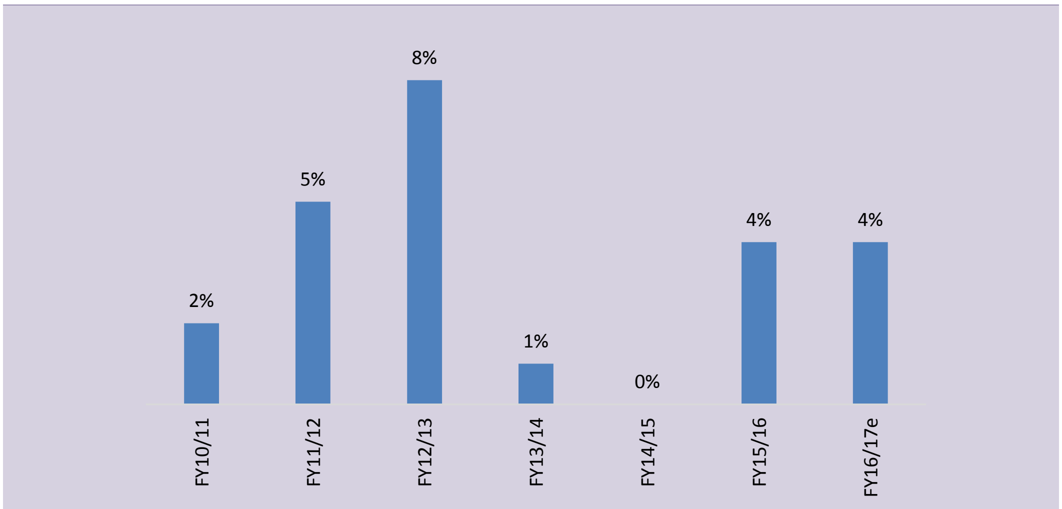
Fig. 1: Organic sales growth in the Americas



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.**

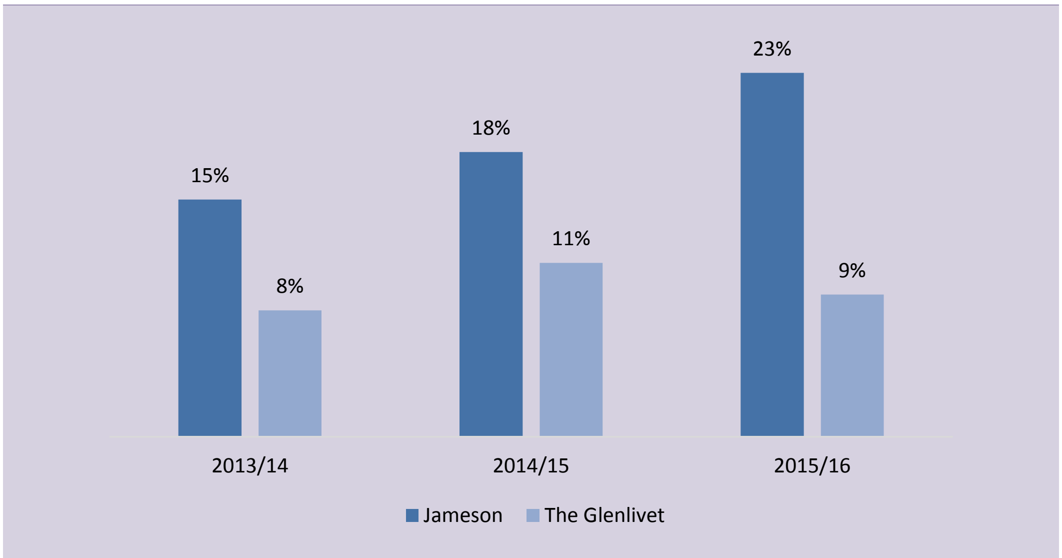
Fig. 2: Organic sales growth in the United States



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

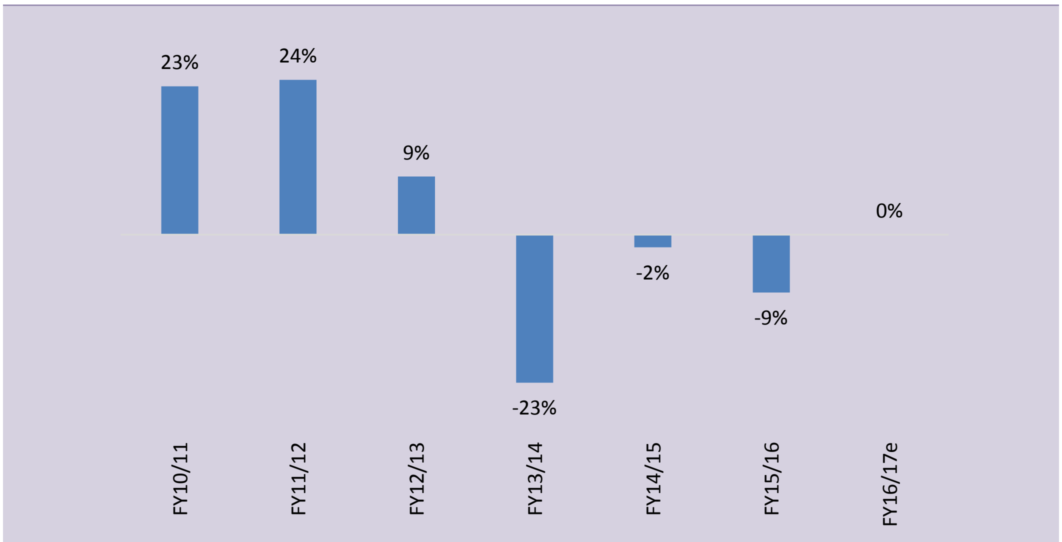
Absolut is showing signs of an improvement but remains in negative territory. Depletions declined by 2% in 2015/16 after -4% in 2014/15. This is the result of measures taken by the group: renegotiation of two distribution contracts, packaging changes, refocusing of the advertising campaigns around the 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.**

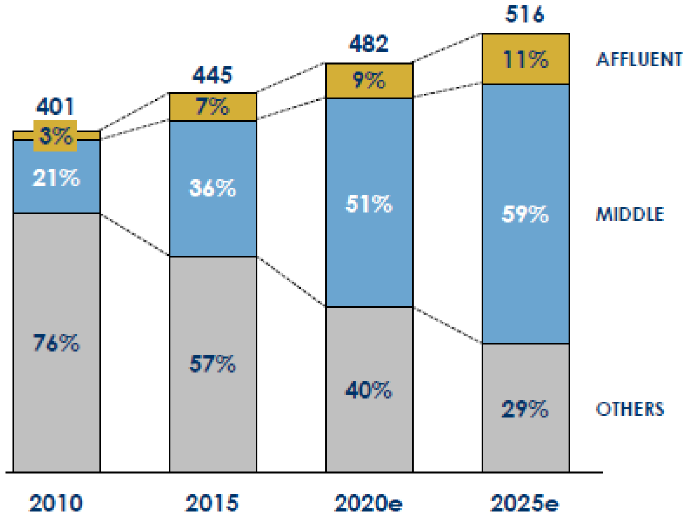
Fig. 4: Organic sales growth in China



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.**

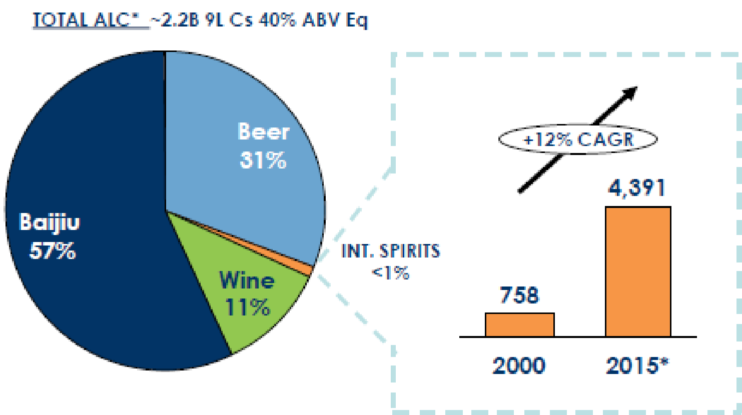
Fig. 5: Chinese households (in millions)



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

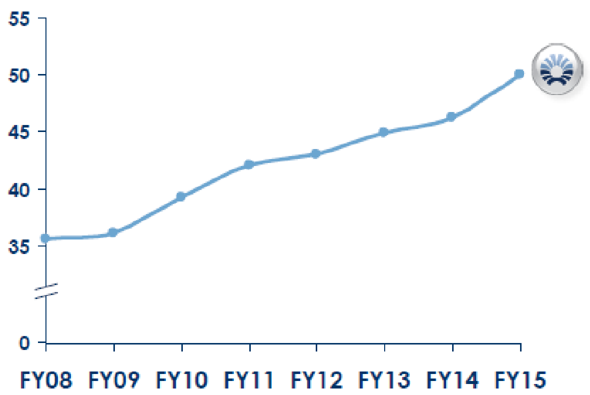


Source: Pernod Ricard

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.

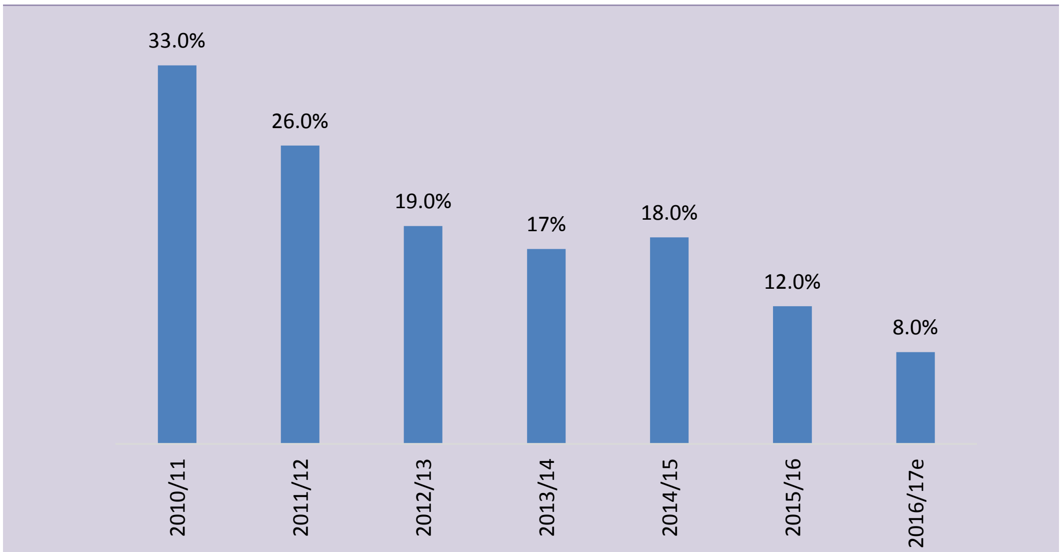
Fig. 7: Trend in Pernod Ricard's market share in value



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

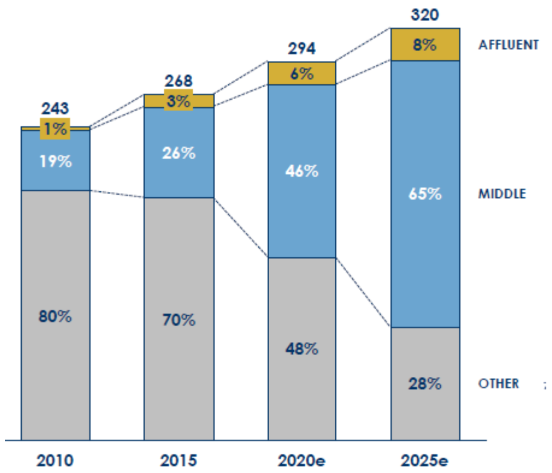


Source: Pernod Ricard, Bryan, Garnier & Co

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.

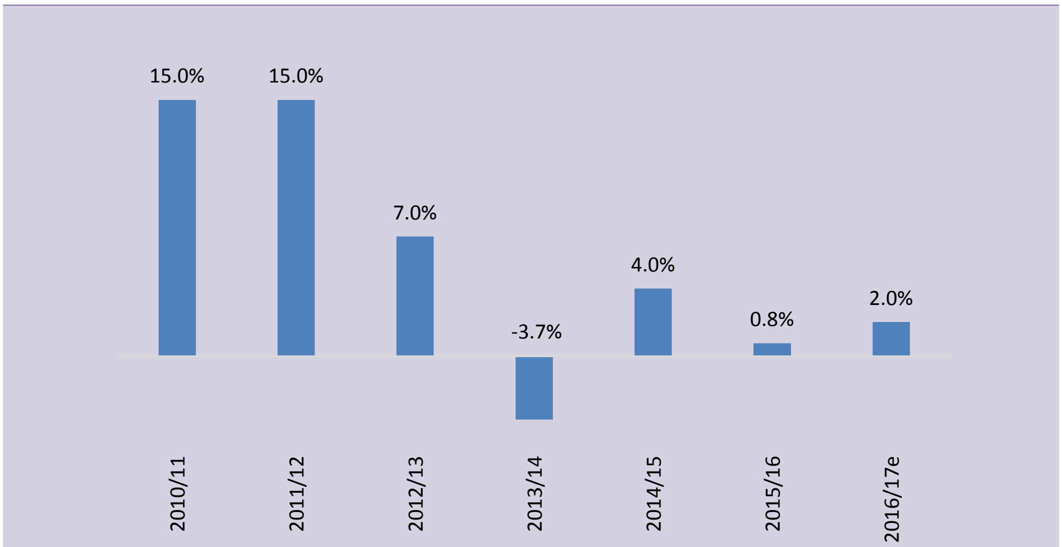
Fig. 9: Indian households (in millions)



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

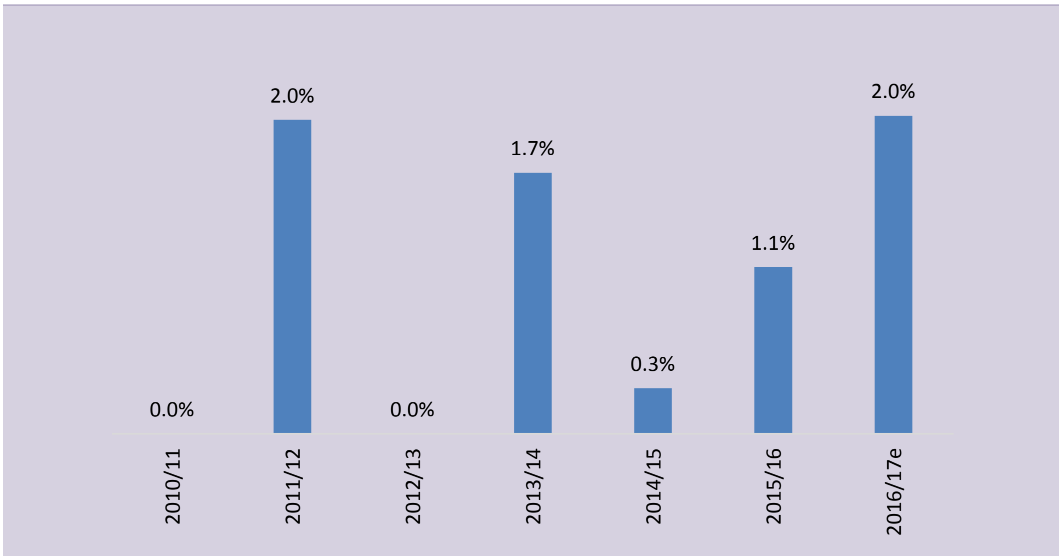


Source: Pernod Ricard, Bryan, Garnier & Co

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**

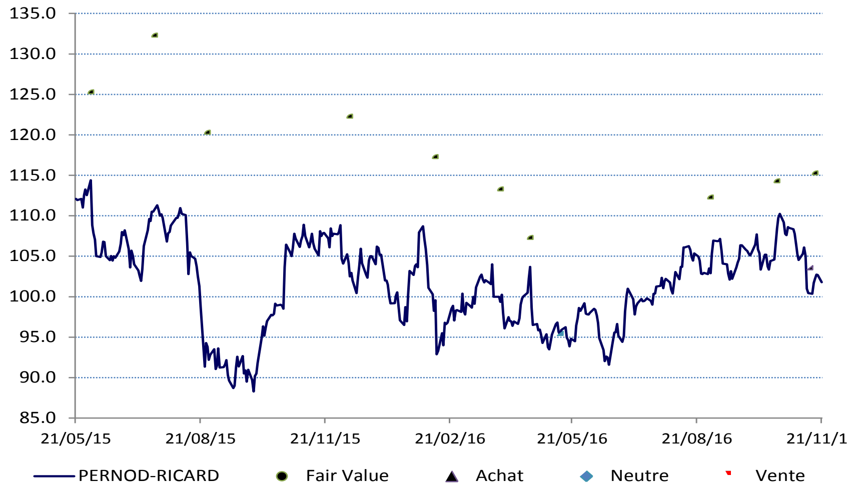
Fig. 15: DCF (2/2)

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

Price Chart and Rating History

Pernod Ricard



Ratings		
Date	Ratings	Price
18/11/2016	BUY	EUR102,75
18/05/2016	NEUTRAL	EUR94,95
29/08/2014	BUY	EUR88,75
28/05/2014	NEUTRAL	EUR89,24

Target Price	
Date	Target price
18/11/2016	EUR115
21/10/2016	EUR114
02/09/2016	EUR112
22/04/2016	EUR107
31/03/2016	EUR113
12/02/2016	EUR117
11/12/2015	EUR122
28/08/2015	EUR120
20/07/2015	EUR132
03/06/2015	EUR125
24/04/2015	EUR129
27/03/2015	EUR122
13/02/2015	EUR110
08/01/2015	EUR102
24/10/2014	EUR101
29/08/2014	EUR103
28/05/2014	EUR94

Please see the section headed "Important information" on the back page of this report.

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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 72% NEUTRAL ratings 0% SELL ratings 28%

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