Creditreform Corporate Rating

Pernod Ricard S.A. (Group)

Creditreform Rating
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Rating object	Rating information	
Pernod Ricard S.A.(Group)	Rating: **BBB**	Outlook: **stable**

Creditreform ID:	582041943
Incorporation:	1975
(Main) Industry:	Wine and spirits
Management:	Alexandre Ricard, CEO

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Rating history:	www.creditreform-rating.de

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Abstract

Company

Pernod Ricard S.A. (Group) – hereafter referred to as PERNOD RICARD – is a leading player on the global market for wines and spirits. The Group is domiciled in Paris and has a worldwide headcount of approx. 18,600 employees. Its global sales revenues are well-nigh evenly divided between the Americas (29 %), Europe (31 %) and Asia / Rest of the World (40 %).

In a challenging market environment, PERNOD RICARD generated sales revenues of EUR 8.69 billion in the business year 2015/2016, 1.4 % more than in 2014/15 (EUR 8.56 billion), essentially due to a positive development on the US market. Over the same period, the Group's overall profit increased by 42.6 % to EUR 1.26 billion (from EUR 0.88 billion in 2014/15). This reflected a significant fall in the volume of impairment write-downs which had decreased the profits in 2014/15 by more than EUR 500 million. Once the Group's profits have been adjusted by this factor, the operating result – with a margin of 26.2 % - turns out to have been fairly stable year-on-year.

For the current business year, PERNOD RICARD expects specifically high growth rates in the US, India and China and an overall organic revenue growth of 2 to 4 %. The Group expects a slight increase of its operating margin in the wake of a concentration of resources on key brands, product innovations and efficiency drives. The figures for the first six months of the business year – sales revenues of EUR 5.06 billion (same period in 2014/15: EUR 4.96 billion, an increase of 2.0 %) with an operating result of EUR 1.5 billion (2014/15: EUR 1.44 billion, + 4,3%) – have confirmed PERNOD RICARD in their optimism for the current business year which will end on 30 June 2017. With sufficient levels of liquidity, moderate amounts of debt and a stable cash flow, PERNOD RICARD appears to operate on a sound foundation of financial security.

Rating result

This rating attests PERNOD RICARD a highly satisfactory level of financial strength with a low-to-medium default risk. This assessment reflects the Group's well-diversified portfolio of products and brands, high innovative power and effective cost management. Over recent years, PERNOD RICARD has been able to reinforce its market position on the basis of increasing sales. This points towards a sustainable and robust development of the company's business.

On the other hand, PERNOD RICARD operates in a challenging market environment that requires a continuous development of the product portfolio and regular structural adjustments. These in turn necessitate significant financial commitments that might affect the economic situation of the Group. The business also appears vulnerable to adverse developments of the economic, political and regulatory environments.

Rating outlook

The one-year outlook for the rating is stable. This outlook is based on the assumption that the economic and political environments remain stable and that no major market disruptions will occur. The currently positive economic developments in the USA and the ongoing recoveries in China and Russia should allow PERNOD RICARD to continue on its path of profitable growth and to use stable cash flows to decrease its overall levels of debt and its leverage ratio (ratio of net debt to EBITDA). The Group's apparent determination to concentrate resources on product innovations and high-margin brands should additionally help to strengthen the business. Based on a well-diversified portfolio and a robust cost management process, PERNOD RICARD should be able to reach its 2 % growth targets for both sales revenues and profit in the current business year.

Relevant rating factors

Financial ratios' extract Basis: consolidated annual statement per 30.06 (IFRS)	Standardized balance sheet	
	2015/2016	**2014/2015**
Total assets	EUR 22.7 billion	EUR 22.6 billion
Revenues	EUR 8.7 billion	EUR 8.6 billion
EBITDA	EUR 2.4 billion	EUR 2.4 billion
EBIT	EUR 2.1 billion	EUR 1.6 billion
EAT	EUR 1.3 billion	EUR 0.9 billion
Equity ratio	41.0 %	40.4 %
Capital lock-up period	71.0 days	72.3 days
Trade-accounts-payable ratio	7.4 %	7.5 %
Short-term capital lock-up	35.7 %	38.2 %
Return on investment	5.3	5.3
Net debt / EBITDA adj.	3.6 %	3.9 %
Ratio of interest expenses to debt	5.9 %	7.4 %

General rating factors

\+ No. 2 on the global market for wines and spirits (in terms of sales revenues)
\+ 17 products are placed among the world's top 100 brands of spirits (in terms of sales revenues)
\+ Good levels of geographical and brand diversification
\+ High innovative powers (new products account for 1 % of the growth in sales revenue)

\- Competition with a high level of intensity
\- High levels of pressure to innovate and to invest
\- High levels of volatility (currency exchange rates and raw material costs)

Current factors (rating 2017)

\+ Sound balance-sheet structures and solid financial foundations
\+ Target-oriented portfolio management
\+ Stable business development

\- Globally weak growth
\- Global political uncertainty
\- Competitive pressures

Prospective rating factors

- \+ High rates of growth in the USA and China, following internal restructuring efforts and market-related improvements
- \+ Efficiency drives for sustainable profitability
- \+ Increase of free cash flow and moves to decrease the overall level of debt

- − Some key brands have lost market share
- − Some financial ratios have deteriorated, reflecting an increase of the working capital, acquisitions / investments or declining businesses
- − Falling levels of social acceptance for the consumption of alcoholic beverages
- − Legal or regulatory restrictions

Best-case scenario:	BBB
Worst-case scenario:	BBB-

Note:
The scenarios are based on the information available at the time of the rating. Within the forecast horizon, some circumstances could occur that would lead to a rating change out of the indicated range.

Best-case scenario

We underpinned our best case scenario for PERNOD RICARD (time horizon: one year) with revenue and profit growth figures that slightly exceeded their current levels. Such a development would allow the Group to gradually reduce its debt. Given the uncertainty and the challenging market conditions in which the Group operates, however, such a development alone would not justify a rating upgrade.

Worst-case scenario

Our worst case scenario for PERNOD RICARD (time horizon: one year) showed that a decline of the rating to a level of BBB- cannot be altogether ruled out. Such a downgrade could, for example, be triggered by a substantial downturn on the operative market, since this would adversely affect the debt situation of PERNOD RICARD and therefore its business outlook.

Business development and outlook

In a challenging market environment, PERNOD RICARD generated sales revenues of EUR 8.68 billion and a profit of EUR 1.26 billion for the business year 2015/2016, significantly better results than in the previous twelve months (2014/15: EUR 8.56 billion and EUR 0.88 billion respectively). Sales revenues improved by 1.4 %, but the profits jumped up by a stunning 42.6 %, mainly reflecting a significantly fall in the volume of impairment write-downs by more than EUR 500 million from the previous year's levels. Once the Group's profits have been adjusted by this factor, the operating result – with a margin of 26.2 % - turns out to have been fairly stable year-on-year. The results in Europe and the Americas registered organic growth rates of 7 % and 4 % respectively, while PERNOD RICARD's organic results in the region Asia / Rest of the World fell by 2 %. Overall, PERNOD RICARD reached an organic growth rate of 2 % over the course of the past business year.

For the current business year, PERNOD RICARD expects an organic growth rate of 2 to 4 %, expecting to benefit from positive developments in the US, India and China. The Group expects to improve its operating margin in the wake of a concentration of resources on key brands, innovations and efficiency drives. Based on the figures for the first six months of the business year as per 31 December 2016 – sales revenues of EUR 5.06 billion (same period in 2014/15: EUR 4.96 billion, an increase of 2.0 %), an operating result of EUR 1.5 billion (2014/15: EUR 1.44 billion, + 4.3%) – we believe that PERNOD RICARD is well on its way of achieving these targets.

Structural risks

PERNOD RICARD is the result of the 1975 merger between the French spirit producers Pernod S.A. and Ricard S.A. and the second largest company within its industry worldwide. Its parent company is the publicly listed Pernod Ricard S.A. which is domiciled in Paris. Much of the share capital is in free float. The largest shareholder is the family business "Societé Paul Ricard", which controls approx. 14 % of the shares.

PERNOD RICARD consists of 85 consolidated companies and operates 101 production sites in 24 countries. Its complex operating structure includes 26 vineyards, 36 distilleries, 50 sites where wine and spirits are stored and aged and 52 filling lines for the company's main products (wine, vodka, gin, rum, whiskey, cognac, brandy, liqueur and tequila) and other spirits. 17 of PERNOD RICARD's products are placed among the world's top 100 brands of spirits (in terms of sales revenues).

PERNOD RICARD is a decentrally structured holding company. Most operating responsibilities have been assigned to the Group's individual companies that are largely free to act independently. The Group essentially restricts itself to collecting license fees and its shares in the corporate profits. Due to the close alignment of its structure to the market's requirements, PERNOD RICARD is capable of reacting quickly to changes on its markets and to seize opportunities for further growth.

PERNOD RICARD has divided its markets into three groups (Europe, the Americas, and Asia / Rest of the World), which make roughly even contributions to the corporate results (respectively accounting for 31 %, 29 % and 40 % of sales).

In his capacity as the Chairman of the Board of Directors and CEO, Alexandre Ricard is the chief representative of PERNOD RICARD. He is therefore in charge not only of overseeing the development of business strategies and structures, but also of the day-to-day running of the Group.

At the end of the business year 2015/2016, PERNOD RICARD employed approx. 18,600 people, roughly the same number as in the previous 12 months. 40 % of these employees worked in production, 31 % in sales, and 29 % in administration. PERNOD RICARD believes that a future-oriented HR strategy is an important element in its long-term plans of sustainably developing and entrenching its market positions.

We believe that the Group's organizational structure provides an appropriate framework for the continuously positive development of its corporate business.

Business risks

The portfolio of international business activities subjects PERNOD RICARD to a wide range of external and internal risks. The Group combats these risks through a prudent business policy with a comprehensive risk management and a strict system of internal controls.

One key risk for PERNOD RICARD is its dependence on the economic development of the target markets where recessive tendencies can adversely affect revenues. Economic downturns can easily cause a fall in the consumption of wines and spirits or make consumers look for cheaper, low-quality brands and alternative products. Due to its international footprint, PERNOD RICARD is also increasingly exposed to country risks: the business is subject to political and legal uncertainties but also liable to suffer from capital-related and financial problems, all the more since PERNOD RICARD generates approx. 38 % of its global sales in the emerging markets of Asia, South America and Eastern Europe.

The level of competition on the market for wine and spirits requires continuous investments in the market and business infrastructures – this may also cause problems, as does the uneven distribution of sales throughout the calendar year with sales peaks just before Christmas and the New Year. Frequently changing consumption patterns require high degrees of entrepreneurial flexibility and innovative strength, while the increasing consolidation of the global market for wines and spirits is constantly shifting the power on the market in favour of customers and consumers, making it increasingly difficult for the manufacturers to place their products profitably.

Businesses depend on their ability to procure raw materials of consistent quality and to keep their production costs under control – neither can be considered as a given. If products were to fall below certain quality thresholds, PERNOD RICARD might easily lose their customers' trust and suffer damages to its reputation as well as sustained financial losses. Finally, the trend towards a falling social acceptance of alcohol consumption also poses a risk for the Group‘s continued economic success.

PERNOD RICARD pursues a long-term strategy with the objective of becoming the world's leading producer of wine and spirits. The Group intends to achieve this through high quality products and customer orientation as well as a strategic development of its well-diversified brand portfolio. PERNOD RICARD has currently a global market share of 16 %, a fair distance behind the current no. 1 on the global market, the UK-based Diageo plc (25 %) but equally far ahead of its closest pursuer, the Bermudas-domiciled Bacardi Ltd. (9 %). PERNOD RICARD intends to increase its market share through a policy of innovations, a robust premium strategy and high levels of cost-efficiency, fighting off other international players as well as local providers which play a role of increasing importance on a hotly contested market.

In view of the Group's overall market position, we believe that it is realistic to expect a positive future development of PERNOD RICARD. It will be difficult for the Group, however, to achieve its stated objective of becoming the global market leader through organic growth alone. Further acquisitions will probably be required.

Financial risks

For analytical purposes, CRA adjusted the original values in the financial statements in the context of its financial ratio analysis. The following descriptions and indicators are based solely on those adjustments.

The financial structures of PERNOD RICARD are overall solid. The structured balance sheet analysis for the business year 2015/16 disclosed an equity ratio of 41.0% (2014/15: 40.3 %) and a moderate net debt of EUR 8.7 billion (2014/15: EUR 9.0 billion), equivalent to 3.6 times the EBITDA. Maturities and debtor structure appear to be sufficiently diversified, with only EUR 2.0 billion of short-term debt. As per 30 June 2016, PERNOD RICARD had cash reserves of approx. EUR 600 million and free credit lines with a total volume of EUR 2.8 billion, secured by the Group as a medium-term financial reserve. PERNOD RICARD also has access to factoring and securitization facilities. Bank debts and bonds, PERNOD RICARD's preferred methods of procuring money, are subject to a covenant that requires compliance with a leverage ratio (net debt / EBITDA) of 5.25. Based on the figures from the most recently disclosed annual accounts and the current financial constellations, compliance with this financial ratio – and with it the solidity of PERNOD RICARD's financial arrangements – appears to be assured.

Financial ratios analysis

Appendix: key ratios

Asset Structure	2013	2014	2015	2016
Fixed asset intensity (%)	67,82	67,17	66,40	66,66
Asset turnover	--	0,38	0,39	0,38
Asset coverage ratio (%)	60,76	65,62	66,27	68,24
Liquid funds to total assets (%)	2,86	2,29	2,41	2,51
Capital Structure				
Equity ratio (%)	36,45	39,87	40,36	40,96
Short-term-debt ratio (%)	21,15	18,72	22,69	21,83
Long-term-debt ratio (%)	4,76	4,21	3,64	4,53
Capital lock-up period (in days)	65,81	67,21	72,33	70,97
Trade-accounts-payable ratio (%)	7,40	7,01	7,49	7,44
Short-term capital lock-up (%)	31,59	27,58	38,20	35,71
Gearing	1,67	1,45	1,42	1,38
Financial Stability				
Cash flow margin (%)	--	16,05	19,81	20,59
Cash flow ROI (%)	--	6,11	7,48	7,88
Debt / EBITDA adj.	5,62	5,86	5,55	5,56
Net Debt / EBITDA adj.	5,37	5,64	5,33	5,33
ROCE (%)	13,63	11,24	8,93	11,73
Debt repayment period	--	15,17	13,90	9,01
Profitability				
EBIT interest coverage	3,73	3,42	2,96	4,33
EBITDA interest coverage	4,19	4,12	4,60	5,01
Ratio of personnel costs to total costs (%)	14,57	15,20	14,87	15,08
Cost income ratio (%)	75,76	77,81	82,02	76,37
Ratio of interest expenses to debt (%)	4,25	4,15	3,92	3,59
Return on investment (%)	8,28	7,05	5,93	7,37
Return on equity (%)	--	12,90	10,08	13,61
Net profit margin (%)	13,88	12,93	10,28	14,46
Interest burden (%)	74,37	75,00	70,35	79,91
Operating margin (%)	24,52	22,35	18,29	23,97
Liquidity				
Cash ratio (%)	13,51	12,22	10,61	11,48
Quick ratio (%)	47,62	47,17	41,67	41,92
Current ratio (%)	152,17	175,36	148,11	152,73

Regulatory requirements

The present rating is an unsolicited corporate rating. Creditreform Rating AG was not commissioned by the company with the preparation of the rating. The present analysis was prepared on a voluntary basis.

The rating is based on the analysis of published information and on internal evaluation factors. The quantitative analysis is primarily based on the annual report for 2016 and on press releases of the company. The information and documents meet the requirements and are in accordance with the published Creditreform Rating AG's rating methodology. An electronic version of our rating methodology can be found on our website www.creditreform-rating.de.

The rating was prepared by analysts Klaus Geukes (k.geukes@creditreform-rating.de) and Marie Watelet (m.watelet@creditreform-rating.de).

A Rating Committee of highly qualified analysts of Creditreform Rating AG was called on March 28, 2017. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant risk factors, the Rating Committee arrived at a unanimous rating decision.

The rating result and a draft of the present rating report were communicated to Pernod Ricard on the same day. The final version of the rating report has been sent to Pernod Ricard on April 4, 2017.

The rating will be monitored as long as CRA removes the rating and sets it to non-rated (n.r.).

In 2011 Creditreform Rating AG was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG (CRAG) is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation.

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No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks.

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1. Annual Report

2. Website

3. Internet research.

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In case where the credit rating is based on more than one methodology or where reference only to the principal methodology might cause investors to overlook other important aspects of the credit rating, including any significant adjustments and deviations, Creditreform Rating AG explains this fact in the credit rating and indicates how the different methodologies or these other aspects are taken into account in the credit rating. This information is integrated in the credit rating report.

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An explanatory statement of the meaning of Creditreform`s default rates are available in the credit rating methodologies disclosed on the website.

Please note:

This report exists in an English version only. This is the only binding version.

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