summer ★ sizzlers

EXANE BNP PARIBAS

DISTILLERS

Spirited attack

2 JULY 2015

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WHY YOU SHOULD READ THIS REPORT

Reliant on highly profitable big brands which are being shunned by the US consumer, Diageo and Pernod have been losing share in the US. Small / Craft brands are at least partly to blame.

US craft spirits are relatively small today but growing rapidly (+58% in 2014). We expect craft spirits supply to increase significantly, reaching a c.8% share in five years. The “too small to make a difference” argument will become increasingly weak in our view.

With almost three quarters of US sales exposed to craft, significant challenges await Diageo (=). It might be a while before Diageo is restored to its former pomp. Pernod (+) is less exposed and appears to be on the front foot in the US, but we expect no quick fix on some of its big brands. Rémy Cointreau (=) is relatively ‘craft-proof’.

See Appendix (on p54) for Analyst Certification, Important Disclosures and Non-US Research Analyst disclosures.

SUMMER SIZZLERS

With the backdrop hazy and valuations warm, ideas may seem hard to come by. As investors cast around for themes to consider over the summer break, our teams have been preparing some food for thought… we invite you to fire up the barbeque for our Summer Sizzlers!

Our last sizzler called for a return to peak Automotive production in Europe. Today we turn our attention to the nascent, but thriving, craft spirits market. Just as with beer, the big players need to act quickly if they are to keep up with the exponential growth in craft spirits, and some seem to be better prepared than others. As we gaze enviously out the window at the cocktail-brandishing holidaymakers already driving this market, we wonder to ourselves:

What do you call a French guy in sandals? Philippe Phloppe!

We offer our eighth Summer Sizzler for your delectation.

Nestlé

Ashtead Group

Steinhoff

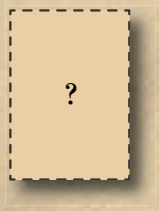
Strategy

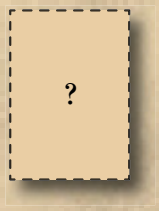
ARM

Anglo American

Automotive

Distillers





Wishing you a sizzling summer
from the Exane BNP Paribas Research Team

DISTILLERS

Spirited attack

2 JULY 2015

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Are craft spirits really a threat?

In our Craft Invasion note, we showed that craft beer is a considerable threat to the big brewers in developed markets. Does the nascent craft spirits industry pose a similar threat to the large distillers in the very profitable US spirits market? We investigate.

Craft volumes could increase tenfold in the next five years

US craft spirits is relatively small today but growing rapidly (+58% in 2014), generating a decent chunk of industry growth (25%). There are currently 600 distilleries (x10 in 10yrs). The average craft distillery is 3 years old with research showing that production increases dramatically after the third year. With more distilleries coming on stream and increased production at those already in existence, we expect craft spirits supply to significantly increase, reaching a c.8% share in five years. The "too small to make a difference" argument will become increasingly weak in our view.

Craft spirits – not just white

One might think that craft distillers would focus their efforts on white spirits such as vodka and gin (easier and faster to produce). However, whiskey is now the most popular craft spirit in the US. We expect a significant rise in supply, creating more competition in this and adjacent categories.

30% of Diageo EBIT is exposed to craft: we expect further market share loss

Overly reliant on highly profitable big brands which are no longer 'cool', Diageo has been losing share in the US. With almost three quarters of its US sales exposed to craft, an over-reliance on the flavour fad (Crown Royal) and despite craft initiatives in whiskey and gin, significant challenges await Diageo in the US. It might be a while before Diageo is restored to its former pomp.

Pernod Ricard and Remy less exposed but likely to make craft acquisitions

Pernod's vodka, gin and liqueur woes will not be easily overcome but the tripling of its salesforce at US wholesalers and craft initiatives should help (it is much less exposed to the US than Diageo of course). Remy's high-end portfolio is much more 'craft-proof'. Both groups could acquire in craft.

Diageo plc (=)
Distillers & Vintners ▪ United Kingdom
Price*: 1,841p ▪ TP: 1,910p ▪ Upside: 4%
Market cap: GBP50.7bn / EUR71.3bn

	06/15e	06/16e	06/17e	06/18e
EPS, Adjusted (p)	88.7	95.5	102.1	107.9
EPS, IBES (p)	90.4	96.5	103.4	110.0
P/E (x)	20.8	19.3	18.0	17.1
Net yield (%)	2.8	2.9	3.1	3.2
FCF yield (%)	3.5	3.5	3.8	4.1
EV/Sales (x)	5.1	5.2	4.9	4.6
EV/EBITDA (x)	15.7	16.0	15.0	14.1
EV/EBITA (x)	17.6	17.9	16.8	15.8
EV/CE (x)	2.9	3.0	2.9	2.8
Net Debt/EBITDA, Adj. (x)	2.8	2.5	2.3	2.0

Pernod Ricard (+)
Distillers & Vintners ▪ France
Price*: EUR103.6 ▪ TP: EUR122 ▪ Upside: 18%
Market cap: EUR27.5bn

	06/15e	06/16e	06/17e	06/18e
EPS, Adjusted (EUR)	5.00	5.70	6.25	6.79
EPS, IBES (EUR)	5.08	5.74	6.24	6.78
P/E (x)	19.6	18.2	16.6	15.3
Net yield (%)	1.8	1.9	2.1	2.3
FCF yield (%)	3.3	3.6	4.6	5.1
EV/Sales (x)	4.2	4.0	3.7	3.5
EV/EBITDA (x)	14.4	13.4	12.4	11.5
EV/EBITA (x)	15.7	14.6	13.5	12.5
EV/CE (x)	1.5	1.5	1.4	1.4
Net Debt/EBITDA, Adj. (x)	3.8	3.2	2.8	2.4

Rémy Cointreau (=)
Distillers & Vintners ▪ France
Price*: EUR64.7 ▪ TP: EUR70 ▪ Upside: 8%
Market cap: EUR3.1bn

	03/15p	03/16e	03/17e	03/18e
EPS, Adjusted (EUR)	1.92	2.21	2.50	2.75
EPS, IBES (EUR)	1.95	2.25	2.59	2.88
P/E (x)	32.1	29.2	25.8	23.5
Net yield (%)	2.5	2.3	2.5	2.5
FCF yield (%)	(0.2)	2.2	2.3	2.4
EV/Sales (x)	3.6	3.4	3.2	3.0
EV/EBITDA (x)	20.3	17.8	16.2	15.0
EV/EBITA (x)	22.6	19.7	17.8	16.4
EV/CE (x)	2.3	2.3	2.2	2.1
Net Debt/EBITDA, Adj. (x)	2.7	2.2	1.9	1.7

** Prices at 30 June*

Contents

Executive summary 3

Spirited attack 8

US craft spirits to grow at a 45% volume CAGR? 11

Craft Spirits production to increase markedly 13

Barriers to entry lowering in US Spirits 15

Category deep-dive 20

American whiskey 21

Vodka: a nightmare for mainstream brands 28

Tequila 33

Rum: a vibrant craft scene 34

Irish whiskey: Pernod both killing and inspiring the competition 35

Company implications 38

Diageo: the most at risk 38

Pernod Ricard: less exposed but work to do 40

Remy: the least exposed 40

Can craft spirits take on the world? 41

Outside of the US, craft is even more embryonic 41

Craft industry – an overview 44

Opening a distillery is not that big of a deal (if you have USD300k) 44

Marketing plan is key to success 47

Craft M&A anyone? 51

Pernod Ricard: a craft acquisition is on the cards 51

Remy Cointreau: US whiskey? 52

Diageo: we could see some small transactions 52

Investment case, valuation and risks 53

Company profiles and financial highlights 57

Executive summary

Small distillers, those with sales less than 100,000 cases, had an estimated 2% value share of the US spirits market in 2014. Among these, craft (authentic liquors from small independent distillers) accounted for c.1% of spirits volumes, more than double the level of two years ago (0.4%).

Figure 1: Small distillers have an estimated 2% value share in the US, of which craft is roughly half

Overview of small and craft distillers in the US

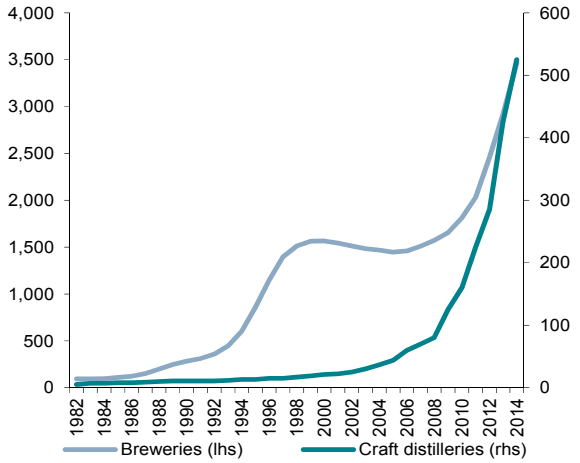
2014	Number of distillers	Avg. production ('000 cases)	Total production ('000 cases)	Volume share	Net sales (USDm)	Value share (est.)
Small distillers (< 100k cases)	729	5	3,496	1.7%	425	2.0%
of which >50k	17	80	1,360	0.7%	175 (est.)	0.8%
of which <50k cases	712	3	2,136	1.0%	250 (est.)	1.2%
of which 'craft'	525 (est.)	4 (est.)	1,922 (est.)	0.9%	225 (est.)	1.1%

Source: DISCUS, American Distilling Institute, Exane BNP Paribas estimates, See page 8 for a definition of what constitutes a craft distiller

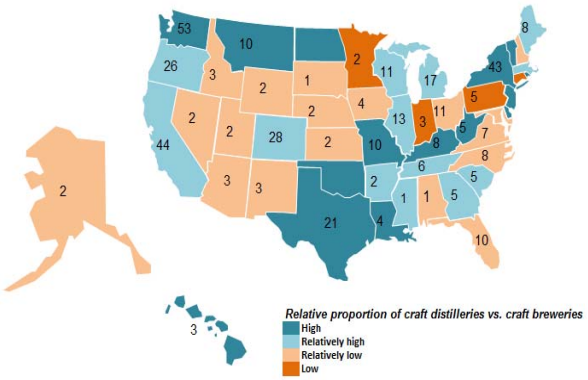
The number of craft distillers has increased tenfold in ten years and craft spirits volumes grew 58% y/y in 2014, up from +50% in 2013. The West Coast, East Coast and Colorado are hot spots for craft spirits:

Figure 2: Craft distilleries in the US: 10x in 10 years

Number of craft distilleries and breweries in the US



Number of craft distilleries by state (2013) and relative penetration of craft distilleries vs. craft breweries (colour)



Source: Brewers Association, American Distilling Institute, Exane BNP Paribas. Colour coding: We divide number of craft breweries by number of craft distilleries – relative proportions below 6 are defined as 'High', 6-10 'Relatively high', 10-20 'Relatively low', and >20 'Low'.

The average craft distillery in the US is only 3 years old. Given that the average production at a craft distillery increases strongly after three years, coupled with further distillery openings, we expect US craft spirits production to significantly rise in coming years and to reach a c.8% volume share in five years.

Figure 3: We expect US craft spirits to grow at a 45% volume CAGR, with volume share rising to c.8%

Modelling craft spirits volume growth

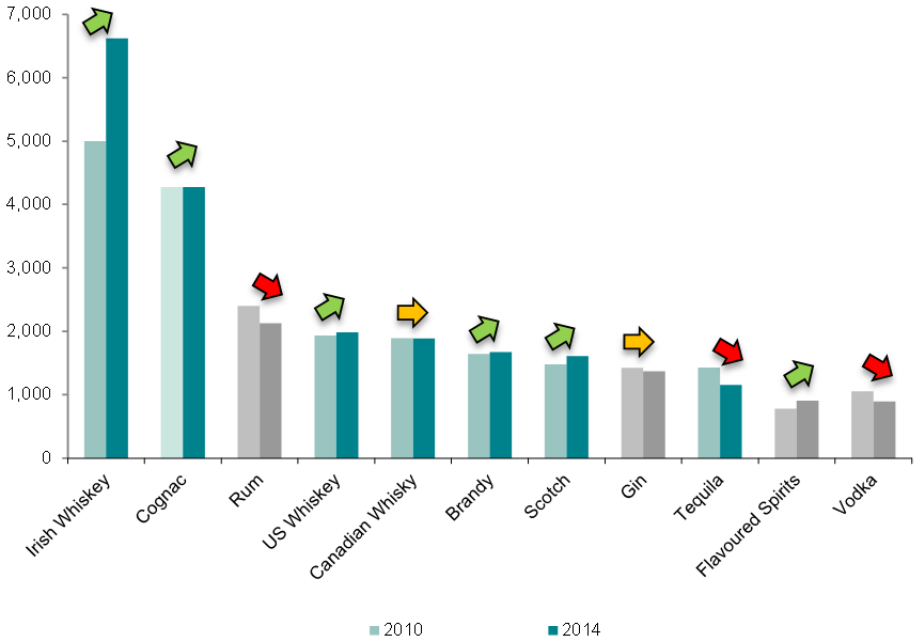
Producers by years of operation	2014	2015e	2016e	2017e	2018e	2019e	2020e
6 years or more	135	188	263	335	405	475	546
4-5 years	106	149	146	140	139	142	146
2-3 years	193	142	134	138	145	150	154
0-1 year	91	126	143	151	156	158	159
Total	**525**	**605**	**685**	**765**	**845**	**925**	**1,005**
New entrants (net of bankruptcies)	100	80	80	80	80	80	80
Avge. prod. by age of operation (9l cases)							
6 years or more	5,858	7,615	9,900	12,870	16,731	21,750	28,275
y/y growth		*30.0%*	*30.0%*	*30.0%*	*30.0%*	*30.0%*	*30.0%*
4-5 years	4,300	5,160	6,192	7,430	8,916	10,700	12,840
y/y growth		*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*
2-3 years	1,321	1,453	1,598	1,758	1,934	2,127	2,340
y/y growth		*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*
0-1 year	1,031	1,031	1,031	1,031	1,031	1,031	1,031
y/y growth		*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Total		**22.0%**	**22.7%**	**23.3%**	**23.9%**	**24.5%**	**24.9%**
Total production (in '000 9l cases)							
6 years or more	789	1,430	2,599	4,316	6,781	10,328	15,434
4-5 years	457	771	903	1,039	1,240	1,519	1,877
2-3 years	255	206	214	243	280	320	361
0-1 year	94	130	147	156	161	163	164
Total cases	**1,894**	**2,537**	**3,863**	**5,755**	**8,462**	**12,330**	**17,835**
y/y growth		***34%***	***52%***	***49%***	***47%***	***46%***	***45%***
of which organic growth		*22%*	*23%*	*23%*	*24%*	*24%*	*25%*
Craft spirits 2014-2020 CAGR	**45%**						
Total market ('000 9l cases)	**207,202**	**210,518**	**213,886**	**217,308**	**220,785**	**224,317**	**227,907**
y/y growth (IWSR forecast)		*1.6%*	*1.6%*	*1.6%*	*1.6%*	*1.6%*	*1.6%*
Share of craft spirits	**0.9%**	**1.2%**	**1.8%**	**2.6%**	**3.8%**	**5.5%**	**7.8%**

Source: ADI, IWSR, Exane BNP Paribas estimates. Note: 2014 production also includes an estimated 300k 9l cases of unknown age (based on the % of distillers, who didn't respond to the ADI survey)

While the production of vodka and gin is a way of generating quick cash-flow for a craft distiller and the US brown spirits industry has in fact become more concentrated since 2010, interestingly there were three times more craft whiskey brands than craft vodka brands in the US last year. As maturing whiskey inventories come to market in coming years, we believe that large US distillers will see higher competition.

Figure 4: Brown spirits are and have become more concentrated

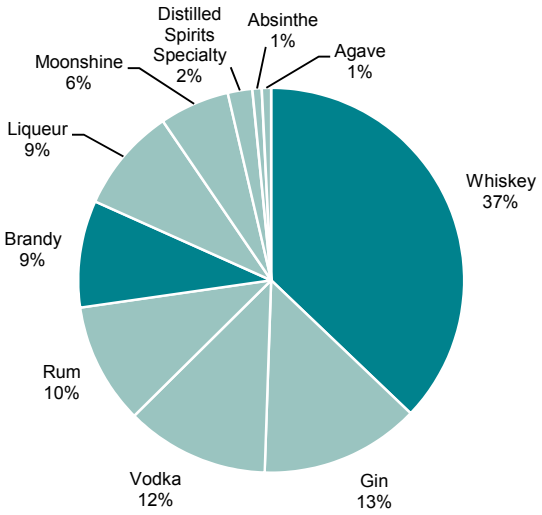
US HHI per Spirits category, 2014 vs. 2010, brown spirits highlighted in dark green



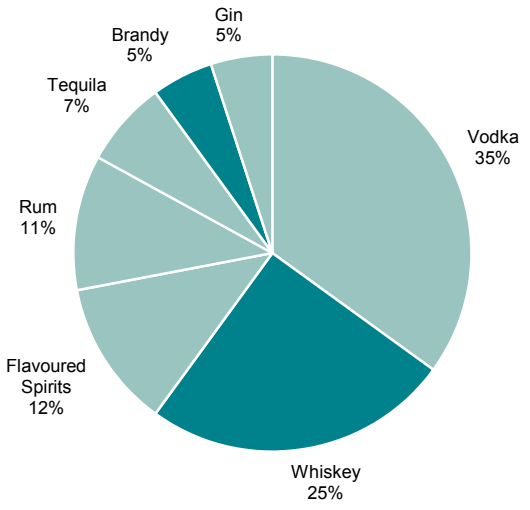
Source: IWSR, Exane BNP Paribas. Note: HHI is calculated by squaring the market share of each company and then summing the resulting numbers. HHI can range from close to zero to 10,000. The closer a market is to being a monopoly, the higher the HHI / market concentration. Note that some rums can be considered brown spirits

Figure 9: There are three times more craft whiskey brands than craft vodka brands in the US

ADI-certified craft spirits brands breakdown, by category



US spirits volume breakdown, by category



Source: American Distilling Institute, IWSR, Exane BNP Paribas.

Diageo has been losing market share in the US, with big brands such as Smirnoff and Captain Morgan out of favour with the millennial.

Figure 5: Diageo and Pernod Ricard have been losing market share in the US

Evolution of value shares, all spirits, US

	2008	2009	2010	2011	2012	2013	2014	2008-2014
Diageo	23.2%	22.6%	22.8%	22.6%	22.4%	22.1%	21.4%	**-1.7%**
Beam Suntory	7.0%	7.4%	7.9%	8.4%	8.5%	8.4%	8.5%	**1.5%**
Pernod Ricard	9.2%	9.0%	8.7%	8.6%	8.4%	8.2%	7.8%	**-1.4%**
Bacardi	9.9%	9.0%	9.0%	8.7%	8.1%	8.0%	7.5%	**-2.3%**
Sazerac	4.8%	4.9%	4.8%	4.7%	4.9%	5.2%	6.1%	**1.3%**
Brown Forman	6.0%	6.3%	5.9%	5.9%	6.0%	5.9%	5.9%	**-0.1%**
Heaven Hill	3.1%	3.3%	3.2%	3.2%	3.2%	3.1%	3.2%	**0.1%**
Campari	2.7%	2.8%	2.8%	2.8%	2.8%	2.8%	2.7%	**0.1%**
Remy Cointreau	1.5%	1.3%	1.3%	1.3%	1.4%	1.3%	1.4%	**-0.2%**

Source: IWSR, Exane BNP Paribas estimates

We estimate that 72% of Diageo US business is exposed to craft (tequila and scotch are relatively safer from the threat of craft), c.30% of group EBIT. While Diageo has reacted to the craft phenomenon and has started to embrace it, ultimately it is a big brand business on high margins (43%e in FY15) which is under attack.

Figure 6: 72% of Diageo US business (30% of group EBIT) is exposed to craft

Overview of Diageo US business by category, exposure to craft and examples of craft initiatives

Diageo (41% of FY14 profit in the US)	% of US sales	2014 US value share	Chg in value share 2014 vs 2011	Category exposure to craft	Example of US craft initiatives
Vodka	25%	25.7%	-0.9%	High	-
Canadian whisky	15%	52.7%	-0.1%	High	-
Scotch	14%	40.9%	1.5%	Low	-
Rum	11%	33.7%	-0.4%	High	-
US whiskey	6%	11.9%	1.3%	High	Orphan Barrel Project, Blade & Bow
Beer	6%	1.0%	-0.1%	High	-
Liqueurs	5%	11.2%	-3.8%	High	-
Gin	3%	24.6%	-1.1%	High	Limited editions of Tanqueray
Tequila	3%	6.6%	1.4%*	Low	-
Other (incl. wine & RTD)	11%				

*Source: IWSR, Diageo, Exane BNP Paribas estimates * Diageo acquired tequila brands DeLeon and Peligroso in 2014*

Diageo's current dependence on flavours is also a worry: we estimate that two-thirds of Diageo's growth in the US has come from Canadian whisky brand Crown Royal in 2015 YTD, a brand which has been super-charged by its latest flavour offering (apple). With the flavoured vodka and rum markets now in decline, we are not sure that the current flavoured whiskey fad (+74% volume growth in 2014) is sustainable.

Figure 7: Diageo has been hugely dependent on Crown Royal

Breakdown of Diageo US retail growth by brand, YTD (as of May 23th)

Source: AC Nielsen, Exane BNP Paribas estimates

All in all, with Diageo overly reliant on highly profitable big brands which are no longer 'cool', almost three quarters of its US sales exposed to craft, an over-reliance on the flavour fad (Crown Royal Regal Apple), and despite craft initiatives in whiskey and gin (as well as 'DistillVentures', a bespoke program to help would-be distillers with their investment), significant challenges await Diageo in the US. It might be a while before Diageo truly gets its pomp back.

Pernod is less at risk from craft than Diageo (we estimate 13% of group EBIT vs. 30% for Diageo is exposed to US craft) and we feel it is doing slightly more than Diageo in the 'craft' arena. Pernod's woes in vodka, gin and liqueurs (67% of US sales) will not be easily overcome but craft initiatives undertaken by the group in other areas such as Canadian whisky are likely to help growth. We also feel relatively optimistic about the growth of Jameson, even if some new joiners are likely to enter the category and thus extrapolating past growth into the future is a tad bullish. That said, investment will be needed if it is to realise its growth goals in the US. We expect the group to invest further in craft-like innovation in the future, be it through own initiatives (like Our / Vodka) or through acquisition(s) of craft distillers. The tripling of the salesforce dedicated to sell Pernod Ricard brands at the group's US distributors is an important step that should help organic growth in FY16 and beyond, but we feel it is likely that Pernod's growth ambitions in the US may have to be tapered somewhat at some point. Ultimately, competition has increased.

Figure 8: 70% of Pernod US business (13% of group EBIT) is exposed to craft

Overview of Pernod Ricard US business by category, exposure to craft spirits and example of craft initiatives

Pernod Ricard (18% of FY14 EBIT in the US)	**% of US sales**	**2014 US value share**	**Chg in value share 2014 vs 2011**	**Category exposure to craft**	**Example of US craft initiatives**
Vodka	35%	9.1%	-2.2%	High	Our / Vodka
Liqueurs	19%	11.8%	-2.0%	High	-
Irish whiskey	17%	81.9%	1.7%	Medium	Jameson Caskmates
Gin	13%	24.1%	-2.3%	High	-
Scotch	9%	11.9%	-1.7%	Low	-
Cognac	2%	3.8%	-0.6%	Low	-
Canadian whisky	1%	1.1%	0.7%	High	Pike Creek
Tequila	0%	2.3%	1.6%*	Low	-
US whiskey	0%	0.1%	-0.1%	High	-
Rum	0%	0.0%	0.0%	High	-
Other (incl. wine, champagne)	6%				

*Source: IWSR, Exane BNP Paribas estimates * Pernod Ricard acquired 20% of tequila Avion in 2011 and a 64% stake in 2014*

We believe Remy Cointreau has the least to lose from the craft trend in the US. Remy has high exposure to cognac which is arguably the category that is the least at risk from newcomers (the availability and cost of buying eaux-de-vie where four multinationals dominate is a barrier, as is the time taken to produce aged product). Furthermore, the group's brands that are most exposed to craft in the US (in liqueurs and rum) are perhaps closer to craft than a Captain Morgan's or a Ricard. We would expect Remy Cointreau to acquire in high-end craft distilling in the US (shopping list within), possibly in bourbon.

Spirited attack

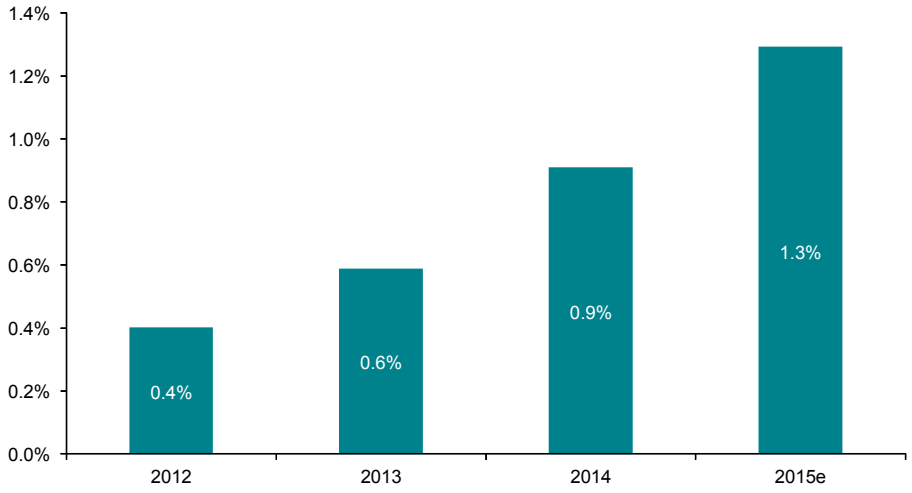
In this report, we analyse the craft spirits trend and its implications for the industry. We first examine the growth and the size of craft distillers and then argue that the barriers to entry are lowering in most Spirits categories in the US. We then analyse craft trends in each category and the reaction of each company in our coverage. Finally, we argue that small craft acquisitions are likely for the large incumbents and that the craft trend is likely to spread outside the US.

Craft spirits now account for 1% of US spirits volumes

Craft spirits have grown rapidly in the US in the last few years. Craft volumes have more than doubled in 2 years, from 0.8m 9L cases in 2012 to 1.9m in 2014. Craft now represents 0.9% of total US spirits volumes, more than double the level of two years ago (0.4% in 2012).

Figure 9: Craft spirits now account for 1% of total US spirits volumes

Craft spirits – volume share evolution in the US



Source: American Distilling Institute (ADI), IWSR, Exane BNP Paribas

Craft distillers generated 7% of US market growth in 2013 and 25% in 2014. Note that these numbers do not include brands that are most likely seen as craft by the consumer, such as Tito's (2.3m cases in 2014, up 82% y/y), but that do not technically meet the criteria of a craft brand.

While there is no consensual definition of what craft spirits are in the US, unlike craft beer, we have found two useful definitions:

– The American Distilling Institute (the ADI, "the voice of craft distilling") defines certified craft distilled spirits as products from an independently-owned distillery (less than 25% of the economic interest controlled by a non-craft alcoholic beverage company) with maximum annual sales of 42,060 9 litre-cases (100,000 proof gallons) where the product is physically distilled and bottled on-site by a certified craft producer.

– The DISCUS (Distilled Spirits Council of the US) is the national trade association representing distillers in the US. It defines 'small distillers' as distillers who sell less than 100,000 cases per annum. In 2014, 712 distillers produced less than 50,000 cases (with an average production of 3,000 cases). They accounted for 1% of the US spirits market. If one adds another 17 distillers that produced between 50,000 and 100,000 cases (with average of 80,000 cases), in total small distillers accounted for

1.7% of total US spirits volumes with a total of 3.5m cases, up from 700,000 cases or fivefold since 2010. In value terms, DISCUS estimates aggregated net sales from small distillers were between USD400m and USD450m, around 2% of total US spirits sales on our estimates. In the remainder of this note, we use the more restrictive definition of craft from the American Distilling Institute since it provides us with more granularity than the definition from DISCUS and also as it only includes genuine craft spirits. In the table below, we outline the primary differences between craft and small spirits in terms of size, average production and market share.

Figure 10: Small distillers have an estimated 2% value share in the US, of which craft is roughly half

Overview of small and craft distillers in the US

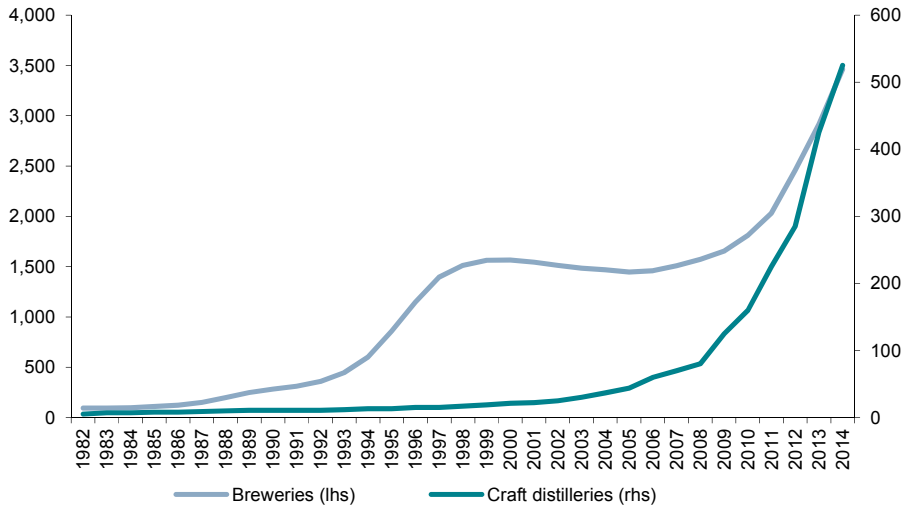
2014	Number of distillers	Avg. production ('000 cases)	Total production ('000 cases)	Volume share	Net sales (USDm)	Value share (est.)
Small distillers (< 100k cases)	729	5	3,496	1.7%	425	2.0%
of which >50k	17	80	1,360	0.7%	175 (est.)	0.8%
of which <50k cases	712	3	2,136	1.0%	250 (est.)	1.2%
of which 'craft'	525 (est.)	4 (est.)	1,922 (est.)	0.9%	225 (est.)	1.1%

Source: DISCUS, American Distilling Institute, Exane BNP Paribas estimates

There has been a sharp increase in the number of distilleries in the US in the last ten years: from less than 50 in 2003 to more than 600 in 2014 (including more than 500 craft distilleries) according to the American Distilling Institute. Note that there are fewer distilleries than distillers (more than 700 according to DISCUS) since several of the very small distillers share a distillery. The rapid increase in the number of distilleries is similar to that observed for craft breweries (there are more than 3,500 breweries today, from 1,500 breweries just 6-7 years ago, see The Craft Invasion for more details). Indeed, between 2008 and 2012, the number of distilleries (+125%) has increased faster than the number of breweries (+61%) although this is from a smaller base. The acceleration of the craft scene came about in beer and spirits around the same time; during the financial crisis. Both are creating and fulfilling demand for alternatives to the mass brands.

Figure 5: Craft distilleries in the US - 10x in ten years

Number of craft distilleries and breweries in the US



Source: Brewers Association, American Distilling Institute, Exane BNP Paribas

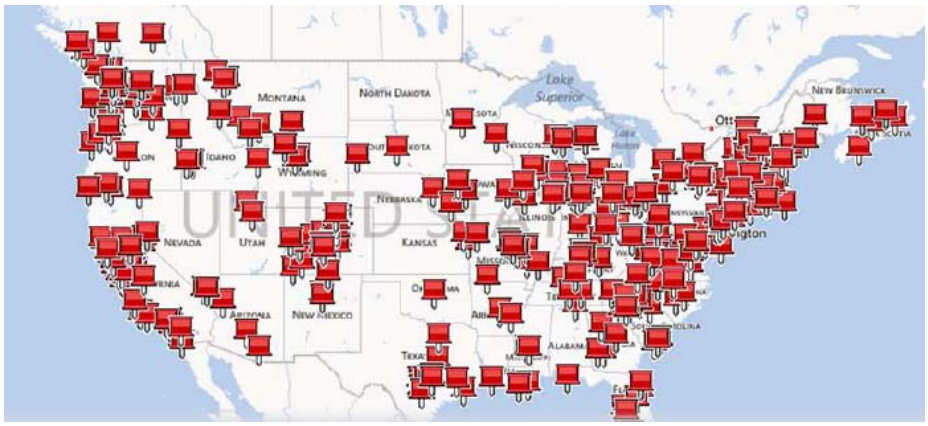
Note that as for the beer, the number of distilleries in the US is still far from the peaks reached in the pre-prohibition years. According to the American Distilling Institute, there were more than 7,000 distilleries in operation in the US at the beginning of the 1900s.

Hot spots for craft distilling - West Coast, Colorado, and East Coast

The states of Washington, California and New York form the top three states for craft distilling in the US in terms of number of distilleries. As of 2013, these three states had 140 craft distilleries, a third of the nation's total. Note also that the three West Coast states of Washington, Oregon and California account for 29% of the nation's total (425). Other states with a high number of craft distilleries include Colorado and Texas.

Figure 2: Hot spots for craft distilling are mostly on the West and East Coasts

Distilleries in the US, 2013

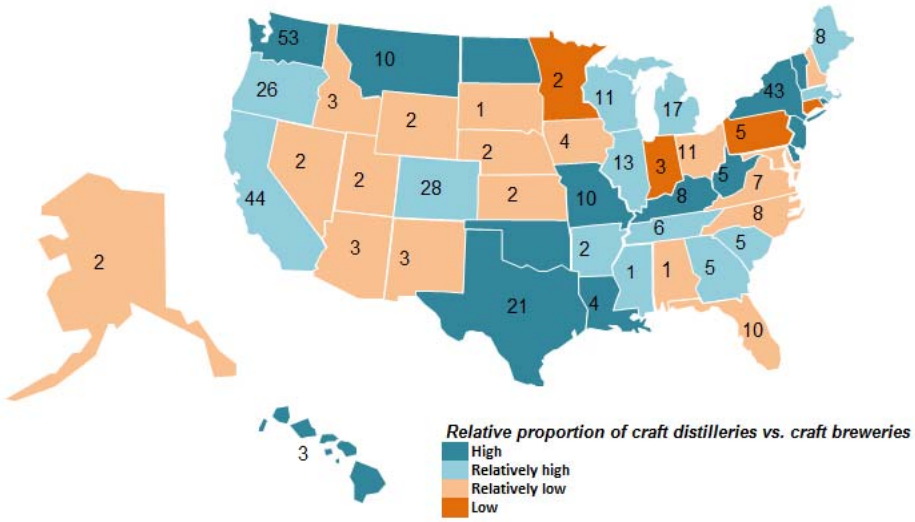


Source: American Distilling Institute

We have compared the geographical location of craft distilleries to the location of craft breweries in order to get a feel for the penetration of craft distilling relative to craft brewing. While there are more craft breweries than craft distilleries in every state in the US (on average there are 7 craft breweries for each craft distillery), the proportion varies greatly according to the state. The map below shows that in the states of New York, Washington, Texas, Missouri and Montana, the number of craft distilleries is both high in absolute terms (>10) and relative to the number of craft breweries.

Figure 11: There are a lot of craft distilleries in NY, Washington, Texas, Missouri and Montana states (both in absolute terms and relative to craft breweries)

Number of craft distilleries by state (number, 2013) and relative penetration of craft distilleries vs. craft breweries (colour)

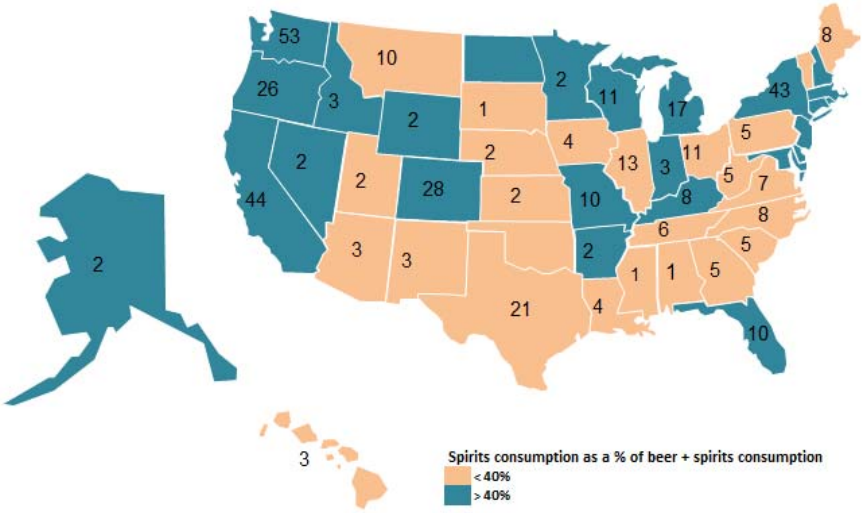


Source: American Distilling Institute, Brewers Association, Exane BNP Paribas. Colour coding: We divide number of craft breweries by number of craft distilleries – relative proportions below 6 are defined as 'High', 6-10 'Relatively high', 10-20 'Relatively low', and >20 'Low'.

Looking at the geographical dispersion of craft distilleries compared to the share of throat of spirits within each US state shows that there are more craft distilleries where spirits consumption is high. There are exceptions such as Texas, Illinois and Montana but overall, there are more craft distilleries in 'spirits states' than in 'beer states' (perhaps this is no more than a statement of the obvious).

Figure 12: There are more craft distilleries in 'spirits states' than in 'beer states'

Number of craft distilleries by state vs. share of spirits consumption relative to beer ('spirits states' in blue, 'beer states' in orange)



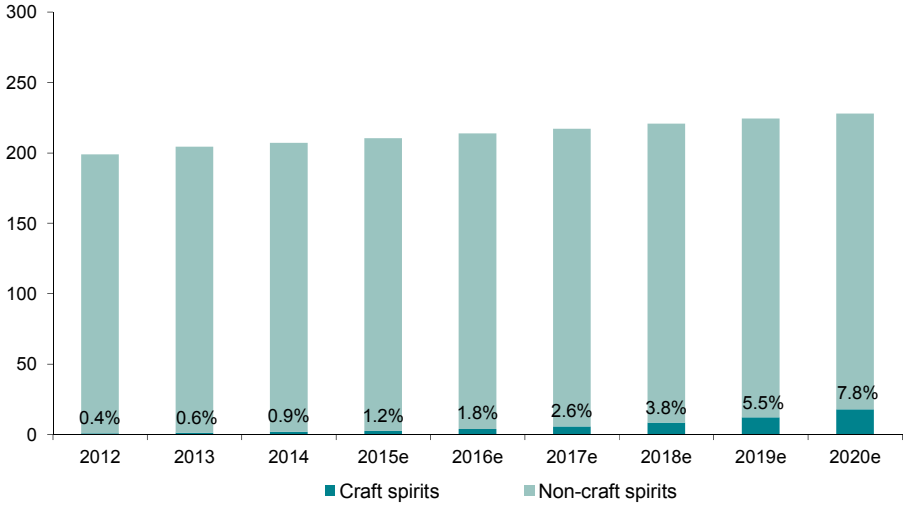
Source: American Distilling Institute, Beer Institute, DISCUS, Exane BNP Paribas estimates

US craft spirits to grow at a 45% volume CAGR?

According to the American Distilling Institute, the share of craft spirits could reach 7-8% of total US distilled spirits volumes by 2020 (from 0.9% in 2014). This would be equivalent to a c.45% volume 2014-2020 CAGR assuming that total US spirits volumes grow at an average of +1.6% (an IWSR forecast).

Figure 13: The ADI expects craft spirits to reach a 7-8% share of total US spirits volumes by 2020

Craft and non-craft spirits volume evolution in the US (in millions 9L cases)



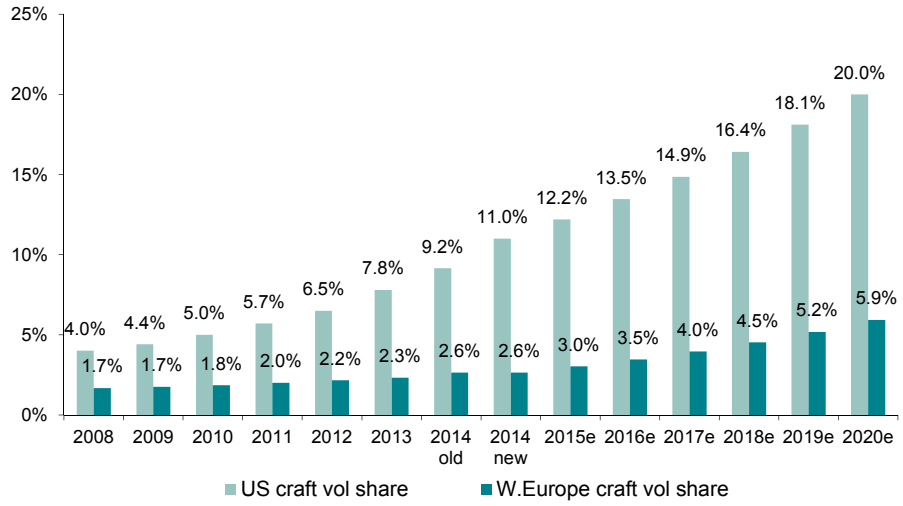
Source: Exane BNP Paribas estimates, American Distilling Institute, IWSR

Is the ADI forecast for craft spirts growth credible? We compare the expected growth trajectory of craft spirits in the US to craft beer in the US, craft beer in Western Europe and to cider growth in the US in order to take a view.

As we laid out in The Craft Invasion, based on forecasts from the Brewers Institute, the volume share of craft beer is expected to grow from 11% in 2014 to 20% in 2020, equivalent to a 9.4% volume CAGR. In Europe, we expect craft beer to grow at a 12.8% volume CAGR in 2014-2020 (the average volume growth of craft beer volumes in the US in 2007-2014).

Figure 14: We expect the share of craft beer to reach 20% in the US and 6% in Western Europe in 2020

Estimated volume share of craft beer in W. Europe (excl. Germany and Belgium) and in the US

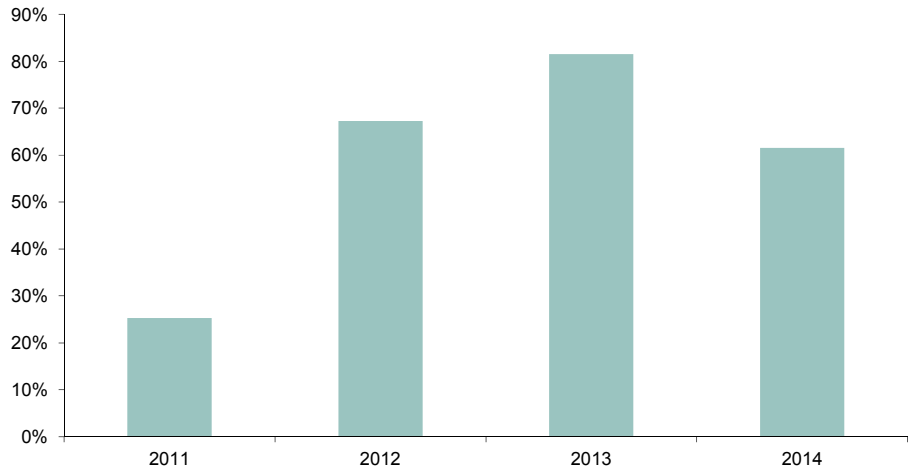


Source: Exane BNP Paribas estimates, Brewers Association

Looking at recent growth in the US cider market also provides insights. Once the preferred drink of Americans, cider was almost on the verge of evaporating in the US up until the beginning of the decade. Over the last couple of years however, its long-predicted return has at last materialised with volume growth rocketing. The category has experienced a 70% volume CAGR in the 2011-2014 period.

Figure 15: Very strong growth for cider in the US

Volume growth of cider in the US off-trade (Nielsen)



Source: AC Nielsen, Exane BNP Paribas

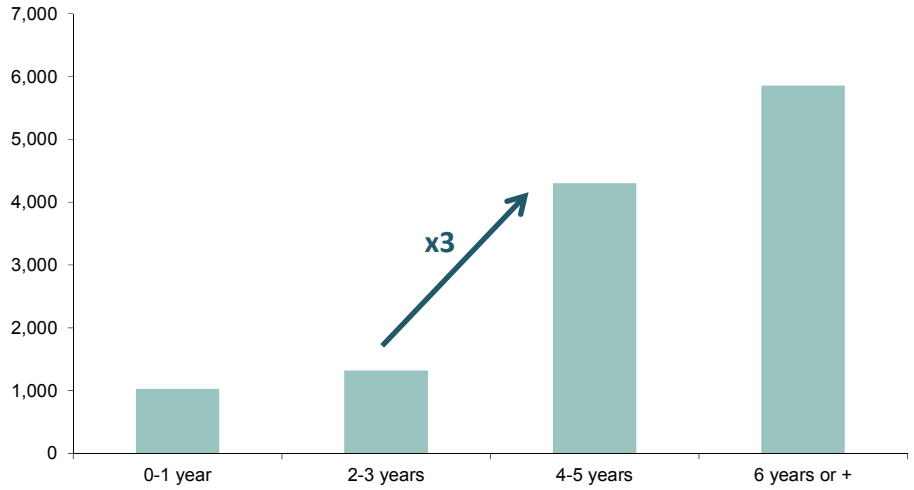
Both cider and craft spirits are supported by a quest for authenticity (cider used to be a key American drink before the 20th century) and diversity (the move away from big brands). With cider volumes accelerating in the last few years (70% volume CAGR in 2011-2014 vs. +25% in 2011), it is perhaps not too optimistic to believe that craft spirits could grow in a similar fashion over the next few years. The forecast 45% volume CAGR for 2015-2020 for craft spirits stands between the average growth we forecast for craft beer in the US (9%) and the growth of cider in the US in 2011-2014 (70%). Note that craft spirits grew volumes by +50% in 2013 and +58% in 2014.

Craft Spirits production to increase markedly

Unlike beer, which can be brewed at home in a short space of time, distilling spirits can take time. According to Clay Risen, author of "American Whiskey, Bourbon, and Rye", it can take a couple of years before even knowing if aged whiskey is good enough to sell. Craft distillers need to find a balance between high quality produce and keeping up with consumer demand. As shown in the chart below, distillers in existence for four to five years have sold on average more than 3 times more volumes than distillers in the existence for 2-3 years.

Figure 16: Distillers in existence for four to five years have sold on average more than 3 times more volumes than distillers in the existence for 2-3 years.

Average volume sold (in 9L cases) by distiller per years in production

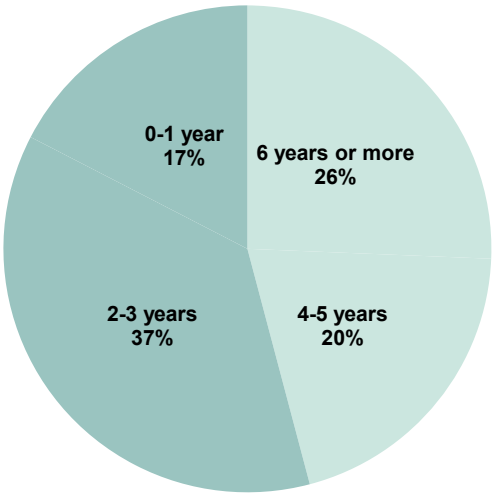


Source: American Distilling Institute, Exane BNP Paribas estimates

Given that almost three-quarters of US distillers have been in operation for 5 years or less, indeed 54% of them have existed for less than three years, it would appear that there is a lot of new supply due to hit the market in the next few years.

Figure 9: Most craft distillers have been in existence for less than three years

Number of distillers by years in production, US



Source: American Distilling Institute, Exane BNP Paribas

If we conservatively assume 80 net distillery openings every year (net of bankruptcies), we forecast that there will be 1,005 craft distilleries in the US in 2020 (i.e. twenty times more than in 2003, x2 vs. 2014). Using the average production by distiller, depending on how many years they have been operating for, we can therefore forecast total production volumes by 2020. Our main assumptions and our estimates are outlined below:

Figure 17: We expect the number of distilleries to double by 2020 and a 45% volume CAGR

Modelling craft spirits volume growth

Producers by years of operation	**2014**	**2015e**	**2016e**	**2017e**	**2018e**	**2019e**	**2020e**
6 years or more	135	188	263	335	405	475	546
4-5 years	106	149	146	140	139	142	146
2-3 years	193	142	134	138	145	150	154
0-1 year	91	126	143	151	156	158	159
Total	**525**	**605**	**685**	**765**	**845**	**925**	**1,005**
New entrants (net of bankruptcies)	100	80	80	80	80	80	80
Avge. prod. by age of operation (9l cases)							
6 years or more	5,858	7,615	9,900	12,870	16,731	21,750	28,275
y/y growth		*30.0%*	*30.0%*	*30.0%*	*30.0%*	*30.0%*	*30.0%*
4-5 years	4,300	5,160	6,192	7,430	8,916	10,700	12,840
y/y growth		*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*	*20.0%*
2-3 years	1,321	1,453	1,598	1,758	1,934	2,127	2,340
y/y growth		*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*
0-1 year	1,031	1,031	1,031	1,031	1,031	1,031	1,031
y/y growth		*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Total		**22.0%**	**22.7%**	**23.3%**	**23.9%**	**24.5%**	**24.9%**
Total production (in '000 9l cases)							
6 years or more	789	1,430	2,599	4,316	6,781	10,328	15,434
4-5 years	457	771	903	1,039	1,240	1,519	1,877
2-3 years	255	206	214	243	280	320	361
0-1 year	94	130	147	156	161	163	164
Total cases	**1,894**	**2,537**	**3,863**	**5,755**	**8,462**	**12,330**	**17,835**
y/y growth		***34%***	***52%***	***49%***	***47%***	***46%***	***45%***
of which organic growth		*22%*	*23%*	*23%*	*24%*	*24%*	*25%*
Craft spirits 2014-2020 CAGR	**45%**						
Total market ('000 9l cases)	**207,202**	**210,518**	**213,886**	**217,308**	**220,785**	**224,317**	**227,907**
y/y growth (IWSR forecast)		*1.6%*	*1.6%*	*1.6%*	*1.6%*	*1.6%*	*1.6%*
Share of craft spirits	**0.9%**	**1.2%**	**1.8%**	**2.6%**	**3.8%**	**5.5%**	**7.8%**

Source: ADI, IWSR, Exane BNP Paribas estimates. Note: 2014 production also includes an estimated 300k 9L cases of Spirits of unknown age (based on the % of distillers who didn't respond to the ADI survey)

If craft spirits were to grow at a 45% volume CAGR to 2020, they would capture 77% of the total incremental growth (in terms of number of cases) of the US spirits market over this period on our estimates. This would result in non-craft spirits growth of only 0.2% on average.

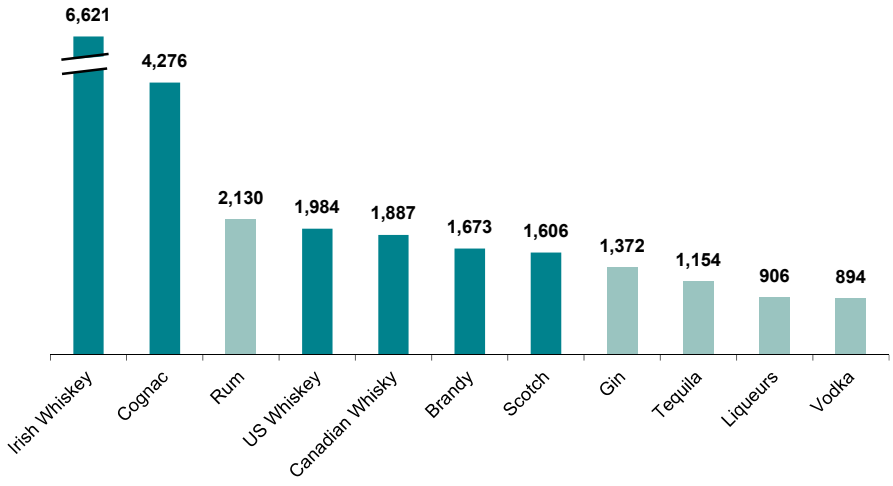
In terms of sensitivity, note that these numbers would respectively be 35% (instead of 77%) and 0.7% (instead of 0.2%) if craft spirits grew at a +30% CAGR.

Barriers to entry lowering in US Spirits

Intuitively one might think that craft spirits would be more skewed towards white spirits such as vodka or gin. Brown spirits, such as whisk(e)y, often require longer ageing periods. Single malt whiskies are commonly aged for 10 to 21 years and while bourbons typically age faster than this, it can still take several years to make a good quality bourbon. This can be challenging for micro-distillers since it can take a while before a return on investment is made. Then there is the jurisdiction consideration. Many brown spirits need to be produced in a particular area to be certified, such as bourbon (the US), scotch (Scotland) or cognac (a region within France). This creates an additional barrier. It is perhaps of little surprise then that the brown spirits categories are more concentrated than white spirits…..and indeed have become more concentrated since 2010…..

Figure 8: Brown spirits are more concentrated than white spirits…

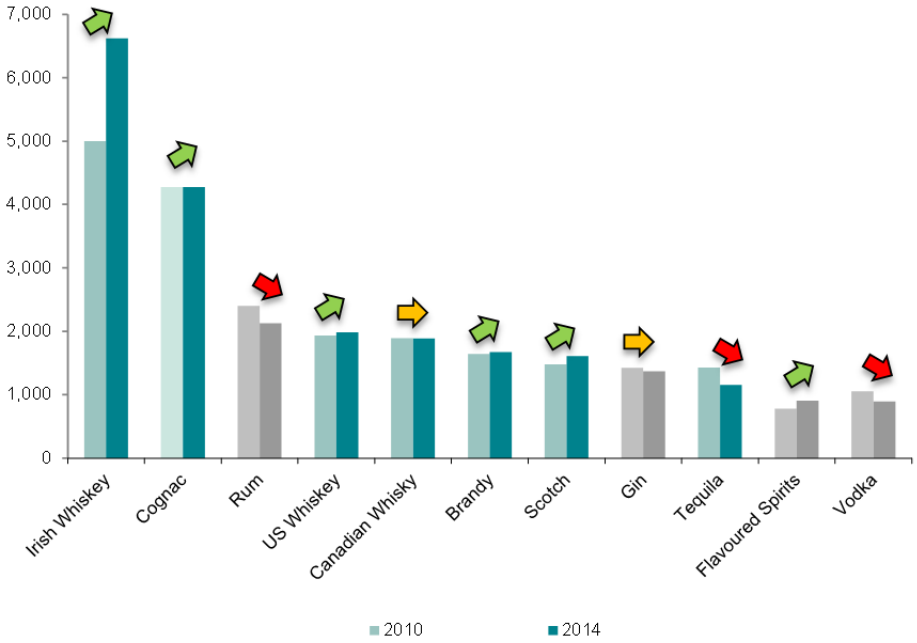
US HHI per Spirits category, 2014, brown spirits highlighted in dark green



Source: IWSR, Exane BNP Paribas. Note: HHI is calculated by squaring the market share of each company and then summing the resulting numbers. HHI can range from close to zero to 10,000. The closer a market is to being a monopoly, the higher the HHI / market concentration. Note that some rums can be considered brown spirits

Figure 18: … and have become more concentrated since 2010

US HHI per Spirits category, 2014 vs. 2010, brown spirits highlighted in dark green



Source: IWSR, Exane BNP Paribas. Note: HHI is calculated by squaring the market share of each company and then summing the resulting numbers. HHI can range from close to zero to 10,000. The closer a market is to being a monopoly, the higher the HHI / market concentration. Note that some rums can be considered brown spirits

In the table below, we summarise the key characteristics of each Spirits category:

Figure 19: Spirits categories - definitions (spirits with geographical constraints highlighted in green)

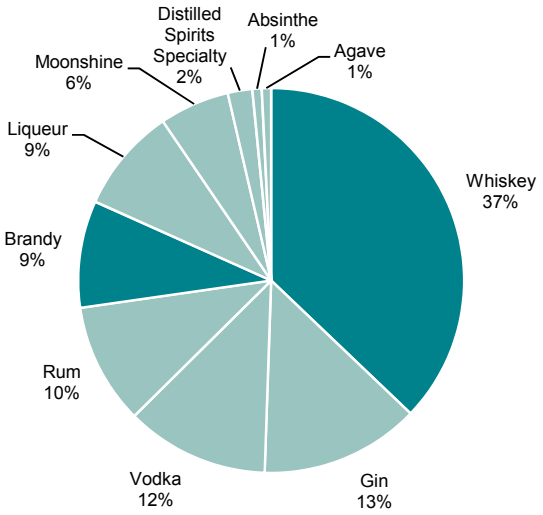
Vodka	Spirits distilled from any material at or above 95% alcohol by volume (190 proof), and if bottled, bottled at not less than 40% alcohol by volume (80 proof)
Bourbon	Whisky **produced in the U.S**. at not exceeding 80% alcohol by volume (160 proof) from a fermented **mash of not less than 51 percent corn** and stored at not more than 62.5% alcohol by volume (125 proof) **in charred new oak containers**
Straight Bourbon	Bourbon whisky stored in charred new oak containers **for 2 years or more** "Straight Bourbon Whisky" can include mixtures of two or more straight bourbon whiskies **provided all of the whiskies are produced in the same state**
Tennessee whiskey	Spirit **manufactured in Tennessee**; filtered through maple charcoal prior to aging, also known as the Lincoln County Process; made from grain that consists of at least 51% corn; distilled to no more than 80% abv; aged in new charred oak barrels; placed in the barrel at no more than 62.5% abv; and bottled at not less than 40% abv.
Rye Whisky	Whisky produced at not exceeding 80% alcohol by volume (160 proof) from a fermented **mash of not less than 51 percent wheat** and stored at not more than 62.5% alcohol by volume (125 proof) **in charred new oak containers**
Scotch	Whisky **produced in Scotland** from **water and malted barley (to which only whole grains of other cereals may be added)** all of which have been: 1 / processed into mash at an alcoholic strength by volume of less than 94.8 percent 2/ converted into a fermentable substrate only by endogenous enzyme systems and 3/ **fermented only by the addition of yeast**. It has to **be matured in Scotland in oak casks of a capacity not exceeding 700 litres for a period of not less than 3 years**. No substance can be added except water or plain caramel colouring. The minimum alcoholic strength by volume is 40%
Irish Whiskey	Whiskey distilled on the island of Ireland from **a yeast-fermented mash of cereals** (saccharified by the diastase of malt contained therein, with or without other natural diastases) at an **alcoholic strength of less than 94.8% by volume** in such a way that the distillate has an aroma and flavour derived from the materials used. The product has to **be aged for at least 3 years in Ireland in wooden casks of a capacity not exceeding 700 litres.**
Gin	Spirits with a main characteristic flavour derived from juniper berries produced by distillation or mixing of spirits with juniper berries and other aromatics or extracts derived from these materials and bottled at not less than 40% alcohol by volume (80 proof)
Brandy	Spirits distilled from the fermented juice, mash or wine of fruit or from its residue at less than 95% alcohol by volume (190 proof) having the taste, aroma and characteristics generally attributed to brandy and bottled at not less than 40% alcohol by volume (80 proof)
Cognac	Grape brandy distilled **in the Cognac region of France in compliance with the laws and regulations of the French Government** (the main constraint being that maturation should be **at least two years in Limousin oak casks**)
Rum	Spirits distilled from the fermented juice of sugar cane, sugar cane syrup, sugar cane molasses or other sugar cane by-products at less than 95% alcohol by volume (190 proof) having the taste, aroma and characteristics generally attributed to rum and bottled at not less than 40% alcohol by volume (80 proof)
Tequila	Spirits **distilled in Mexico in compliance with the laws and regulations of the Mexican Government** from a fermented mash **derived principally from the Agave Tequilana Webe**r ("blue" variety), with or without additional fermentable substances having the taste, aroma and characteristics generally attributed to Tequila and bottled at not less than 40% alcohol by volume (80 proof)
Liqueur	Flavoured spirits product containing not less than 2½% by weight sugar, dextrose, levulose or a combination thereof made by mixing or redistilling any class or type of spirits with or over fruits, flowers, plants or pure juices therefrom or other natural flavouring materials or with extracts derived from infusions, percolation or maceration of such materials

Source: ttb.gov, gov.uk, Exane BNP Paribas

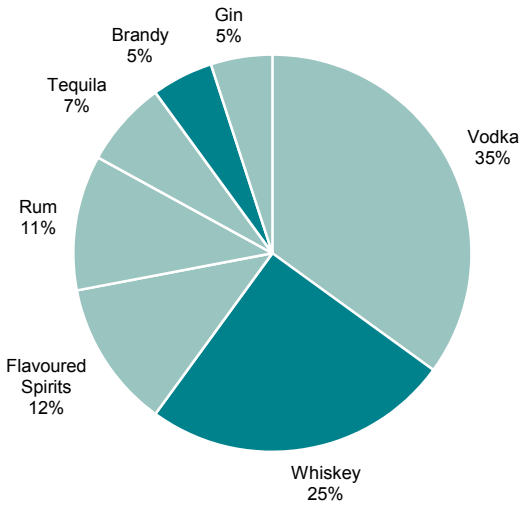
Interestingly though, in the US, whiskey is by far the largest category in terms of the number of certified craft brands: 37% of the craft spirit brands certified by the ADI are whiskey brands.

Figure 20: There are three times more craft whiskey brands than craft vodka brands in the US

ADI-certified craft spirits brands breakdown, by category



US spirits volume breakdown, by category



Source: American Distilling Institute, IWSR, Exane BNP Paribas.

A few observations are worthy of comment here:

– Firstly and quite understandably, there is no craft cognac or craft scotch in the US craft spirits landscape. This is explained by the higher regulatory barriers for these categories, mostly in terms of location of production and maturation (as cited above).

– Secondly, while technically not tequila, several agave spirits brands have developed. These are very similar to tequila (agave-based spirits) but are not produced in the Jalisco state in Mexico and hence can't be labelled as tequila.

– Thirdly, gin's share of craft spirits is more than twice as large as its share of the broader US spirits market. Whereas good whisky and rum can take years to produce, an award winning gin can be produced in just a few days. According to Ed Pilkington, a marketing director at Diageo: "gin takes about 24 hours of steeping and steaming, followed by three days of leaving it to rest."

– Fourthly, the relatively high share of moonshine is noticeable. Also called white lightning or mountain dew, and typically made with corn mash, moonshine is basically a white whiskey (i.e. an un-aged whiskey) that was typically produced illicitly, mostly in the Appalachian region. While the term "moonshine" has often implied that the liquor has been produced illegally, you can also see the term on legal bottles in attempt to brand products in a 'cool' manner.

– If we take moonshine and whiskey together, the enlarged 'whiskey' category accounts for 43% of craft spirit brands in the US and is more than three times larger than the next largest craft category (gin). One of the explanations behind this is the renaissance in American whiskey in recent years. Another explanation could be gender. AC Nielsen and Beam Suntory commented in 2014 that around 37% of whiskey drinkers in 2014 were women, up from only 7% in 2012 in the US.

In 2008/2009, 56% of craft distillers owned at least one vodka brand according to the American Distilling Institute while only 41% owned a whiskey brand. In 2012/2013, 49% of craft distillers owned a vodka brand while the proportion of those owning a whiskey brand rose significantly to 64%. We believe that this increase is as a result of ageing whiskey coming on-shelf.

Figure 21: 64% of craft distillers offered a whiskey brand in 2012/13, vs. 38% in 2006/07

Proportion of craft distillers who offer a given product

	Vodka	Gin	Whiskey	Rum	Other
2006/2007	48%	31%	38%	24%	69%
2008/2009	56%	32%	41%	29%	44%
2010/2011	44%	25%	52%	20%	41%
2012/2013	49%	36%	64%	28%	36%

Source: American Distilling Institute, Exane BNP Paribas

With many craft distillers commencing operations with a white spirits offering, to aid distillery economics as they also produce aged whiskey, it is no surprise that vodka remains a popular category: roughly half of new entrants have a vodka product. Note that the drop in the 'Other' category is due to the fact that prior to the crisis, new entrants were much more likely to be 'farm wineries' than now, and those wineries would usually produce brandies, cordials or eaux-de-vie. With today's new entrants mostly starting their business from scratch, the share of these spirits has dropped.

Category deep-dive

Diageo and Pernod Ricard losing market share in the US

In the table below, we show that Diageo and Pernod Ricard have lost 140 bps and 90bps of value share respectively in the US since 2010. In the same period, Bacardi lost 150bps of share while Brown-Forman, Heaven Hill, Campari and Remy Cointreau broadly held their share constant. Sazerac has gained share due to the resounding success of Fireball (a cinnamon whiskey-based liqueur) and for Beam, now part of Suntory, the weight of American whiskey has been the main driver of its share gains.

Figure 22: Diageo and Pernod Ricard are losing market share in the US

Evolution of value shares, all spirits, US

	2008	2009	2010	2011	2012	2013	2014	2008-2014
Diageo	23.2%	22.6%	22.8%	22.6%	22.4%	22.1%	21.4%	**-1.7%**
Beam Suntory	7.0%	7.4%	7.9%	8.4%	8.5%	8.4%	8.5%	**1.5%**
Pernod Ricard	9.2%	9.0%	8.7%	8.6%	8.4%	8.2%	7.8%	**-1.4%**
Bacardi	9.9%	9.0%	9.0%	8.7%	8.1%	8.0%	7.5%	**-2.3%**
Sazerac	4.8%	4.9%	4.8%	4.7%	4.9%	5.2%	6.1%	**1.3%**
Brown Forman	6.0%	6.3%	5.9%	5.9%	6.0%	5.9%	5.9%	**-0.1%**
Heaven Hill	3.1%	3.3%	3.2%	3.2%	3.2%	3.1%	3.2%	**0.1%**
Campari	2.7%	2.8%	2.8%	2.8%	2.8%	2.8%	2.7%	**0.1%**
Remy Cointreau	1.5%	1.3%	1.3%	1.3%	1.4%	1.3%	1.4%	**-0.2%**

Source: IWSR, Exane BNP Paribas estimates

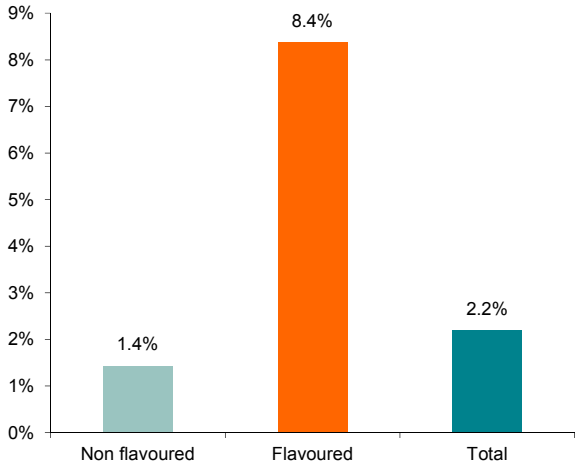
With American whiskey and flavours being key drivers of industry growth in the US, we start our category analysis with these two segments.

Flavoured whiskey drove more volume growth than non-flavoured spirits in 2014

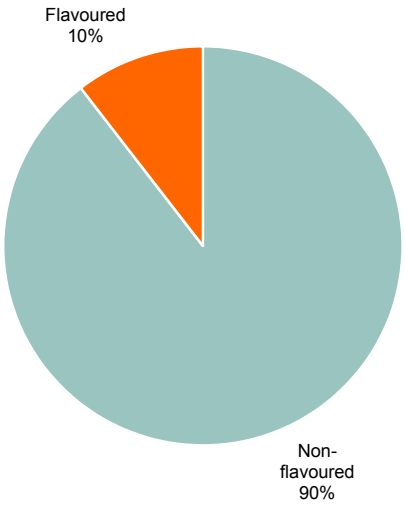
Americans are keen on flavours. Accounting for 24.6m cases according to DISCUS, 10% of shipments, flavoured spirits grew by 1.9m cases (+8% y/y) vs. 2.2% for the overall market in 2014. Non-flavoured volumes increased 1.4% in 2014.

Figure 23: Flavoured spirits accounted for 10% of US spirits shipments and grew 8% in 2014

Breakdown of growth in US Spirits shipments - 2014



Breakdown of US Spirits shipments, 2014



Source: DISCUS, Exane BNP Paribas estimates

Flavoured whiskey volumes were the key driver of growth in total flavoured spirits, up 74% y/y in 2014, accounting for 1.8% of the market:

Figure 24: Flavoured whiskey drove more volume growth than all of non-flavoured spirits in 2014 (2.8mn cases vs 2.6mn cases)

Overview of flavoured and non-flavoured volume growth

	2013 shipments (mn cases)	Growth (mn cases)	Growth (% y/y)	2014 shipments (mn cases)
Total	205.7	4.5	2.2%	210.2
Non-flavoured	183.0	2.6	1.4%	185.6
Flavoured	22.7	1.9	**8.4%**	24.6
o.w.				
Whiskey	*3.8*	*2.8*	***73.7%***	*6.6*
Vodka				*13.0*
Rum				*5.0*
Vodka+Rum	*18.9*	*-0.9*	***(4.8%)***	*18.0*

Source: DISCUS, Exane BNP Paribas estimates

American whiskey

In 2006/2007, 38% of craft distillers owned an American whiskey brand. In 2012/2013, the proportion of craft distillers owning a whiskey brand rose significantly to 64%:

Figure 25: 64% of craft distillers now have a whiskey brand (vs. 38% in 2006/07)

Proportion of craft distillers who offer a Spirits product

	Vodka	Gin	Whiskey	Rum	Other
2006/2007	48%	31%	38%	24%	69%
2008/2009	56%	32%	41%	29%	44%
2010/2011	44%	25%	52%	20%	41%
2012/2013	49%	36%	64%	28%	36%

Source: American Distilling Institute, Exane BNP Paribas

There are now around 500 ADI-certified craft whiskey brands in the US.

Figure 26: Examples of craft whiskey brands

Source: Mensjournal.com

A key driver of growth in American whiskey has been the successful marketing of the category to women. While only 7% of whiskey volumes were consumed by women in 2012 according to Nielsen, this proportion rose to 37% in 2014. This is a very significant increase in such a short amount of time.

While Brown-Forman (Jack Daniel's) has lost share of the US whiskey category according to IWSR, the other big two (Beam and Diageo) have gained ground since 2010.

Figure 27: Diageo and Beam have been gaining share in US whiskey

Evolution of value shares, US Whiskey, US

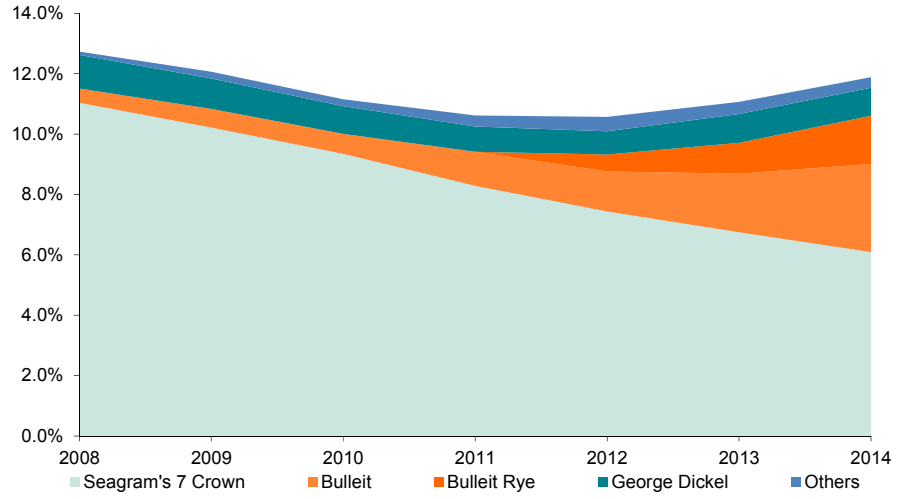
	2008	2009	2010	2011	2012	2013	2014
Brown Forman	35.8%	37.1%	35.5%	35.6%	35.8%	34.8%	33.4%
Beam Suntory	26.9%	27.3%	30.0%	30.0%	30.2%	30.0%	30.8%
Diageo	12.7%	12.1%	11.2%	10.6%	10.6%	11.1%	11.9%
Heaven Hill	7.2%	7.3%	7.5%	7.9%	7.7%	7.8%	8.4%
Campari	4.4%	4.7%	4.7%	4.8%	4.9%	5.2%	4.8%
Sazerac	6.5%	5.7%	5.5%	5.0%	4.6%	4.3%	4.0%

Source: IWSR, Exane BNP Paribas estimates

For Diageo, share gains are largely as a result of the success of bourbon and rye brand Bulleit (and Tennessee whiskey brand George Dickel to a lesser extent), which has offset significant share losses at Seagram's 7 Crown in the last two years:

Figure 28: Diageo's silver Bulleit

Value share of Diageo US whiskey brands

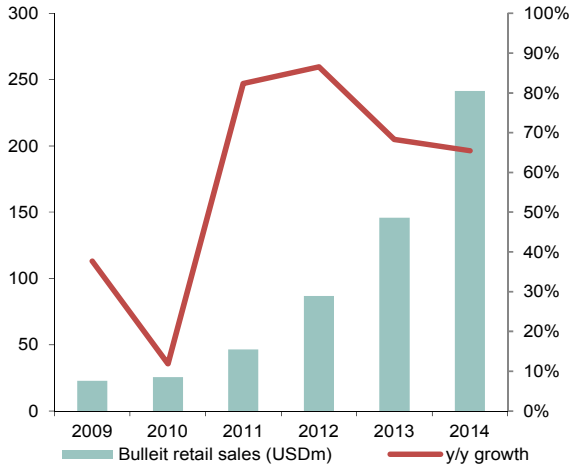


Source: IWSR, Exane BNP Paribas

Bulleit sales increased 65% in 2014, +68% in 2013 and +87% in 2012. The brand now holds a 4.5% share of the US whiskey market. Diageo announced in May 2014 its intention to invest $115 million to build a new 750,000 9-litre case distillery and six barrel warehouses. This capacity is slightly more than the total existing volume of Bulleit (736,000 cases in 2014 according to IWSR). Along with Bulleit Bourbon, *"the facility will distil a number of current and future Diageo bourbon and North American Whiskey brands"*. Diageo aims to have the distillery operational in late 2016. This investment will aid the group's plan to roll out Bulleit internationally, from Brazil to Australia and Spain to China (see map below).

Figure 29: Bulleit growing strongly in the US and is now being rolled out internationally

Bulleit retail sales (lhs) and sales growth (rhs) in the US



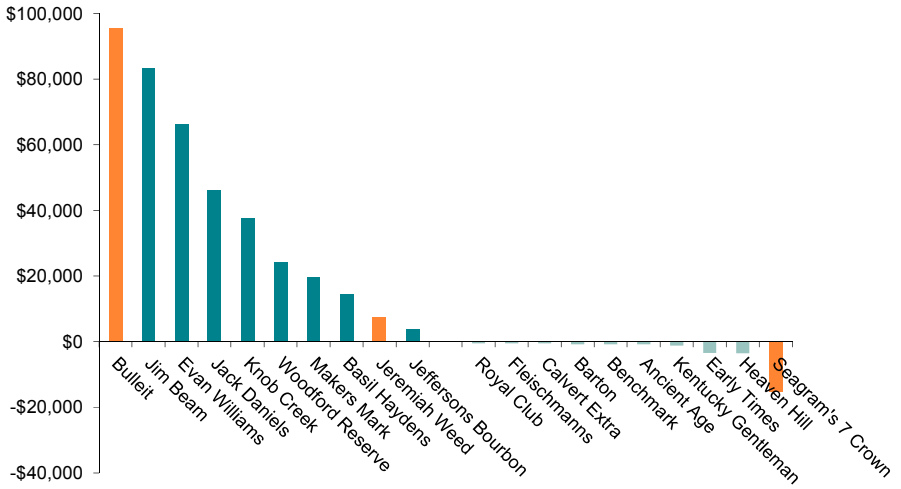
Bulleit - international expansion plan

Source: Diageo, IWSR, Exane BNP Paribas estimates

On the other hand, Diageo's Seagram's 7 Crown is struggling. Since 2008, volume and retail sales of the brand have declined in each year according to IWSR, with the brand being seen as a drink that "your dad mixed with 7-Up decades ago" (a mix known as "7 and 7"). Diageo has put little support behind the brand. Having a large brand at the low end of the market can have its benefits in terms of generating economies of scale and attracting a bigger consumer pool, but these benefits are steadily eroding as the brand slowly dies. It is perhaps not a crazy notion to say that Diageo may cut its losses on the brand at some point in the future, as it did on Bushmills, if attempts at rejuvenating it are unsuccessful.

Figure 30: Diageo US at the extremes in US Whiskey

US Whiskey retail sales growth, Top and bottom 10 brands, 2014 (Diageo brands in orange)



Source: IWSR, Exane BNP Paribas

Diageo has a stated ambition to become "the number one craft distiller in North American whiskey in the US". The group launched the Orphan Barrel Whiskey project in 2014 (a range of expensive whiskeys) and recently launched Blade and Bow.

Figure 31: Diageo wants to "be the number one craft distiller in North American whiskey in the US"

Two craft American whiskeys launched in 2014 by Diageo's Orphan Barrel Whiskey project

Diageo's Blade and Bow (launched in Q215)

Source: The Spirits Business, The Whiskey Wash

Diageo is not alone in going down the craft whiskey route. One of Diageo's key competitors in this category (Beam Suntory) has recently launched its "Jim Beam Signature Craft" edition, further evidence that large players are trying to jump on the craft bandwagon.

Figure 32: A mainstream whiskey brand marketed as 'craft'

Jim Beam Signature Craft

Source: drinkspirits.com

Diageo has a lot to lose in Canadian whisky

In Canadian whisky, Diageo relies mostly on Crown Royal (it also sells Seagram's VO). While this brand outperformed the market from 2010 to 2013, it slowed last year losing substantial share within the Canadian whisky category.

Figure 33: Diageo lost share in Canadian whisky in 2014

Evolution of value shares, Canadian Whisky in the US

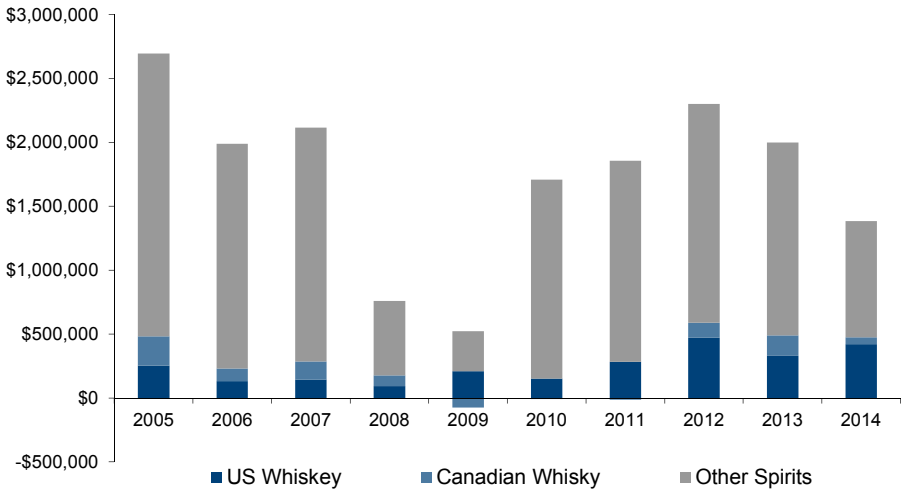
	2008	2009	2010	2011	2012	2013	2014
Diageo	54.2%	52.4%	53.0%	52.8%	52.4%	53.8%	52.7%
Beam Suntory	11.8%	12.3%	11.8%	11.6%	11.7%	11.5%	12.4%
Constellation	10.4%	10.3%	10.4%	10.4%	11.0%	10.8%	10.7%
Sazerac	7.3%	7.9%	8.1%	8.1%	7.7%	7.3%	7.1%
Brown Forman	8.2%	8.3%	8.0%	7.5%	7.1%	6.5%	6.2%
Pernod Ricard	0.4%	0.4%	0.4%	0.4%	0.6%	0.6%	1.1%
Campari	0.3%	0.3%	0.3%	0.4%	0.4%	0.4%	0.6%

Source: IWSR, Exane BNP Paribas

Given that the Crown Royal brand accounts for more than half of the category in value terms, its slowdown impacted the Canadian whisky's contribution to growth in 2014.

Figure 34: US Whiskey accounted for >30% of US industry growth in 2014

Incremental retail sales by category, US spirits market

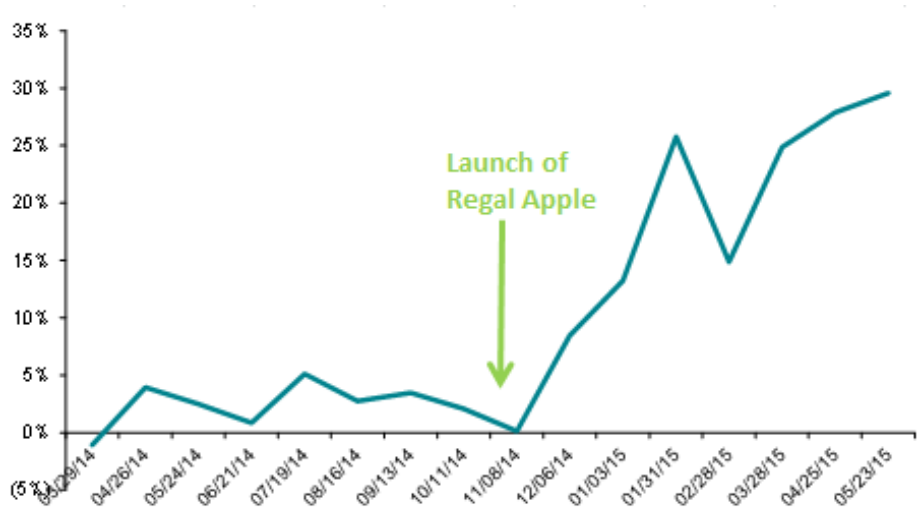


Source: IWSR, Exane BNP Paribas estimates

Diageo took action in November 2014 with the launch of Crown Royal Regal Apple, an apple-flavoured Canadian whisky variant. This launch had an almost instantaneous impact, materially boosting the brand's growth rate:

Figure 35: Apple-flavoured Crown Royal has materially boosted brand growth

Crown Royal retail sales growth in the off-trade, US

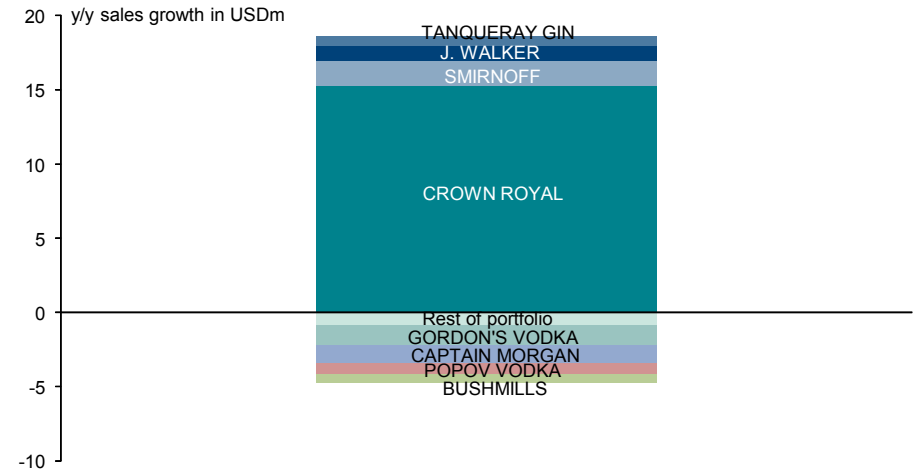


Source: AC Nielsen, Exane BNP Paribas estimates

The success of this launch has been such that, based on off-trade data, 68% of the Diageo's sales growth in the US has come from Crown Royal since the beginning of this year. Put another way, excluding Crown Royal, Diageo's sales growth in the US off-trade would +1.4%, not the +4.8% as reported by AC Nielsen.

Figure 36: Diageo has been hugely dependent on Crown Royal

Breakdown of Diageo US retail growth by brand, YTD (as of May 23th)

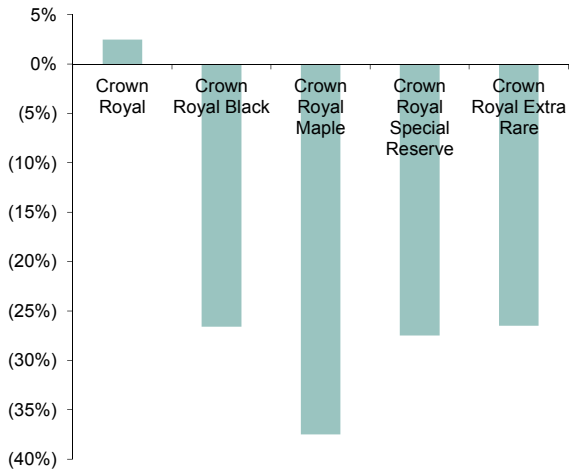


Source: AC Nielsen, Exane BNP Paribas estimates

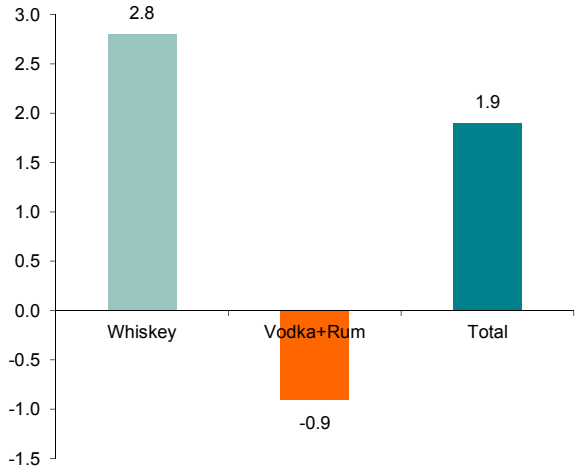
This dependence is a bit of a worry in our view. Should the current fad for flavoured whiskey fade (as it did for flavoured vodka, now in decline), Diageo's Crown Royal may find itself in a spot of bother. Diageo will be hoping that Crown Royal Maple Syrup, a variant of Crown Royal launched in November 2012, is not a sign of things to come for Regal Apple. In 2014, volumes of that variant declined 38% y/y according to IWSR (-44% according to NABCA).

Figure 37: Crown Royal's past innovations in decline

2014 - y/y volume change in sub-brands of Crown Royal



2014- y/y change of US flavoured spirits (in mn cases)



Source: IWSR, DISCUS, Exane BNP Paribas estimates

On top of its overreliance on Regal Apple, Diageo also faces the risk of increased competition as new players come into the Canadian whisky category. Via its Canadian subsidiary, Corby's, Pernod Ricard has launched Pike Creek, a "richly flavourful premium whisky" according to canadianwhisky.org. Campari acquired Forty Creek in March 2014, the fastest growing Canadian whisky brand in Canada. Positioned as a "high-end, handcrafted" whisky brand (with a price premium of c.50% vs. the market average according to Campari), the brand is well placed to benefit from the demand for super premium Canadian whiskies in the US. As of 2013, only 20% of the brand's sales were in the US and Campari intends to increase that share. This can't be good news for Diageo's very dominant position.

Figure 38: Pernod and Campari both now have a Canadian whisky brand

Pernod Ricard's Canadian Whisky Pike Creek

Campari's Canadian Whisky Forty Creek

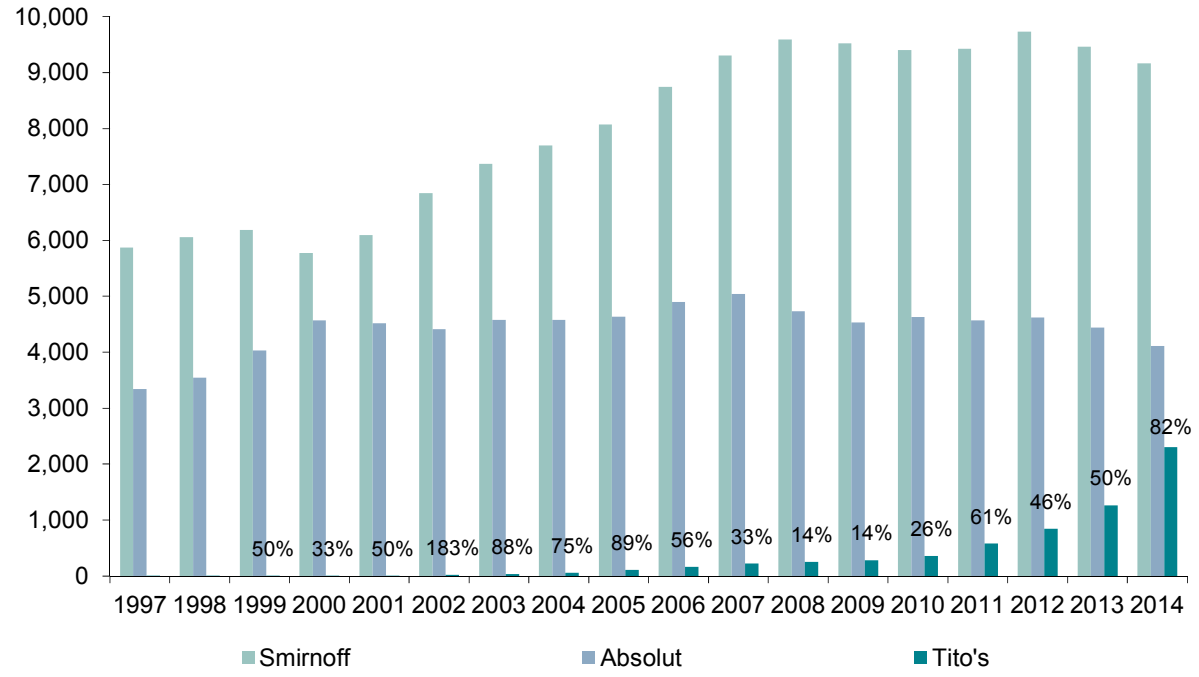
Source: The spirits business, Campari

Vodka: a nightmare for mainstream brands

Unlike whisky, white spirits such as vodka are often easier to produce, can grow very quickly with the right marketing strategy and distillers can make a quicker 'buck'. The most famous success story recently in the vodka sector is Tito's "handmade" vodka, which has grown from 56,000 cases in 2004 to 2.3m in 2014. Tito's is now more than half the size of Absolute in the US:

Figure 39: Tito's 'handmade' vodka volumes are now more than half of Absolut's volumes

Tito's vodka vs. Smirnoff and Absolut, volumes in 000s 9L cases, United States (incl. % y-o-y growth for Tito's)

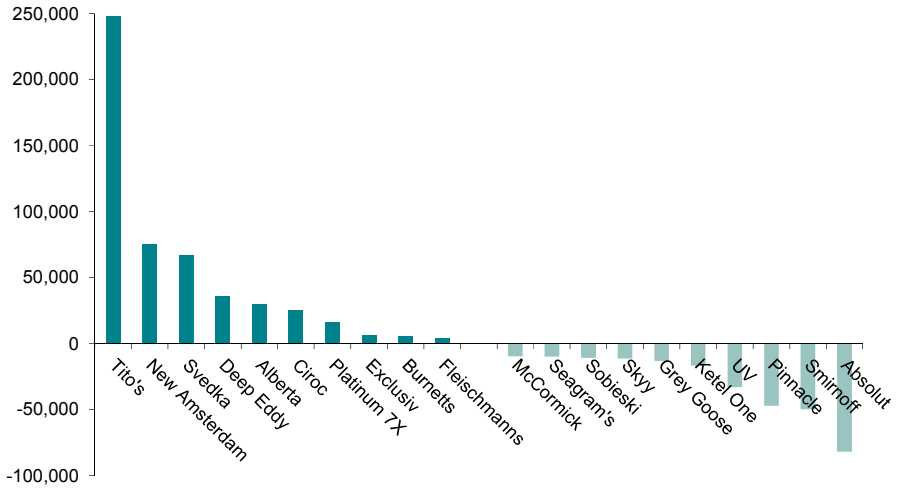


Source: IWSR, Exane BNP Paribas

Tito's has delivered a large chunk of the growth in US vodka but other brands, not marketed as craft, have also chipped in: New Amsterdam (E&J Gallo), Svedka (Constellation Brands), Alberta (Beam Suntory), Ciroc (Diageo), Platinum 7X and Fleischmann's (Sazerac) and Burnett's (Heaven Hill).

Figure 40: Tito's growth in vodka has dwarfed all other brands

Vodka incremental retail sales, Top and bottom 10 brands, US, thousand dollars, 2014



Source: IWSR, Exane BNP Paribas

These performances have resulted in share loss for the large vodka incumbents in the US. Diageo, Pernod, Bacardi, Beam, Brown-Forman and Campari have all lost ground since 2011.

Figure 41: Diageo, Pernod and Bacardi have lost market share in US vodka

Evolution of value shares, US, Vodka

	2008	2009	2010	2011	2012	2013	2014
Diageo	25.5%	24.3%	26.9%	26.6%	27.0%	26.5%	25.7%
Pernod Ricard	14.5%	13.6%	12.5%	11.4%	10.7%	9.9%	9.1%
Bacardi	12.2%	11.2%	10.5%	9.7%	8.9%	8.5%	8.3%
Sazerac	6.9%	6.9%	6.8%	6.6%	6.7%	6.2%	6.4%
Constellation	3.8%	5.0%	5.5%	5.5%	5.0%	5.1%	5.6%
Campari	5.5%	5.3%	5.3%	5.0%	4.8%	4.8%	4.7%
Beam Suntory	2.3%	3.0%	3.6%	5.5%	5.2%	5.1%	4.6%
Titos	0.6%	0.7%	0.8%	1.3%	1.7%	2.5%	4.5%
Heaven Hill	2.0%	2.2%	1.9%	2.2%	2.3%	2.4%	2.4%
Brown Forman	0.6%	0.6%	0.6%	0.6%	0.6%	0.5%	0.5%

Source: IWSR, Exane BNP Paribas

Having analysed US vodka growth rates since 2004, we make three observations:

1) Consistent outperformers are rare in vodka

Out of the 50 largest vodka brands in the US, only 6 have outperformed the market in value terms in the 2004-2008, 2008-2011 and 2011-2014 periods (dark green in the chart below): Tito's, Ciroc (Diageo), Pearl (Luxco), Burnett's (Heaven Hill), UV (Philipps Distilling Company) and Svedka (Constellation Brands).

2) Successful brands often offer good value….

A bottle of Burnetts, Fleischmanns or Exclusiv can be bought at around USD10 per bottle or even lower. Part of the success of these brands has been due to the fact that an increasing proportion of US consumers are looking for cheaper brands, propositions not typically associated with Diageo or Pernod.

3) …or have a story

A bottle of Hangar One vodka has an original shape and a clear story ("spicy grape", etc.). Tito's introduced US consumers to the concept of "handcrafted" vodka (now perhaps a dubious claim). Platinum 7x argues that its products have a smoother taste as they are distilled seven times.

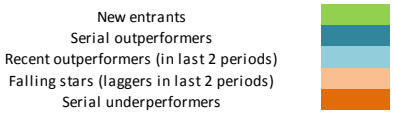
There are more vodka brands that have consistently lagged the market (in dark orange in the chart below): Popov (Diageo), Absolut (Pernod), Gordon's (Diageo) and Barton (Sazerac) to name a few.

Figure 42: More underperformers than outperformers in US Vodka

Value CAGR of vodka brands in the US (brands ranked in descending 2011-14 CAGR)

2011-2014 outperformers	2011-14 value CAGR	2008-11 value CAGR	2004-08 value CAGR
New Amsterdam	227%	n.a.	n.a.
Deep Eddy	178%	n.a.	n.a.
Exclusiv	76%	92%	n.a.
Titos	58%	35%	45%
Ivanabitch	22%	n.a.	n.a.
Hangar One	21%	14%	8%
Platinum 7X	16%	29%	n.a.
Ciroc	14%	64%	57%
Pearl	13%	32%	20%
Burnetts	10%	14%	14%
Fleischmanns	10%	7%	2%
Russian Standard	10%	31%	n.a.
Luksusowa	6%	3%	8%
Taaka	6%	9%	-4%
Aristocrat	6%	5%	3%
Crystal Head	5%	n.a.	n.a.
Crystal Palace	5%	0%	-1%
UV	5%	17%	34%
Svedka	4%	22%	53%
Belvedere	4%	5%	5%
VODKA MARKET	**3%**	**7%**	**9%**

2011-2014 laggers	2011-14 value CAGR	2008-11 value CAGR	2004-08 value CAGR
Skol	3%	2%	2%
Finlandia	3%	0%	-6%
Ketel One	2%	5%	11%
Tanqueray Sterling	1%	-2%	-4%
Skyy	1%	4%	11%
Three Olives	0%	10%	44%
Heaven Hill	0%	12%	3%
Nikolai	-1%	4%	1%
Smirnoff	-1%	4%	9%
Stolichnaya	-1%	-5%	3%
Other brands	-1%	5%	5%
Phillips	-1%	3%	2%
Sobieski	-1%	59%	n.a.
Grey Goose	-2%	-1%	19%
Georgi	-2%	3%	5%
McCormick	-2%	-2%	1%
Van Gogh	-2%	6%	17%
Pinnacle	-3%	69%	122%
Jacquin Royal	-3%	1%	2%
Vladimir	-3%	2%	3%
Absolut	-3%	-1%	2%
Kamchatka	-4%	5%	1%
Charbay	-4%	2%	28%
Seagram's	-5%	8%	16%
Gilbeys	-7%	5%	-7%
Gordons	-8%	-6%	-7%
Popov	-8%	-11%	1%
Barton	-12%	4%	8%
Wolfschmidt	-12%	10%	-17%
Fris	-20%	15%	2%



Source: IWSR, Exane BNP Paribas

Diageo's Smirnoff is losing share right now, mostly in its flavoured variants. A re-focus on Smirnoff Red would undoubtedly help although we hold doubts on whether Smirnoff can outperform the broader vodka market in an environment where big brands are less fashionable. Diageo may have more success with Ketel One. The brand's growth rate has been slowing down, lagging the broader market in both the 2008-2011 and 2011-2014 periods. We believe that Ketel One could play the card of authenticity given the heritage and history of its distillery in the Netherlands much more than it currently is.

For Pernod's Absolut, there is no easy solution. In the current environment, the brand's revised communication surrounding the heritage of the brand makes sense but again, size matters….for the wrong reasons in Absolut's case. Pernod could reduce the price gap vs. the competition but we are not sure Pernod would be happy to venture down that road - it might prove a costly and unsuccessful move. For Pernod vodka, the future may reside in the "Our / Vodka" initiative: a series of local vodkas sold in an innovative packaging format (small bottles with a cap, like beer). The "Our / Detroit", "Our / New York", "Our / Miami" (but perhaps also "Our / Paris" or "Our / Amsterdam") may resonate much better with the consumer than Absolut in the current climate.

Figure 43: A "local vodka" by Pernod

Pernod Ricard's "Our / Vodka"

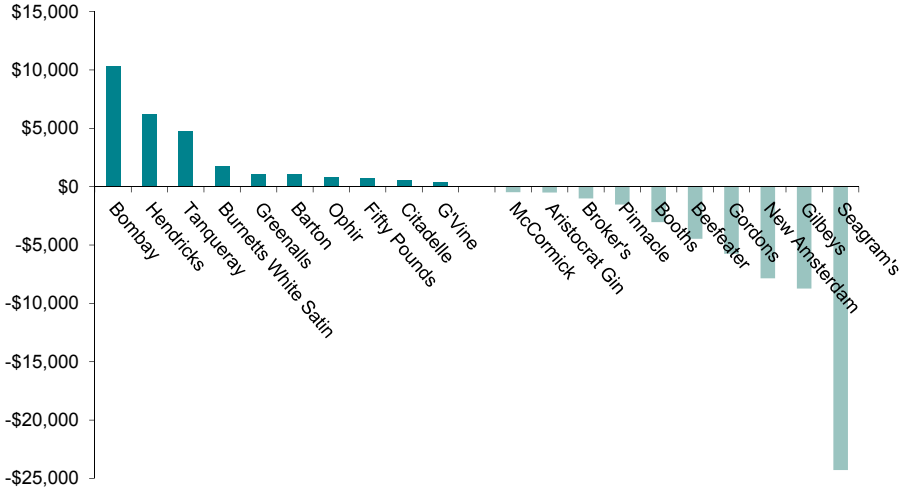
Source: Pernod Ricard

Gin: Diageo and Pernod squeezed between Bacardi and craft gins

With high-end gin proving popular lately, it is no surprise that craft is trying to get in on the act. Out of the top ten growing gin brands last year in $ terms, seven were small brands (Greenalls, Barton, Ophir, Fifty Pounds, Citadelle, G'Vine, Burnetts White Satin).

Figure 44: Of the top ten growing Gin brands last year, 7 were small brands

Gin incremental retail sales, Top and bottom 10 brands, US, 2014



Source: IWSR, Exane BNP Paribas

Pernod Ricard has lost share in US gin in every year since 2008. Beam, Diageo and Heaven Hill have lost share in every year but two. The key exception is Bacardi, whose Bombay Sapphire is performing well (one of the rare bright spots in Bacardi's portfolio).

Figure 45: With the exception of Bacardi, the big boys are generally losing share in gin

Evolution of value shares, US Gin

	2008	2009	2010	2011	2012	2013	2014
Diageo	27.4%	25.8%	25.4%	25.7%	24.8%	24.3%	24.6%
Pernod Ricard	31.2%	30.2%	27.4%	26.4%	26.4%	25.3%	24.1%
Bacardi	13.1%	12.5%	14.0%	14.9%	16.0%	17.7%	18.7%
Sazerac	4.7%	4.9%	5.6%	5.5%	5.2%	4.9%	5.1%
Beam Suntory	3.5%	3.9%	3.6%	3.3%	3.0%	2.9%	2.3%
Heaven Hill	3.0%	2.9%	3.0%	2.3%	2.2%	1.9%	2.0%

Source: IWSR, Exane BNP Paribas estimates

Similar to Diageo in whiskey with Seagram's 7, Pernod is suffering in gin with Seagram's gin. Beefeater is doing a bit better but was still down in value terms last year. Diageo is suffering with Gordon's Gin but Tanqueray is performing better. Charles Tanqueray was kind enough to leave a recipe book before passing away which, according to Diageo, could form a base to launch new craft-like gins based on 19th century's recipes. One example is Old Tom Gin, a variant of Tanqueray launched last year and which followed Tanqueray Malacca, a popular spiced gin launched in 2013. It is crucial for Diageo and Pernod to renew its gin offerings in the face of the ever-growing competition: there are around 200 craft gin brands in the US certified by the ADI. Aviation Gin, St George Spirits, Green Hat Gin and Brooklyn Gin are some of the more popular brands

Figure 46: Diageo is reviving very old gin recipes to battle against new craft gins

Diageo's Tanqueray Old Tom Gin limited edition

Some popular craft gins

Source: The Spirits Business, GQ.com

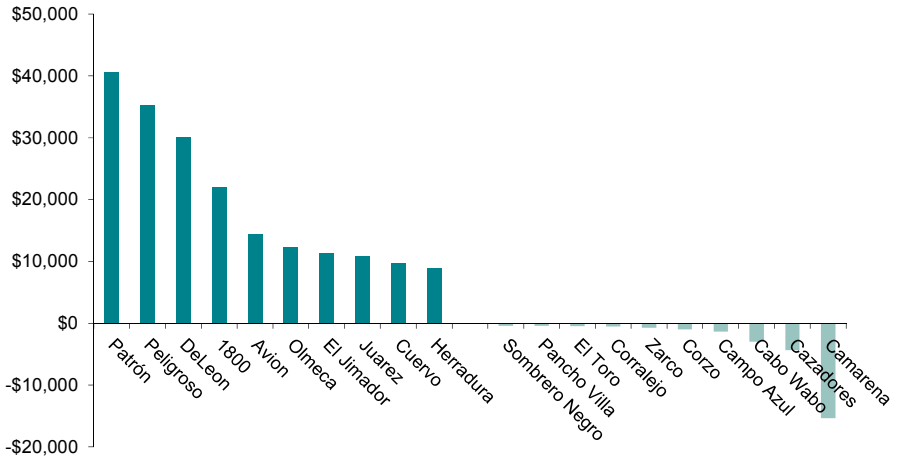
Campari is also embracing the craft gin phenomenon in the US. In 2013, it agreed a distribution deal with Bulldog craft gin, with an option to fully acquire the brand, inventory, production and distribution contracts in 2020 if agreed targets are met.

Tequila

Tequila does not have to be aged but it has to be produced in Mexico (in the state of Jalisco and limited municipalities in the states of Guanajuato, Michoacán, Nayarit and Tamaulipas). This adds a barrier for craft distillers. There are no ADI certified tequila brands in the US although there are a few Agave brands. As a consequence, the fastest growing tequila brands in the US in 2014 (in $ terms) almost all belonged to large Spirits companies (the exception being Luxco's Juarez).

Figure 47: Almost all of the fastest growing tequila brands belong to large companies

Tequila incremental retail sales, Top and bottom 10 brands, US, 2014



Source: IWSR, Exane BNP Paribas estimates

Pernod and Diageo are growing their relatively small share of the US tequila market, with the contribution from recent acquisitions (DeLeon, Peligroso for Diageo, Avion for Pernod Ricard) aiding share development.

Figure 48: Pernod and Diageo are growing their small share of US tequila

Evolution of value shares, US, Tequila

	2008	2009	2010	2011	2012	2013	2014
Patrón	27.3%	27.6%	27.1%	26.9%	26.3%	25.5%	25.1%
Cuervo	26.0%	24.9%	23.4%	21.1%	19.9%	19.3%	18.6%
Beam Suntory	10.3%	10.7%	11.4%	11.6%	10.7%	10.8%	10.6%
Proximo Spirits	5.5%	6.0%	6.7%	6.9%	7.3%	8.1%	8.2%
Diageo	6.5%	4.4%	4.6%	5.2%	5.5%	5.3%	6.6%
Brown Forman	3.9%	4.4%	4.5%	4.5%	4.7%	4.6%	4.8%
Sazerac	5.6%	5.4%	5.0%	4.9%	4.8%	4.5%	4.5%
Pernod Ricard	0.0%	0.0%	0.2%	0.8%	1.2%	1.7%	2.3%
Luxco	2.2%	2.3%	2.1%	2.2%	2.1%	2.0%	2.1%
Bacardi	3.4%	3.6%	3.1%	2.8%	2.5%	2.3%	2.1%

Source: IWSR, Exane BNP Paribas estimates – Note: both Pernod and Diageo have conducted acquisitions

Diageo and Pernod won't have it all their own way in the lucrative premium tequila segment. Sazerac announced in September 2014 the creation of a craft division called "Bond & Royal Spirits Company", dedicated to developing brands within the specialty and craft spirits space. Most of their existing brands are tequilas or mezcal (a similar liquor) such as Del Maguey Single Village Mezcal, Siete Leguas Tequila and the Casa San Matias Tequilas.

Rum: a vibrant craft scene

After whiskey, vodka and gin, rum is the next most popular category for craft distillers. It accounts for 10% of craft brands according to the ADI and 28% of craft distillers offer a rum brand. Here, distillers can produce an un-aged rum to generate short-term cash flows while they mature more profitable aged dark rums. We show below an example of what the craft rum scene has to offer in the US:

Figure 49: There is no shortage of craft rum brands

Old Ipswich rum

Balcones Texas Rum

Dancing Pines rum

Wicked Dolphin rum

Three Sheets rum

The Real McCoy rum

Freshwater Michigan rum

Rougaroux rum

Source: The Spirits Business

Craft rum is not good news for Diageo's Captain Morgan. Not only does Diageo have to contend with the waning popularity of 'Captain Morgan with Coke', it also now needs to find a counter-offensive to craft rum. On top of that, Captain Morgan is not particularly suited to the current 'shot' culture in US rum. Little wonder then that Diageo has been losing share in US rum:

Figure 50: Diageo is losing share in US rum

Evolution of value share, US Rum

	2008	2009	2010	2011	2012	2013	2014
Diageo	35.5%	37.9%	35.4%	34.2%	34.6%	34.3%	33.7%
Bacardi	40.0%	35.0%	35.7%	36.1%	34.7%	34.8%	33.2%
Beam Suntory	4.3%	4.8%	5.3%	5.0%	5.2%	4.8%	5.0%
Heaven Hill	2.5%	2.9%	3.2%	3.4%	3.6%	3.9%	4.0%
Campari	0.9%	0.9%	1.0%	1.2%	1.3%	1.3%	1.7%
Sazerac	1.5%	1.5%	1.4%	1.3%	1.3%	1.2%	1.2%
Remy Cointreau	1.1%	1.2%	1.2%	1.2%	1.1%	1.0%	1.0%
Hood River	0.5%	0.5%	0.5%	0.5%	0.5%	0.4%	0.4%

Source: IWSR, Exane BNP Paribas

Hopes for Diageo rest on super-premium rum Zacapa in our view, a brand from Guatemala (and one that we can personally recommend). This would not solve the 'big brand issue' the group has with Captain Morgan though. There is no quick fix here.

Irish whiskey: Pernod both killing and inspiring the competition

Much has been written on the success of Pernod's Irish whiskey brand, Jameson. It has been remarkable. The brand continues to take share from an elevated position.

Figure 51: Pernod keeps gaining market share in Irish whiskey in the US

Evolution of value shares, Irish Whiskey in the US

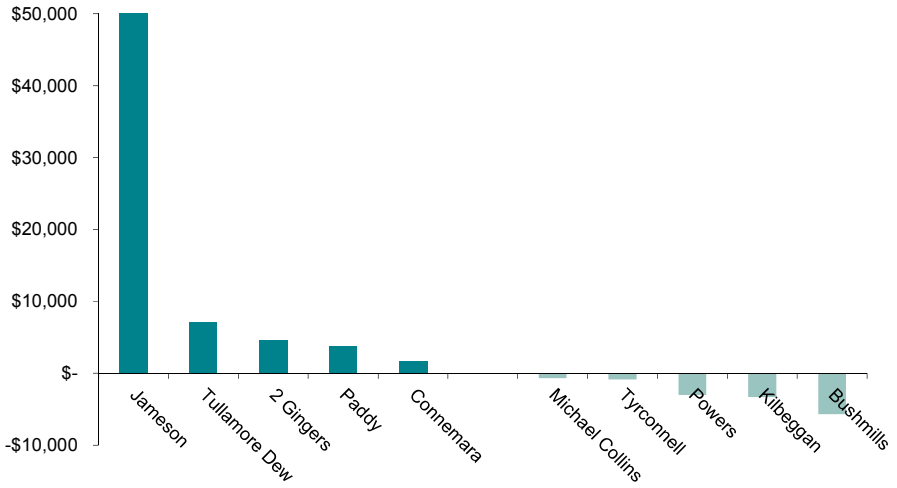
	2008	2009	2010	2011	2012	2013	2014
Pernod Ricard	69.7%	74.8%	77.0%	80.2%	79.3%	80.2%	81.9%
Cuervo	17.9%	14.2%	13.5%	10.7%	10.3%	8.3%	7.1%
Wm Grants	6.2%	6.0%	5.4%	4.6%	4.6%	4.6%	5.2%
Beam Suntory	1.7%	1.2%	1.2%	1.0%	2.1%	2.0%	2.1%
Castle Brands	1.2%	0.9%	0.8%	0.7%	0.7%	0.6%	0.6%

Source: IWSR, Exane BNP Paribas

The success of Jameson has been such that it forced Diageo to sell the Bushmills brand to Cuervo spirits. It could well be that the Mexicans eventually do a better job with this iconic brand than Diageo has but this may take time and effort. In terms of the rest of the competition, Jameson has clearly inspired a handful of smaller producers such as Teeling. Many of the 'craft' Irish whiskey brands are owned by larger companies such as Cooley / Kilbeggan distillery which was bought by Beam in 2012 or Tullamore Dew (owned by William Grant and Sons). So far, none of these has really threatened Jameson, even if a craft brand '2 Gingers' (what a name!) has managed to secure a small piece of the growing Irish whiskey cake (+169% volume growth since 2012).

Figure 52: Jameson rolls on

Irish Whiskey incremental retail sales, Top and bottom 5 brands, US, 2014



Source: IWSR, Exane BNP Paribas. Note: 'Paddy' is also owned by Pernod

Will the strong performance for Jameson continue? We would be inclined to think so although it may be naïve of Pernod to extrapolate the growth of recent years into the future.

Figure 53: A craft-like Irish whiskey offering by Jameson

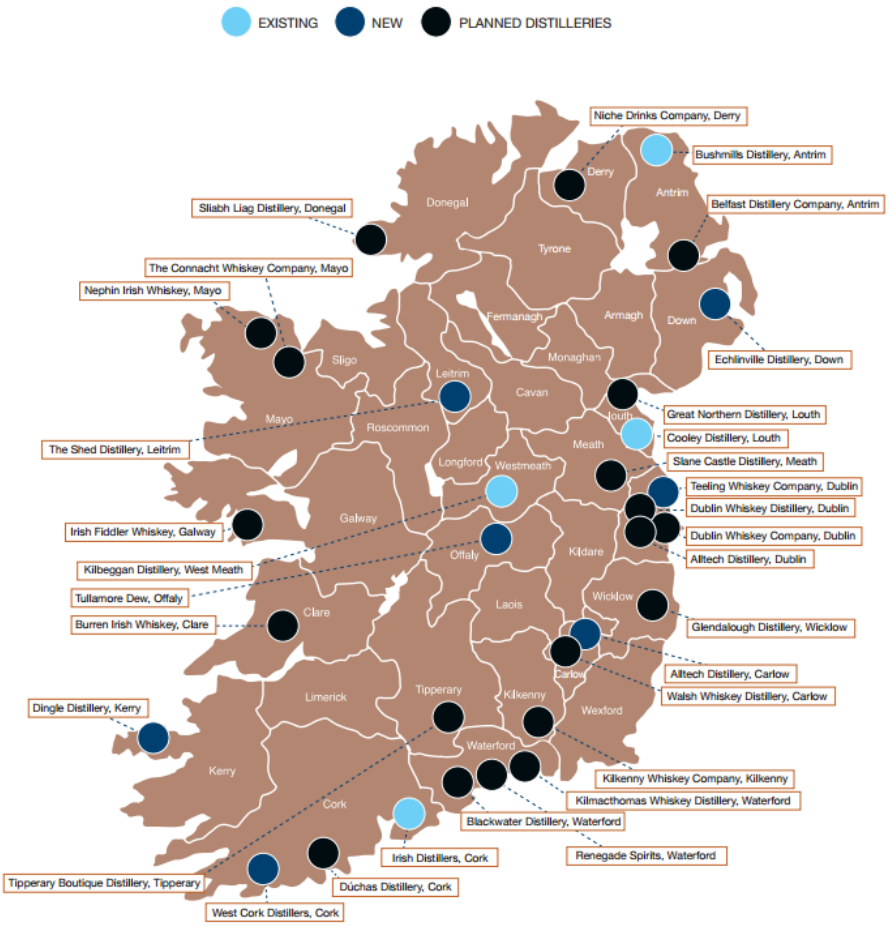
Jameson Caskmates

Source: Pernod Ricard

More investment is on the way in Irish whiskey. There are 26 new or proposed distilleries across Ireland according to the Irish whiskey association. Ireland plans to triple the global market share of Irish whiskey by 2030 (from 4% to 12% of global whisk(e)y sales), to grow exports from 6.5m 9-litre cases to 12m by 2020, and then to double exports again to 24m 9-litre cases by 2030. Investment of over €1bn between 2010 and 2025 is planned with production set to rise by 41% between 2010 and 2025.

Figure 54: Irish whiskey – from 4 distilleries to 30 in the near future

Location of Irish distilleries - Breakdown between existing, new and planned (as of May 2015)



Source: Irish Whiskey Association

Company implications

We struggle to see craft spirits being anything other than a net negative for the distillers under our coverage, although perhaps not as negative (yet) as craft is for the brewers (see The Craft Invasion) (the distillers are reacting faster and craft spirits are not as big as craft beer is). Craft spirits represents increased competition and the big brand is no longer best.

We believe Remy Cointreau has the least to lose from the craft trend in the US given its portfolio make-up. Pernod is doing more than Diageo on the craft front and has less to lose (much lower exposure to the US), although we don't think Absolut's woes are easily fixed and Pernod's growth ambitions in the US may have to be tapered somewhat. Diageo's innovation efforts in the whiskey category in the US are encouraging but the group remains reliant on the profitability of its big brands in the US. We expect limited margin expansion (higher investment) for Diageo in the future in the US and it will be very difficult for it to avoid further market share losses in our view.

Diageo: the most at risk

We estimate that almost three quarters of Diageo's US business, representing around 30% of group EBIT, is exposed to craft. That is effectively all of Diageo's spirits business in the US apart from scotch and tequila. In response, Diageo has launched several craft or craft-like initiatives recently, a positive sign (it has learnt lessons from the slow reaction of the big brewers in the US). Interestingly, the group also introduced recently 'DistillVentures', a bespoke program to help would-be distillers with their investment (in exchange for a call option on the newly created business).

This said, in the context of Diageo's portfolio, these efforts are relatively small and to date, limited to two categories to the best of our knowledge (bourbon and gin).

Figure 55: 72% of Diageo US business (30% of group EBIT) is exposed to craft

Overview of Diageo US business by category, exposure to craft and examples of craft initiatives

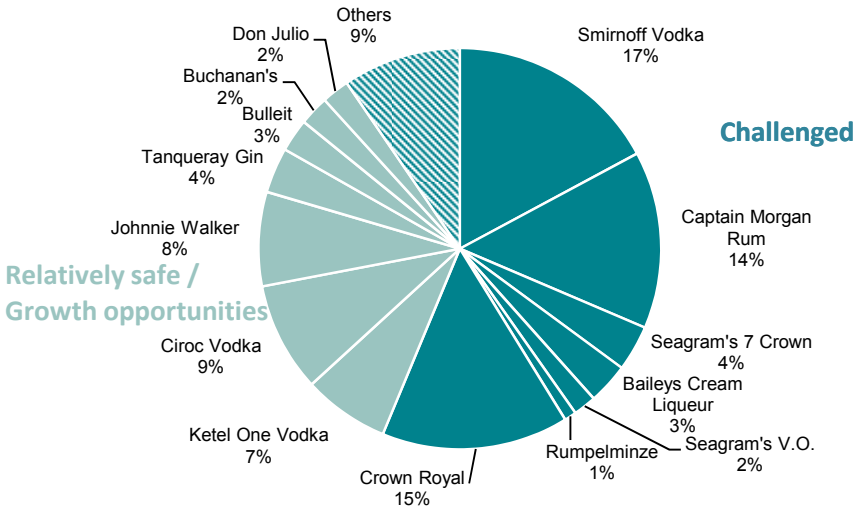
Diageo (41% of FY14 profit in the US)	% of US sales	2014 US value share	Chg in value share 2014 vs 2011	Category exposure to craft	Example of US craft initiatives
Vodka	25%	25.7%	-0.9%	High	-
Canadian whisky	15%	52.7%	-0.1%	High	-
Scotch	14%	40.9%	1.5%	Low	-
Rum	11%	33.7%	-0.4%	High	-
US whiskey	6%	11.9%	1.3%	High	Orphan Barrel Project, Blade & Bow
Beer	6%	1.0%	-0.1%	High	-
Liqueurs	5%	11.2%	-3.8%	High	-
Gin	3%	24.6%	-1.1%	High	Limited editions of Tanqueray
Tequila	3%	6.6%	1.4%*	Low	-
Other (incl. wine & RTD)	11%				

*Source: IWSR, Diageo, Exane BNP Paribas estimates * Diageo acquired tequila brands DeLeon and Peligroso in 2014*

Further investments are likely and thus will limit margin progression (we expect 20bps margin expansion p.a. in North America in FY16e-19e). The problem here is very simple: Diageo US has very high margins on brands which are simply not in vogue today. Defending market share positions / high margins is not an easy task.

Figure 56: Diageo's US spirits business – a challenged portfolio

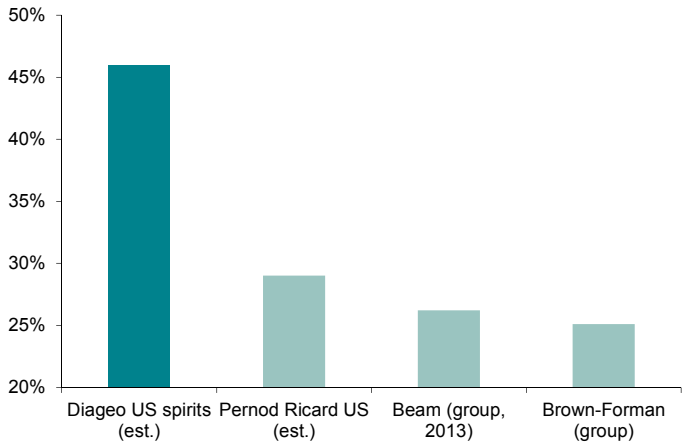
Breakdown of CY2014 Diageo spirits retail sales in the US



Source: IWSR, Exane BNP Paribas estimates. Others include Dickel (0.5% of US spirit sales, Peligroso (0.4%), DeLeon (0.3%) and various scotch brands totalling 1.8% of US spirit sales

Figure 57: Diageo generates a very high margin in the US

Diageo US EBIT margin vs. competitors, FY14 (to Jun-14 for Diageo and Pernod Ricard), FY15 for Brown-Forman, FY13 for Beam



Source: Companies, IWSR, Exane BNP Paribas estimates, Note: Beam is part of Beam Suntory since 2014

Pernod Ricard: less exposed but work to do

The proportion of Pernod's US business that is exposed to craft is similar to Diageo at 70%. As a proportion of group profit though, Pernod is less at risk (an estimated 13% vs. 30% for Diageo). On a negative note, Pernod's woes in vodka, gin and liqueurs (67% of US sales) will not be easily overcome (the 'Our Vodka' initiative could well work but it is unlikely to offset the decline of Absolut given its sheer size). On a positive note, craft initiatives undertaken by the group in other areas such as Canadian whisky are likely to help growth and we feel relatively optimistic about the growth of Jameson, even if some new joiners are likely to enter the category and thus extrapolating past growth into the future is a tad bullish. Overall, we feel Pernod is doing slightly more than Diageo in craft and has less to lose, but investment will be needed if it is to realise its growth goals in the US. We expect the group to invest in craft in the future, be it through own initiatives (like Our / Vodka) or through acquisition(s) of craft distillers. The tripling of the salesforce dedicated to sell Pernod Ricard brands at the group's US distributors is an important step that should certainly help organic growth in FY16 and beyond, but we feel it is likely that Pernod's growth ambitions in the US may have to be tapered somewhat at some point

Figure 58: 70% of Pernod US business (13% of group EBIT) is exposed to craft

Overview of Pernod Ricard US business by category, exposure to craft spirits and example of craft initiatives

Pernod Ricard (18% of FY14 EBIT in the US)	**% of US sales**	**2014 US value share**	**Chg in value share 2014 vs 2011**	**Category exposure to craft**	**Example of US craft initiatives**
Vodka	35%	9.1%	-2.2%	High	Our / Vodka
Liqueurs	19%	11.8%	-2.0%	High	-
Irish whiskey	17%	81.9%	1.7%	Medium	Jameson Caskmates
Gin	13%	24.1%	-2.3%	High	-
Scotch	9%	11.9%	-1.7%	Low	-
Cognac	2%	3.8%	-0.6%	Low	-
Canadian whisky	1%	1.1%	0.7%	High	Pike Creek
Tequila	0%	2.3%	1.6%*	Low	-
US whiskey	0%	0.1%	-0.1%	High	-
Rum	0%	0.0%	0.0%	High	-
Other (incl. wine, champagne)	6%				

*Source: IWSR, Exane BNP Paribas estimates * Pernod Ricard acquired stakes in tequila Avion in 2011 and 2014*

Remy: the least exposed

We believe Remy Cointreau has the least to lose from the craft trend in the US. Remy has a high exposure to cognac, 68% of CY14 US sales, which is arguably the category that is the least at risk from newcomers (the availability and cost of buying eaux-de-vie where four multinationals dominate is a barrier, as is the time taken to produce aged product). Furthermore, the group's brands that are most exposed to craft in the US (in liqueurs and rum) are much closer to craft than a Captain Morgan's or a Ricard. Dating back from 1703, Mount Gay is the oldest rum in the world and plays the craft card well. In liqueurs, while Cointreau could almost be called a 'big brand', the brand is a key ingredient of many very famous cocktails which could offer some protection against craft liqueurs in our view.

Figure 59: Only 28% of Remy Cointreau US business (8% of group EBIT) is exposed to craft

Overview of Remy Cointreau US business by category, exposure to craft spirits and example of craft initiatives

Remy Cointreau (34%e of FY15 EBIT in the US)	**% of US sales**	**2014 US value share**	**Chg in value share 2014 vs 2011**	**Category exposure to craft**	**Example of US craft initiatives**
Cognac	68%	20.6%	-0.1%	Low	-
Liqueurs	21%	2.3%	-0.1%	High	-
Rum	7%	1.0%	-0.2%	High	Some Mount Gay variants
Scotch	3%	0.1%	0.0%	Low	Bruichladdich
Other	1%				The Botanist gin

Source: IWSR, Exane BNP Paribas estimates. Remy Cointreau acquired Bruichladdich in 2012

Can craft spirits take on the world?

Outside of the US, craft is even more embryonic

Craft spirits is smaller outside of the US. One of the more developed craft spirits outside the US is gin, especially in the **UK**. Sales of premium gin in the UK have jumped by a third since 2010 and now account for 22% of the entire gin market in the country. According to AC Nielsen, this could rise to a third by 2017. Craft distillers have embraced the trend: in 2009, Sipsmith was the first distiller to open in London for almost 200 years. There are now seven distilleries operating in the city.

Figure 60: There are now 7 distillers in London

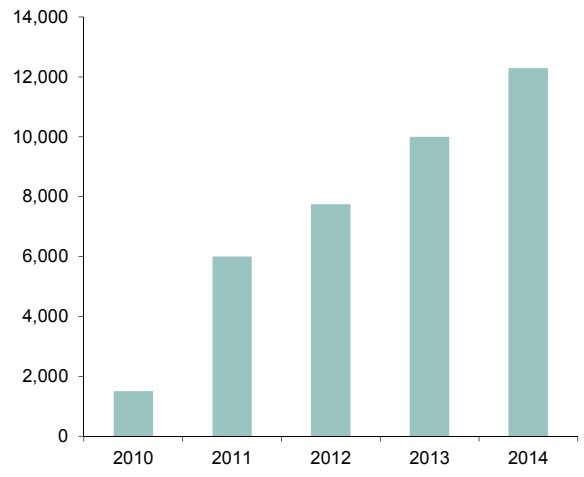
Source: askmen.com

In **Spain,** where premium gin is also growing fast, a number of gin distillers have also popped up, such as Gin Mare or Santamania London dry gin.

Figure 61: Gin Mare volumes have doubled in three years

Gin Mare, a Spanish craft gin

Gin Mare, 9L cases sales, Spain



Source: fastforward-imaging.com, IWSR, Exane BNP Paribas

Germany too can boast its own premium gins. The Preussische Spirituosen Manufaktur (Prussian Spirits Manufactory) in Berlin produce the “very mild and lightly lemony” Adler Gin, while in Munich's Maxvorstadt district, historians Daniel Schönecker and Maximilian Schauerte have produced the certified-organic Duke Gin, named after German duke Henry the Lion, Munich's founder. And from the Black Forest in southern Germany comes Monkey 47, crowned in 2011 as the world's best gin.

Despite higher barriers to entry for **Scotch,** notably the obligation for Scotch to be produced and aged in Scotland for a minimum of 3 years, the Scottish Craft Distillers Association (created in 2014) already has more than 30 member distillers, producing Scotch brand such as Tweedale and Prometheus.

Figure 62: Examples of craft Scotch

The Tweeddale

Prometheus, The Glasgow Distillery

Source: thegoodspiritsco.com, maltfascination.com

While of course it is possible to see craft scotch producers mushroom, the time needed to age the product and the fact that Europe is probably around 5 years behind the US in terms of craft spirits penetration, probably means that we are not likely to see the scotch market being seriously threatened by craft distillers in the short term (the bigger issue in this timeframe is growth challenges for the Scotch category itself).

Scotland is not all about Scotch. It is also one of the world’s largest exporters of gin, led by brands such as Gordon’s, Tanqueray and Hendricks. As Scotch typically takes time to mature, many craft distillers start with gin, which is much faster to produce and sell, to finance the production of Scotch.

Figure 63: Examples of Scottish craft gin

Rock Rose Gin, Dunnet Bay Distillery

Pickering's Gin, the first new gin distillery in Edinburgh in 150 yrs

Source: rockrosegin.co.uk, ginfoundry.com

In June 2015, Brewdog, Scotland's largest independent brewer, unveiled plans to open a distillery in Scotland. Brewdog will launch a range of spirits using its beers as a base, hinting at hop-infused gin and oak-aged spirits.

In 1880, **Ireland** had more than 160 distilleries producing over 400 brands of Irish whiskey. Things are very different today. For a variety of reasons (US prohibition, war of independence, World war), there are now only 4 distilleries and Pernod's Jameson represents more than 65% of the category. As we mentioned above, Jameson's success has inspired a handful of smaller producers such as Teeling. Many of the craft Irish whiskey brands however are owned by larger companies such as the Cooley / Kilbeggan distillery which was bought by Beam (now Beam Suntory) in 2012 or Tullamore Dew (owned by William Grant and Sons). So far, none of them have seriously threatened Jameson but more investment is on the way. There are 26 new or proposed distilleries across Ireland according to the Irish whiskey association. Ireland plans to triple the global market share of Irish whiskey by 2030 (from 4% to 12% of global whiskey sales), to grow exports from 6.5m 9-litre cases to 12m by 2020 and to double exports again to 24m 9-litre cases by 2030. There is planned investment of over €1bn between 2010 and 2025 and production is set to rise by 41% between 2010 and 2025.

There are around 50 distilleries operating in **Australia,** many of which are craft distillers such as Sullivans Cove or Four Pillars. The development of craft spirits is however being held back by the tax structure. Unlike beer and wine, there are no concessions for small spirits producers. According to Stu Gregor, founder of Four Pillars Gin, while his company makes $12 net revenue per bottle, the Federal government receive $29 ($24 excise plus $5 GST). He claims that an American craft distiller is taxed 10 times less than an Australian one.

Craft distillers currently contribute less than 0.2% of spirits sales in **South Africa**, with an estimated annual production of less than 184,000 bottles (750ml equivalent) worth R36.7m in sales according to Distillique, a company that supplies distilling equipment in South Africa. There are currently 19 active craft distillers in South Africa.

Craft industry – an overview

Here we outline the process of launching a spirits brand in the US (legal requirements, duration, capital needed) to understand if the barriers to entry have lowered in the US. We also examine margin structure and marketing strategies.

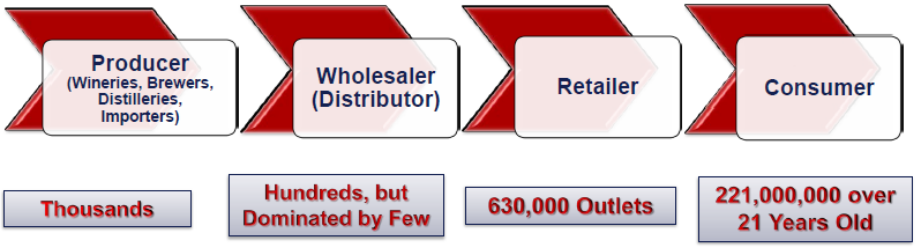
Opening a distillery is not that big of a deal (if you have USD300k)

The three-tier system allows for efficient and quick access to >600,000 outlets

A key specificity of the US alcoholic beverage market is the three-tier system. The system makes it obligatory for alcoholic beverage producers to sell their products to a wholesaler, and not directly to a retailer (see caption below). The system makes it easier for a would-be distiller to sell its products: it is more practical to be listed at one or at a number of wholesalers than to deal with / convince a high number of retailers. This is especially true since US wholesaling is rather concentrated: out of the hundreds of distributors in operation in the US, five companies command a 57% market share (2014). One of the key disadvantages of the system though is that the process makes the price of the final product higher than what it would have been had no wholesaler been involved (along with decreasing the lobbying power of large producers, increasing the price of alcoholic drinks to control alcohol abuse was precisely one of the goals of the American Anti-Trust Act that laid the foundations of the Three Tier System).

Figure 64: Wholesalers allow access to 630,000 outlets

The US three-tier System



Source: US Beverage Alcohol Forum, 2013

Figure 65: Five wholesalers control 57% of US wine & spirit sales

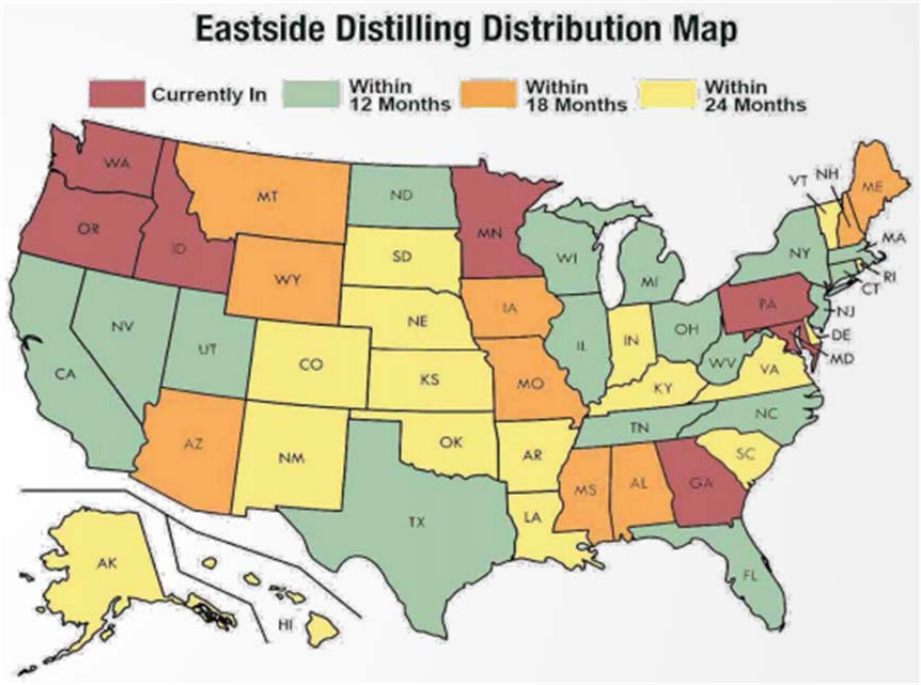
Market share and penetration of the largest US wine and spirit wholesalers

U.S Wine & Spirit Wholesalers	Revenue (2014P)	Market Share % (2014P)	Total States Covered	Accessible Market %	Largest Markets (>$250mm)
Southern Wine & Spirits	$11.4B	22.2%	35	72.2%	AZ, CA, CO, FL, ID, IL, KY, NV, NY, WA
Republic National Distributing Company	$5.8B	11.4%	20	35.9%	CO, FL, IN, LA, MD, SC, TX, VA
Charmer Sunbelt Group	$5.3B	10.4%	14	36.4%	CO, FL, MD, NJ, NY
Glazer's	$3.6B	7.0%	13	22.9%	LA, MO, TX
Young's Market Company	$2.9B	5.8%	10	22.5%	CA, WA

Source: Companies, TTB, EastSide Distilling Co

Compared to the more fragmented distribution landscape across other countries/regions, the US system makes it easier to reach a high number of outlets in a relatively short space of time. In the map below, we show the roadmap of Eastside Distilling Company, a craft distilling company based in Oregon that sold 6,400 cases in 2014 and generated net sales of USD1.1m (up 42% y/y). From its current presence in 7 states (May 2015), the company expects to cover half of US states within a year. While this is slower than large distillers, it is nonetheless very respectable.

Figure 66: Eastside Distilling (a craft distiller) - planned distribution coverage



Source: Eastside Distilling Company

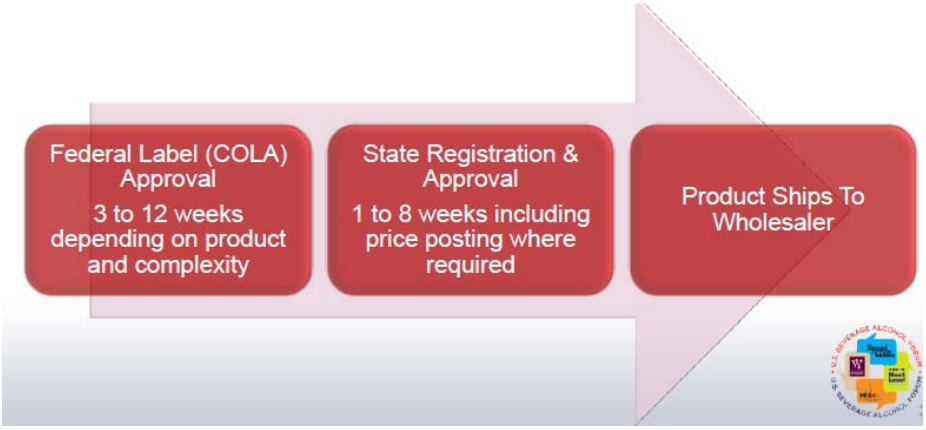
What about the legal requirements for a US spirits producer? These can be split into two categories: federal requirements and state level requirements.

At the federal level, the key for a spirits producer is to get a COLA, Certificate Of Label Approval. The approval process and timeline is dependent upon the product and specific requirements of the TTB (Alcohol and Tobacco Tax and Trade Bureau). Note that in 2012, the TTB received 13,687 applications for new spirits brands, up from 11,006 in 2009 and 7,505 in 2006. While this number looks high, it is lower than the number of malt beverages (mostly beer) applications and only a fraction of wine applications (122,447 in 2012). On average, it took the TTB 22 days to process an application in 2012.

At state level, other approvals are necessary and vary depending on the state: most states require the out of state entity (shipper) to maintain certain state licenses and / or permits in order to sell products to wholesalers. Most of them also require the Federal COLA as a requirement for brand approval. In total, it takes between 4 and 20 weeks to get both approvals.

Figure 67: It takes between 4 and 20 weeks to get approval to launch a brand

Simplified timeline of registration and approval processes to launch a Spirits brand in the US

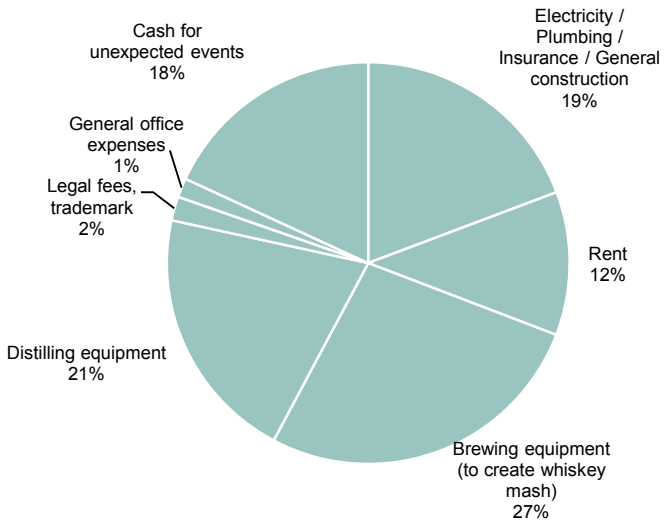


Source: US Beverage Alcohol Forum

In its (very detailed) guide for would-be craft distillers, the American Distilling Institute estimates that it costs over $350,000 to build a distillery capable of producing 3,000 to 5,000 cases per year (in line with the average production of a craft distiller in the US). This estimate assumes investment in year one of around $260,000, followed by another $100,000 in year two. In the figure below, we break down the expenses required. Distilling and brewing equipment (the latter being to obtain whiskey mash) accounts for almost half of the initial investment.

Figure 68: Distilling / brewing equipment costs around half of the initial capital

Breakdown of year one expenses to start a craft distillery (total: USD259,600)



Source: American Distilling Institute, Exane BNP Paribas

Marketing plan is key to success

In its business plan for a 'typical' craft distiller, the American Distilling Institute assumes that year two sees the production of 2,000 cases of gin and 330 cases of whiskey, in line with the strategy at most distillers with the sale of gin helping to finance the production of longer-aged whiskey. It is assumed that a gin bottle is sold at a retail price of USD21.67 (USD260 per case) and that whiskey is sold at a retail price of USD29.17 (USD350 per case), of which wholesaling and distributor fees account for USD11.4 on average (50% fee), COGS for USD3.0, marketing costs for USD2.0 and excise taxes USD2.2. In the table below, we outline the year one P&L of a craft distiller based on the business plan of the ADI. In a nutshell, it shows that marketing costs are high (22% of net sales) and that the business is not that profitable with a 3% operating margin, despite a high gross margin, if one assumes staff costs of USD50k (i.e. not much).

Figure 69: Craft distilling requires high A&P but has low COGS

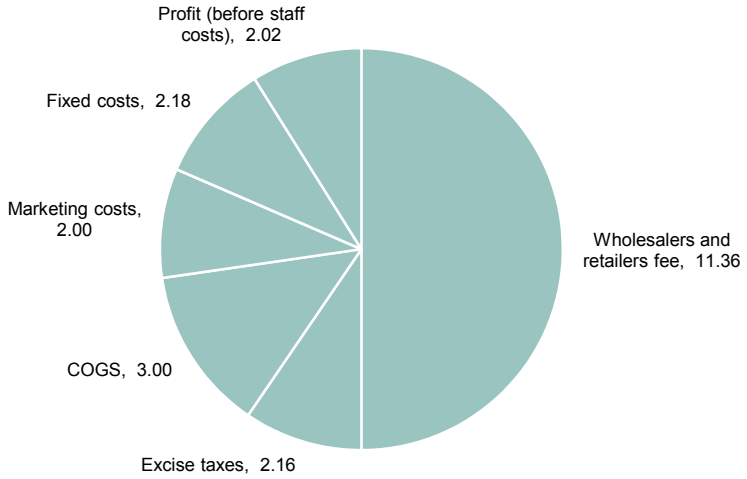
Year one P&L of a craft distiller – example from American Distilling Institute

	Gin	Whiskey	Total / Average	Per bottle
Volume (cases)	2,000	330	2,330	
Retail price (USD)	260	350	273	
Retail sales (USD)	520,000	115,500	635,500	22.73
Wholesalers and retailers fee (at 50%)	260,000	57,750	317,750	11.36
Gross sales (USD)	260,000	57,750	317,750	11.36
Excise taxes (USD)	-49,418	-10,976	-60,394	-2.16
Net sales (USD)	210,582	46,774	257,356	9.20
Direct COGS (USD)	-72,000	-11,880	-83,880	-3.00
Gross profit (USD)	138,582	34,894	173,476	6.20
Gross margin	66%	75%	67%	
Marketing costs (USD)	-48,000	-7,920	-55,920	-2.00
% of net sales	-22.8%	-16.9%	-21.7%	
Fixed costs (USD - rent, utilities, insurance, G&A)			-61,000	- 2.18
% of net sales			-23.7%	
Operational profit (*assuming no personnel expenses)*			56,556	2.02
Operational margin *(assuming no personnel expenses)*			22%	
Operational profit *(with staff cost of USD50k)*			6,556	0.23
Operational margin *(with staff cost of USD50k)*			3%	

Source: American Distilling Institute, Exane BNP Paribas

Another way to illustrate the importance of marketing costs is to say that for each bottle of spirits sold at USD23, a craft distiller generates net sales of USD9.2 and spends USD2 in marketing costs, vs. USD3 in COGS.

Figure 70: Estimated breakdown of the retail price of an USD22.73 bottle (based on the ADI business plan)



Source: American Distilling Institute, Exane BNP Paribas

As for craft beer, there are few listed US craft distillers. We have only found one genuine craft distiller which produces and sells its own spirits, Eastside Distilling Company. Based in Portland, Oregon, the company sells "handcrafted" bourbon, whiskey, vodka and rum, as well as some liqueurs. It commenced production in 2008 and sold 6,400 cases in 2014, up 60% from 2013, the first year when it published accounts. The accounts reveal that the craft distiller generated a 53% gross margin in 2014, down from 59% in 2013, the drop explained by investment in distribution and higher cost of ingredients. The accounts also show that opex is very high at 47% of sales (in 2013). Note that 2014 is not representative of a normal year since the group significantly upped opex ahead of a large increase in production capacity (from a production capacity of 6,400 cases in 2014 to 1,000,000 cases when fully operational).

Figure 71: Craft distilling: high growth, high investment

P&L of Eastside Distilling Company

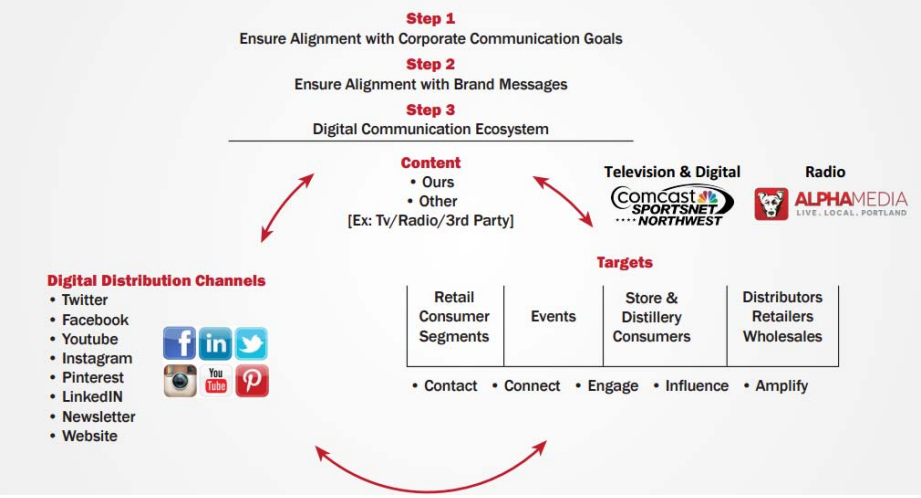
USD	2013	2014	2015 outlook
Volume (cases)	4,000	6,400	35,000-55,000
Sales	880,454	1,435,416	7,000,000
Less excise taxes	138,897	379,972	
Net sales	741,557	1,055,444	
y/y change		*42%*	
Revenue per case	185	165	
y/y change		*-11%*	
Cost of sales	303,220	494,889	
y/y change		*63%*	
Gross profit	438,337	560,555	
Gross margin	**59.1%**	**53.1%**	
Opex	347,582	1,366,341*	
% of sales	**47%**	**129%**	
Goodwill impairment	0	3,246,149	
Stock-based compensation	-	10,000	
(Loss) income from operations	90,755	-4,051,935	
Adjusted operating income (loss)	90,755	-805,786	
Adjusted operating margin	**12.2%**	**-76.3%**	
Other expenses - net	3,769	3,736	
of which interest expense	1,552	3,974	
(Loss) income before income taxes	86,986	-4,055,671	
Provision for income taxes	0	1,500	
Net (loss) income	86,98	-4,057,171	

*Source: Eastside Distilling Company, Exane BNP Paribas, * From Eastside Distilling 10-K: 'This increase is primarily due to the hiring of additional sales personnel and event coordinators related to our new retail location, an increase in production staff as well as increased legal and accounting costs related to the October 2014 merger agreement'.*

We note that digital marketing is the main communication tool of the company:

Figure 72: Digital advertising is key to a craft distiller's success

Eastside Distilling Company – marketing strategy



Source: Eastside Distilling Co

Share of voice

Given small distillers' higher marketing cost as a % of sales, and the superior growth profile, one of the obvious consequences is that the share of voice (share of total marketing spend) of the large distillers will fall if their marketing budgets stay constant as a % of sales. In the table below, we have showed what the share of voice of small distillers might be in two years, and what the impact would be for incumbents. The assumptions made include marketing as a % of sales remaining constant for both small distillers and for large companies (for the latter, we use Diageo's marketing costs in North America as a proxy) and 45% volume growth for small distillers and 1.6% for the rest of the market.

The assumptions employed are rather conservative and the results striking: in this scenario, the share of voice of small distillers could double within two years to reach 5%, at the expense of large distillers who would lose 2.5% of share of voice. Put it differently, out of the estimated USD365m incremental marketing expenditures over the next two years in this scenario, more than USD100m would come from small distillers.

Figure 73: The share of voice of small distillers could double within two years

Estimating the share of voice of small distillers in the US

	Small distillers	Large distillers	Comment
Year 1 (2014)			
Bottles (thousands)	42	2,486	based on 2014 volume share estimate from DISCUS
Net sales (USDm)	425	20,825	mid-point of 2014 estimate from DISCUS for small distillers
Value share	2.0%	98.0%	Exane estimate based on 2014 estimate from DISCUS
Marketing cost per bottle (USD)	**2.0**	**1.3**	USD2 is based on ADI business plan
Marketing cost as a % of sales	**19.7%**	**15.6%**	based on Diageo North America marketing spend
Total marketing cost (USDm)	84	3,249	
Share of voice	**2.5%**	**97.5%**	
Year 2			
Bottles (thousands)	61	2,526	assumes 45% volume growth for small distillers, 1.6% for large
Net sales (USDm)	629.00	21,658.00	assumes 4% value growth for other, 3% price mix for craft
Value share	2.8%	97.2%	Exane estimate based on growth expectations mentioned above
Marketing cost per bottle (USD)	**2.0**	**1.3**	
Marketing cost as a % of sales	**19.7%**	**15.6%**	assumed constant
Total marketing cost (USDm)	124	3,379	
Share of voice	**3.5%**	**96.5%**	
Year 3			
Bottles (thousands)	88	2,567	assumes 45% volume growth for small distillers, 1.6% for other
Net sales (USDm)	931	22,524	assumes 4% value growth for other, 3% price mix for craft
Value share	4.0%	96.0%	Exane estimate based on growth expectations mentioned above
Marketing cost per bottle (USD)	**2.1**	**1.4**	
Marketing cost as a % of sales	**19.7%**	**15.6%**	assumed constant (it would have to be 19.5% for large distillers
Total marketing cost (USDm)	184	3,514	to get a share of voice similar to the value share)
Share of voice	**5.0%**	**95.0%**	
Incremental volume ('000 bottles)	**46**	**80**	Year 3 vs. Year1
Incremental net sales (USDm)	**506**	**1,699**	Year 3 vs. Year1
Incremental mktg costs (USDm)	**100**	**265**	Year 3 vs. Year1

Source: DISCUS, American Distilling Institute, Diageo, IWSR, Exane BNP Paribas estimates

This illustration is very simplified but nevertheless likely means that large spirits companies may have to increase their marketing budget in the US. In the example above, it would require a c.400bps increase in marketing as a % of sales for large players to secure a share of voice equal to their value share in Year 3. Maintaining share of voice constant in Year 3 vs. Year 1 would be very difficult - marketing costs would have to be 32% of sales (all else being equal, i.e. ignoring the growth generated by the additional marketing spend).

With this in mind, we now analyse what the craft threat could mean for the incumbents by detailing trends by category.

Craft M&A anyone?

In this section, we show that Diageo, Pernod Ricard and Remy Cointreau are all likely acquirers of craft distillers. We highlight a list of potential targets for Remy Cointreau and question the rationale of an acquisition of Tito's by Pernod

Pernod Ricard: a craft acquisition is on the cards

Pernod's CEO has hinted on several occasions that they are looking at acquisitions in craft spirits (Financial Times, Feb. 18th, The Spirit Business, Feb. 17th). The size of any potential craft deal is likely to be very small however: for instance the only listed craft distiller (Eastside Distilling) who sold 6,400 cases in 2014 and expects to sell between 35k and 55k cases this year has a market cap of less than USD100m. Perhaps the only exception to that statement is Tito's. While it is not technically considered as craft by the American Distilling Institute, we suspect consumers view it as craft and that is all that really matters. Tito's sold 2.3m cases last year. Applying the average transaction multiple in recent mono-brand deals in the US spirits market (including craft-ish brands such as Forty Creek) of USD935 per case, Tito's could be valued on USD2.1bn.

Figure 74: On average, craft/craft-like brands have been acquired at a price per case of USD935dollars (or 9x sales)

Overview of latest acquisitions in US spirits

Year	Brand	Acquirer	Vol. ('000 cases)	Acquisition price (USDm)	Price per case (USD)	Revenue multiple
2015	Angel's Envy Bourbon	Bacardi	45	n.a.	n.a.	n.a.
2014	Forty Creek et. Al	Campari	404	167	414	5x
2012	Pinnacle & Calico jack	Beam	3,000	605	202	5x
2011	Skinny Girl	Beam	110	90	818	11x
2010	Zacapa	Diageo	100	200	2,000	16x
2007	Cabo Wabo	Campari	56	91	1,625	10x
2007	Ketel One	Diageo	1,700	1,800	1,059	8x
2007	Svedka	Constellation	1,100	384	349	8x
2006	42 Below	Bacardi	90	91	1,011	13x
Average					**935**	**9x**

Source: IWSR, Companies, TTB, ParkStreet, US Census Bureau, Exane BNP Paribas estimates

We believe that Pernod's bad experience with the acquisition of Absolut will probably deter them from investing such a large sum of money in another US vodka brand - who knows if the fad for craft vodka will stay? On top of that, Tito's faces legal challenges. Tito's has always professed to be "handmade," but this term is now being disputed in court. According to a lawsuit, and as reported by Statesman.com and FoodRepublic.com, Tito's vodka is actually made "via a highly mechanised process that is devoid of human hands." Tito's founder Tito Beveridge has commented: "We disagree with the claims made against us and plan to defend ourselves against this misguided attack."

The controversy around Tito's is not unique. Similar lawsuits have been filed against Templeton Rye, Angel's Envy, Diageo's Bulleit Rye and Jim Beam Bourbon. So far, Beam Suntory's Maker's Mark is the first spirits brand to have successfully defended its status as "handmade". The brand faced a class-action lawsuit last year, with plaintiffs seeking damages of more than $5 million. The judge however dismissed the complaint. According to Chuck Cowdery, a bourbon expert, Maker's Mark has always pointed to the fact that every bottle is individually dipped in wax by hand. The constant human oversight of all processes was also seen as a component of "handmade".

All in all, acquiring Tito's would be a rather risky deal for Pernod Ricard in our view: only a continuation of double-digit volume growth would make the deal value creative by Year 8 on our back of the envelope computations (assuming a valuation of USD2.1bn) and the fad and legal risks are a consideration.

Remy Cointreau: US whiskey?

During its FY15 conference call on June 17th, Remy Cointreau said they would not exclude an acquisition in the US, a small "jewel" to build on. Acquisition criteria includes a brand with a retail price >USD50 (an 'exceptional' spirit in Remy parlance), a brand with a story and a brand with the potential to roll out in other regions. In short, Remy Cointreau is perhaps looking for the American equivalent of Bruichladdich, its scotch brand? With management commenting several times on the strength of the American whiskey category, an area where Remy is absent, we believe this category could be on management's preferred list. To build a list of potential targets, we have screened more than 1,400 certified US craft brands (list available upon request), of which we show below those priced at more than $50 per bottle (18 craft distillers in total).

Figure 75: A list of potential targets for Remy Cointreau in US whiskey

Distiller	Main Whiskey	Main Whiskey avg. price	Website
American Craft Whiskey Distillery	Low Gap California Whiskey	$70	craftdistillers.com
Bardstown Barrel Selections	Redemption Straight Rye	$60+	bardstownbarrelselections.com
Cacao Prieto	Widow Jane	$60+	www.cacaoprieto.com/liquor
Catoctin Creek Distilling	Roundstone Rye Cask Proof	$50+	catoctincreekdistilling.com
Coppersea Distilling	New York "Raw" Rye	$60+	coppersea.com
Few Bourbon Whiskey	**Few Spirits**	**$55**	**fewspirits.com**
Garrison Brothers Distillery	Garrison Brothers Texas Straight Bourbon	$80+	garrisonbros.com
Hillrock Estate Distillery	Solera Aged Bourbon	$80	www.hillrockdistillery.com
J.W.Overbey & Co.	J.W.Overbey Bourbon	$40 for 375ml	jwoverbey.com
Kings County Distillery	Kings County Bourbon	$40 for 375ml	kingscountydistillery.com
Njoy Spirits	Wild Buck Whiskey	$54	njoyspirits.com
Peach Street Distillers	Colorado Straight Bourbon	$55	peachstreetdistillers.com
Pittsburgh Distilling Co.	Wigle Pennsylvania Bourbon	$40-$80	http://wiglewhiskey.com
Sonoma County Distilling	**West of Kentucky Bourbon**	**$60**	**sonomacountydistilling.com**
StilltheOne Distillery	287 Single Malt Whiskey	$50	stilltheonedistillery.com
The Old Pogue Distillery	Old Pogue Bourbon	$50	oldpogue.com
Venus Spirits	**Wayward Bourbon**	**$50+**	**venusspirits.com**
Westland Distillery	**Westland American Single Malt**	**$70+**	**westlanddistillery.com**

Source: Exane BNP Paribas, American Distilling Institute

Figure 76: Some acquisition candidates for Remy in US whiskey

Westland Distillery

Sonoma County Distilling

Few Bourbon Whiskey

Venus Spirits

Source: Companies, Exane BNP Paribas

While there is lack of visibility on the precise size of these companies, we can nonetheless provide a broad sense of materiality. Since they are all considered craft by the ADI, it is reasonable to assume that none of them produce more than 50k cases. Using the previous valuation multiple of less than a thousand dollars per case, we arrive at theoretical maximum valuation of USD50m.

Diageo: we could see some small transactions

Diageo has recently added some small acquisitions, principally in tequila (DeLeon, Peligroso), but also in rum (Zacapa), to its US portfolio. We could see similar additions in craft, but these are highly unlikely to move the needle.

Investment case, valuation and risks

Diageo plc (Neutral, Target Price 1910p)

Investment case

In the near-term, Diageo is likely to continue to experience weak sell-in numbers as the group cleans inventories. On a more positive note, consumer demand is on the up and the organisation is trying to change.

Valuation methodology

We base our target price on 12m EPS to March 17e, using a 19x P/E multiple.

Risks to rating and target price

Downside risks to our target price include lower than expected profit growth in the US (e.g. through aggressive discounting), difficulties related to the restructuring/ integration of the Indian business and prolonged share losses in Western Europe and Nigeria. Upside risks include a faster than anticipated recovery of scotch volumes in China, South Korea and Latin America and a more aggressive cost management/reduction.

Pernod Ricard (Outperform, Target Price EUR122)

Investment case

We expect Pernod to benefit from a better consumer environment in the US. In India, while Diageo is busy integrating USL, Pernod is free to surf on improved macro trends. With the high gross margin French market possibly picking up, an improved Spain and China stabilising, we expect better top line and bottom line momentum at Pernod compared to Diageo. We revise our P/E-based target price to EUR122 and maintain our Outperform rating

Valuation methodology

We base our target price on 12m EPS to March 17e, using a c.20x P/E multiple.

Risks to rating and target price

Risks include share losses in the US against a potentially more aggressive Diageo as well as deterioration in end demand for spirits in China.

Rémy Cointreau (Neutral, Target Price EUR70)

Investment case

Remy Cointreau is facing heightened competition on top of structural issues in China (no recovery likely this year). To counter this, the worst is probably behind Remy in the country and the group is performing well in markets such as the US. Longer term, we see good growth returning for Remy, although not at the heady rates of the recent past.

Valuation methodology

To arrive at our target price, we assume a P/E multiple of 28x (based on March 17. EPS), a halfway house between the current multiple and what could be described as a 'normal' multiple for Remy (to reflect a partial recovery in earnings but perhaps not a complete one).

Risks to rating and target price

Short-term risks include a significant deterioration/improvement in end demand for cognac in China and in the US. Conversely, further USD appreciation could trigger EPS upgrades. Longer-term risks include structurally lower demand for high-end cognac across Asia (cf. Japanese example) as well as multiple deflation.

DISCLOSURE APPENDIX

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Stock Rating
Exane's Ratings are relative ratings defined against the performance of the MSCI Index sectors.

Outperform (O/P): The stock is expected to outperform the stock's MSCI sector over a 12-month investment horizon.
Neutral: The stock is expected to perform in line with the performance of the stock's MSCI sector over a 12-month investment horizon.
Underperform (U/P): The stock is expected to underperform the stock's MSCI sector over a 12-month investment horizon.
Under review: The rating of the stock has been placed under review after significant news. Any possible change will be confirmed as soon as possible in the form of a new broadly disseminated report
Restricted (RS): The stock is covered by Exane but there is no Rating and no Target Price because Exane is involved in an equity capital market transaction relating to the subject company.
Not Rated (NR): The stock is covered by Exane but there is no Rating and no Target Price at this time.
Not Covered (NC): Exane does not cover this company.

Definitions

For an explanation of definitions used in Exane research reports, please see the glossary at https://www.exane.com/jsp/action/commun/JSPacLexique.jsp

Distribution of Exane BNP Paribas' equity recommendations

As at 01/07/2015 Exane BNP Paribas covered 596 companies. The companies that, for regulatory reasons, are not accorded a rating by Exane BNP Paribas are excluded from these statistics. For regulatory reasons, our ratings of Outperform, Neutral and Underperform correspond respectively to Buy, Hold and Sell; the underlying signification is, however, different as our ratings are relative to the sector.

40% of the companies covered by Exane BNP Paribas were rated Outperform. During the last 12 months, Exane acted as underwriter and/or distributor for BNP Paribas on 8% of the companies with this rating for which BNP Paribas acted as manager or co-manager in an offering of equity securities. BNP Paribas provided investment banking services to 67% of the companies accorded this rating*.

41% of the companies covered by Exane BNP Paribas were rated Neutral. During the last 12 months, Exane acted as underwriter and/or distributor for BNP Paribas on 5% of the companies with this rating for which BNP Paribas acted as manager or co-manager in an offering of equity securities. BNP Paribas provided investment banking services to 69% of the companies accorded this rating*.

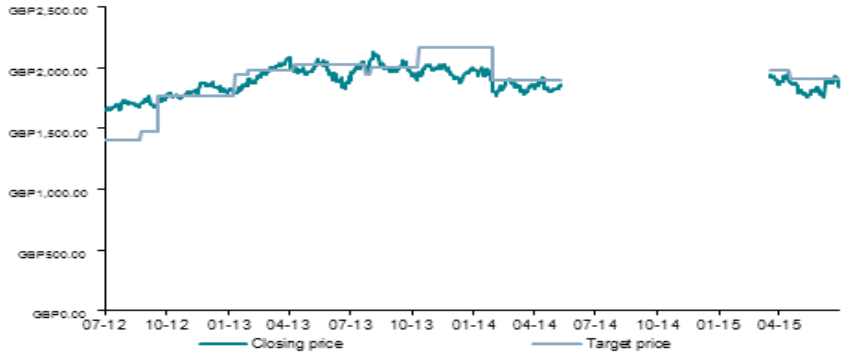
20% of the companies covered by Exane BNP Paribas were rated Underperform. During the last 12 months, Exane acted as underwriter and/or distributor for BNP Paribas on 2% of the companies with this rating for which BNP Paribas acted as manager or co-manager in an offering of equity securities. BNP Paribas provided investment banking services to 68% of the companies accorded this rating*.

** Exane is independent from BNP Paribas. Nevertheless, in order to maintain absolute transparency, we include in this category transactions carried out by BNP Paribas independently from Exane. For the purpose of clarity, we have excluded fixed income transactions carried out by BNP Paribas.*

Price and Ratings Chart

Diageo plc

Historical closing price & target price **(as of 30/06/2015)**



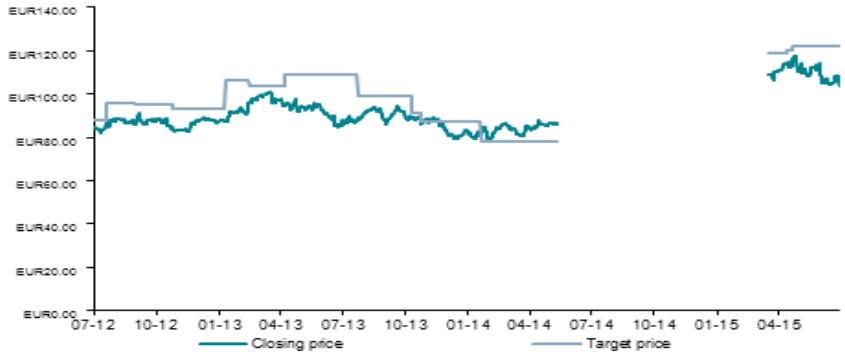
Historical of Rating & target price changes

Date	Closing price	Target price	Rating	Changes
17/04/15	GBP1896.50	GBP1910	=	TP
19/03/15	GBP1954.00	GBP1975	=	Rating & TP
31/01/14	GBP1820.00	GBP1900	+	TP
11/10/13	GBP1921.00	GBP2170	+	Rating & TP
01/08/13	GBP2054.00	GBP2010	=	TP
24/07/13	GBP2020.00	GBP1950	=	TP
08/04/13	GBP1997.00	GBP2033	=	TP
01/02/13	GBP1877.00	GBP1980	=	TP
11/01/13	GBP1788.00	GBP1950	=	TP
20/09/12	GBP1708.00	GBP1766	=	TP
24/08/12	GBP1698.00	GBP1481	=	TP

Source: Exane BNP Paribas

Pernod Ricard

Historical closing price & target price **(as of 30/06/2015)**



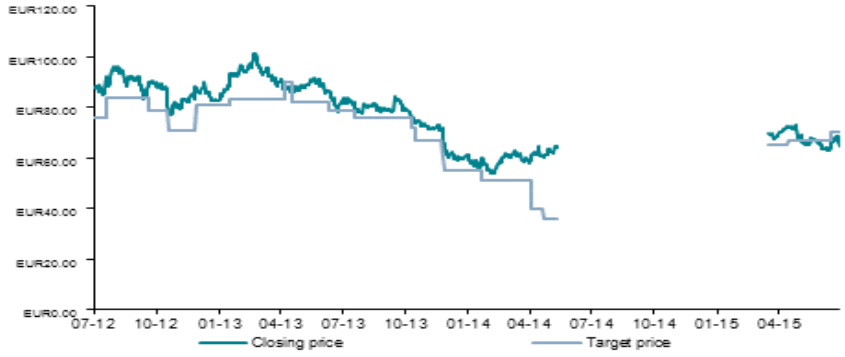
Historical of Rating & target price changes

Date	Closing price	Target price	Rating	Changes
23/04/15	EUR113.60	EUR122	+	TP
14/04/15	EUR113.40	EUR120	+	TP
19/03/15	EUR109.20	EUR119	+	Rating & TP
20/01/14	EUR82.20	EUR78	-	Rating & TP
24/10/13	EUR88.87	EUR87	=	TP
11/10/13	EUR89.10	EUR91	=	Rating & TP
24/07/13	EUR87.79	EUR99	+	TP
08/04/13	EUR94.38	EUR109	+	TP
15/02/13	EUR96.03	EUR104	+	TP
11/01/13	EUR87.29	EUR106	+	TP
26/10/12	EUR83.77	EUR93	+	TP
31/08/12	EUR85.66	EUR95	+	TP
20/07/12	EUR86.78	EUR96	+	TP

Source: Exane BNP Paribas

Rémy Cointreau

Historical closing price & target price **(as of 30/06/2015)**



Historical of Rating & target price changes

Date	Closing price	Target price	Rating	Changes
18/06/15	EUR66.05	EUR70	=	TP
15/04/15	EUR72.20	EUR67	=	TP
19/03/15	EUR70.31	EUR65	=	Rating & TP
22/04/14	EUR60.87	EUR36	-	TP
04/04/14	EUR59.08	EUR40	-	Rating & TP
22/01/14	EUR59.70	EUR51	=	TP
27/11/13	EUR66.00	EUR55	=	TP
25/11/13	EUR71.12	EUR60	=	TP
17/10/13	EUR73.56	EUR67	=	TP
11/10/13	EUR76.10	EUR72	=	TP
19/07/13	EUR82.08	EUR76	=	TP
12/06/13	EUR86.40	EUR79	=	TP
19/04/13	EUR87.29	EUR82	=	TP
08/04/13	EUR87.23	EUR90	=	TP
18/01/13	EUR91.78	EUR83	=	TP

Source: Exane BNP Paribas

The latest company-specific disclosures, valuation methodologies and investment case risks for all other companies covered by this document are available on www.exane.com/toolbox/compliance.

DIAGEO PLC (Neutral)

Price at 30 Jun. 15 / Target Price

Distillers & Vintners | Beverages - United Kingdom

1,841p / 1,910p +4%

Company description

The 1997 merger of Grand Met and Guinness gave birth to Diageo as the world leader in spirits. It has subsequently focused purely on alcoholic beverages with spirits, wines and Guinness beer, which dominates the niche segment. The Group has a strong product portfolio with sector leading brands (such as Johnnie Walker whisky, Smirnoff vodka or Captain Morgan rum) and has now gained critical mass in terms of size. Diageo is the undisputed leader of the very profitable US spirits market and has recently increased its EM exposure through acquisitions in China, Turkey, Brazil and India (United Spirits). The US and India are now the group's largest markets.

Management

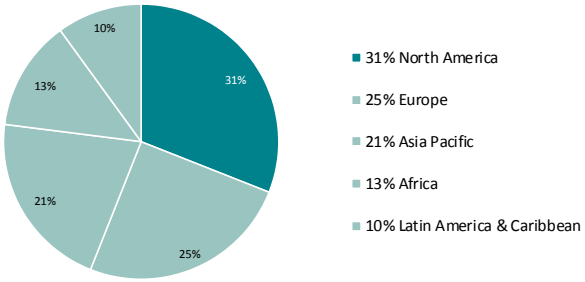
Ivan Menezes, CEO

Deirdre Mahlan, CFO

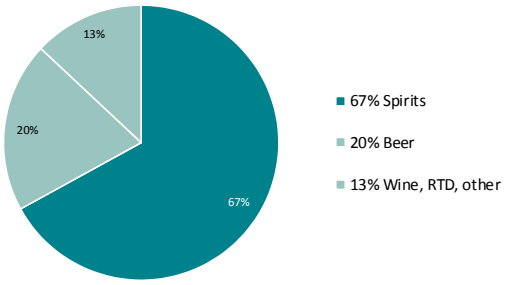
Ownership structure

Other Shareholders	100.0%

FY14 sales by region (incl United Spirits)



FY2014 sales by activity



Analyst

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Peer group YTD performance

Stock	Price (30 Jun. 15)		YTD performance in EUR (%) Abs.	Rel. Sector
Carlsberg (+)	DKK	607.5	28.1	13
Baron de Ley (+)	EUR	88.7	18.3	4
Rémy Cointreau (=)	EUR	64.7	16.8	3
Heineken (-)	EUR	68.1	16.5	3
AB InBev (=)	EUR	107.5	16.1	3
Pernod Ricard (+)	EUR	103.6	12.3	(1)
Diageo plc (=)	**p**	**1,841**	**10.3**	(3)
SABMiller (+)	p	3,304	7.6	(5)

Sector calendar

01 Jul. 15	**Diageo plc**: Innovation day
21 Jul. 15	**Rémy Cointreau**: Q1 Sales
23 Jul. 15	**SABMiller**: Q1 2016 Sales
	SABMiller: AGM
29 Jul. 15	**Rémy Cointreau**: AGM
30 Jul. 15	**AB InBev**: H1 2015 Results
	Baron de Ley: Q2 2015 Results
	Diageo plc: FY 2015 Preliminary Results
03 Aug. 15	**Heineken**: H1 2015 Results
19 Aug. 15	**Carlsberg**: Q2 2015 Results
27 Aug. 15	**Heineken**: Heineken seminar
	Pernod Ricard: FY 2015 Results
28 Aug. 15	**MZB Group**: Q2 2015 Results
01 Sep. 15	**AB InBev**: ABInBev China seminar
22 Sep. 15	**Diageo plc**: Western Europe presentation
23 Sep. 15	**Diageo plc**: AGM
15 Oct. 15	**SABMiller**: Q2 2016 Sales
16 Oct. 15	**Rémy Cointreau**: H1 Sales
22 Oct. 15	**Pernod Ricard**: Q1 2015 Sales
27 Oct. 15	**Diageo plc**: Diageo Asia Pacific presentation
28 Oct. 15	**Heineken**: Q3 2015 Sales
30 Oct. 15	**AB InBev**: Q3 2015 Results
05 Nov. 15	**Pernod Ricard**: AGM
10 Nov. 15	**Diageo plc**: Investor conference - New-York
11 Nov. 15	**Carlsberg**: Q3 2015 Results
12 Nov. 15	**Baron de Ley**: Q3 2015 Results
	SABMiller: H1 2016 Results
13 Nov. 15	**MZB Group**: Q3 2015 Results
26 Nov. 15	**Rémy Cointreau**: Half-year earnings 2015-16
15 Dec. 15	**Diageo plc**: Diageo North America presentation
29 Feb. 16	**Baron de Ley**: Q4 2015 Results

Price at 30 Jun. 15 / 12m Target Price
1,841p / 1,910p +4%
Reuters / Bloomberg: DGE.L / DGE LN

DIAGEO PLC (Neutral)

Analyst: Eamonn Ferry (+44) 207 039 9404

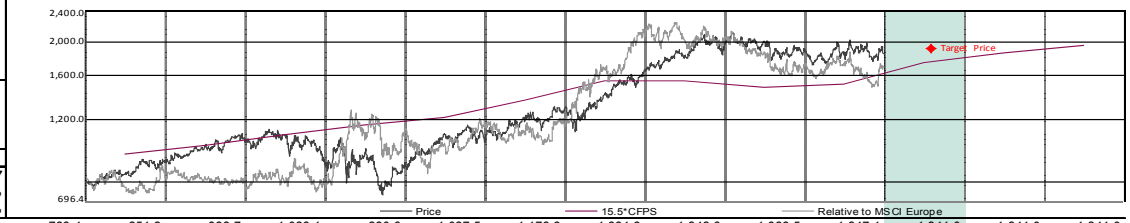
Distillers & Vintners | Beverages - United Kingdom

Company Highlights	GBPm / EURm
Enterprise value	58,841 / 82,711
Market capitalisation	50,701 / 71,269
Free float	50,701 / 71,269
3m average volume	85 / 119

Performance (*)	1m	3m	12m
Absolute	1%	(1%)	2%
Rel. Sector	4%	4%	(5%)
Rel. MSCI Europe	7%	5%	1%

12m Hi/Lo : 2,023p -9% / 1,710p +8%

CAGR	1998/2014	2014/2017
EPS restated (**)	7%	7%
CFPS	8%	9%



Price (yearly avg from Jun. 05 to Jun. 15)	*739.4*	*851.2*	*992.7*	*1,039.1*	*890.6*	*1,027.5*	*1,173.9*	*1,391.9*	*1,848.6*	*1,933.5*	*1,847.1*	*1,841.0*	*1,841.0*	*1,841.0*
PER SHARE DATA (p)	**Jun. 05**	**Jun. 06**	**Jun. 07**	**Jun. 08**	**Jun. 09**	**Jun. 10**	**Jun. 11**	**Jun. 12**	**Jun. 13**	**Jun. 14**	**Jun. 15e**	**Jun. 16e**	**Jun. 17e**	**Jun. 18e**
No of shares year end, basic, (m)	3 050.000	3 051.000	2 931.000	2 822.000	2 754.000	2 754.000	2 754.000	2 754.000	2 754.000	2 754.000	2 754.000	2 754.000	2 754.000	2 754.000
Avg no of shares, diluted, excl. treasury stocks (m)	2 978.433	2 853.740	2 707.549	2 583.426	2 492.646	2 489.801	2 499.561	2 509.000	2 517.000	2 517.000	2 517.000	2 517.000	2 517.000	2 517.000
EPS reported	*49.06*	*50.55*	*54.80*	*60.60*	*66.50*	*70.90*	*83.60*	*92.60*	*104.40*	*95.50*	*89.08*	*95.92*	*102.57*	*108.35*
EPS restated, fully diluted	48.95	50.32	54.40	60.19	66.30	70.79	83.38	92.08	103.78	95.08	88.69	95.50	102.12	107.88
% change	*1.5%*	*2.8%*	*8.1%*	*10.6%*	*10.1%*	*6.8%*	*17.8%*	*10.4%*	*12.7%*	*(8.4%)*	*(6.7%)*	*7.7%*	*6.9%*	*5.6%*
CFPS	70.63	61.58	65.25	70.04	74.39	78.13	87.69	98.94	99.20	94.84	97.47	111.66	118.87	125.18
Book value (BVPS) (a)	119.4	147.6	135.5	124.0	117.0	145.5	190.5	202.9	255.5	247.7	286.2	331.7	381.4	434.7
Net dividend	29.55	31.10	32.70	34.35	36.10	38.10	40.40	43.50	47.40	51.70	51.70	53.71	56.41	59.60
STOCKMARKET RATIOS	**Jun. 05**	**Jun. 06**	**Jun. 07**	**Jun. 08**	**Jun. 09**	**Jun. 10**	**Jun. 11**	**Jun. 12**	**Jun. 13**	**Jun. 14**	**Jun. 15e**	**Jun. 16e**	**Jun. 17e**	**Jun. 18e**
P / E (P/ EPS restated)	15.1x	16.9x	18.2x	17.3x	13.4x	14.5x	14.1x	15.1x	17.8x	20.3x	20.8x	19.3x	18.0x	17.1x
P / E relative to MSCI Europe	75%	105%	229%	182%	91%	92%	112%	100%	110%	108%	115%	120%	126%	133%
P / CF	10.5x	13.8x	15.2x	14.8x	12.0x	13.2x	13.4x	14.1x	18.6x	20.4x	18.9x	16.5x	15.5x	14.7x
FCF yield	8.0%	5.5%	5.0%	4.6%	5.7%	7.4%	5.7%	4.3%	2.9%	2.3%	3.5%	3.5%	3.8%	4.1%
P / BVPS	6.19x	5.77x	7.33x	8.38x	7.61x	7.06x	6.16x	6.86x	7.24x	7.80x	6.45x	5.55x	4.83x	4.24x
Net yield	4.0%	3.7%	3.3%	3.3%	4.1%	3.7%	3.4%	3.1%	2.6%	2.7%	2.8%	2.9%	3.1%	3.2%
Payout	60.4%	61.8%	60.1%	57.1%	54.5%	53.8%	48.5%	47.2%	45.7%	54.4%	58.3%	56.2%	55.2%	55.2%
EV / Sales	4.04x	3.93x	4.18x	4.00x	3.33x	3.49x	3.63x	4.00x	4.68x	5.34x	5.06x	5.16x	4.90x	4.63x
EV / Restated EBITDA	12.6x	12.6x	13.4x	12.7x	10.7x	11.0x	11.3x	12.2x	13.8x	15.6x	15.7x	16.0x	15.0x	14.1x
EV / Restated EBITA	14.0x	14.0x	14.7x	14.0x	11.9x	12.4x	12.5x	13.5x	15.2x	17.5x	17.6x	17.9x	16.8x	15.8x
EV / OpFCF	14.7x	15.6x	16.3x	17.5x	14.6x	12.6x	15.5x	18.3x	24.5x	30.1x	22.9x	22.6x	21.1x	20.0x
EV / Capital employed (incl. gross goodw ill)	3.8x	3.5x	3.9x	3.4x	2.9x	3.0x	3.2x	3.0x	3.4x	3.7x	2.9x	3.0x	2.9x	2.8x
ENTERPRISE VALUE (GBPm)	**27,177**	**28,546**	**31,235**	**32,339**	**31,000**	**34,096**	**36,038**	**43,065**	**53,528**	**54,748**	**54,923**	**58,841**	**58,287**	**57,701**
Market cap	21,976	24,182	26,683	26,664	22,130	25,543	29,265	34,729	46,252	48,454	46,288	50,701	50,701	50,701
+ Adjusted net debt	4,144	4,082	4,845	6,447	7,419	6,954	6,450	7,570	8,403	8,850	9,771	9,298	8,736	8,140
+ Other liabilities and commitments	1,965	1,404	889	931	2,217	1,983	1,415	1,673	1,026	960	1,359	1,336	1,345	1,355
+ Revalued minority interests	1,152	1,026	1,206	1,368	1,872	2,052	2,106	2,495	2,110	1,347	2,368	2,368	2,368	2,368
- Revalued investments	2,060	2,148	2,388	3,070	2,639	2,436	3,198	3,402	4,263	4,863	4,863	4,863	4,863	4,863
P & L HIGHLIGHTS (GBPm)	**Jun. 05**	**Jun. 06**	**Jun. 07**	**Jun. 08**	**Jun. 09**	**Jun. 10**	**Jun. 11**	**Jun. 12**	**Jun. 13**	**Jun. 14**	**Jun. 15e**	**Jun. 16e**	**Jun. 17e**	**Jun. 18e**
Sales	**6,729**	**7,260**	**7,481**	**8,090**	**9,311**	**9,780**	**9,936**	**10,762**	**11,433**	**10,258**	**10,863**	**11,399**	**11,898**	**12,466**
Restated EBITDA (b)	**2,163**	**2,267**	**2,335**	**2,537**	**2,889**	**3,088**	**3,197**	**3,537**	**3,883**	**3,503**	**3,495**	**3,687**	**3,874**	**4,082**
Depreciation	(219)	(223)	(216)	(233)	(276)	(337)	(313)	(339)	(353)	(369)	(376)	(394)	(411)	(431)
Restated EBITA (b) (**)	**1,944**	**2,044**	**2,119**	**2,304**	**2,613**	**2,751**	**2,884**	**3,198**	**3,530**	**3,134**	**3,119**	**3,293**	**3,462**	**3,651**
Reported operating profit (loss)	1,736	2,044	2,159	2,226	2,443	2,574	2,595	3,158	3,431	2,707	2,865	3,293	3,462	3,651
Net financial income (charges)	(126)	(186)	(212)	(319)	(592)	(462)	(397)	(397)	(424)	(388)	(462)	(382)	(344)	(325)
Affiliates	185	131	149	177	164	142	176	213	199	252	173	181	194	208
Other	27	157	138	35	2	(34)	(14)	136	(83)	57	98	0	0	0
Tax	(383)	(181)	(678)	(522)	(292)	(477)	(343)	(1,038)	(529)	(447)	(538)	(563)	(606)	(650)
Minorities	(64)	(57)	(67)	(76)	(104)	(114)	(117)	(130)	(109)	67	(89)	(126)	(136)	(168)
Goodw ill amortisation														
Net attributable profit reported	1,375	1,908	1,489	1,521	1,621	1,629	1,900	1,942	2,485	2,248	2,048	2,404	2,570	2,715
Net attributable profit restated (c)	**1,458**	**1,436**	**1,473**	**1,555**	**1,653**	**1,763**	**2,084**	**2,310**	**2,612**	**2,393**	**2,232**	**2,404**	**2,570**	**2,715**
CASH FLOW HIGHLIGHTS (GBPm)	**Jun. 05**	**Jun. 06**	**Jun. 07**	**Jun. 08**	**Jun. 09**	**Jun. 10**	**Jun. 11**	**Jun. 12**	**Jun. 13**	**Jun. 14**	**Jun. 15e**	**Jun. 16e**	**Jun. 17e**	**Jun. 18e**
EBITDA (reported)	**1,960**	**2,258**	**2,369**	**2,459**	**2,719**	**2,946**	**2,947**	**3,569**	**3,834**	**3,336**	**3,241**	**3,687**	**3,874**	**4,082**
EBITDA adjustment (b)	**203**	**9**	**(34)**	**78**	**170**	**142**	**250**	**(32)**	**49**	**167**	**254**	**0**	**0**	**0**
Other items	33	9	34	(78)	(160)	(349)	(344)	(169)	(502)	(443)	(266)	0	0	0
Change in WCR	(53)	(192)	(180)	(282)	(282)	334	(112)	(529)	(553)	(597)	(128)	(349)	(350)	(391)
Operating cash flow	**2,143**	**2,084**	**2,189**	**2,177**	**2,447**	**3,073**	**2,741**	**2,839**	**2,828**	**2,463**	**3,101**	**3,338**	**3,524**	**3,691**
Capex	(296)	(257)	(274)	(328)	(327)	(374)	(419)	(484)	(643)	(642)	(698)	(733)	(765)	(801)
Operating free cash flow (OpFCF)	**1,847**	**1,827**	**1,915**	**1,849**	**2,120**	**2,699**	**2,322**	**2,355**	**2,185**	**1,821**	**2,402**	**2,605**	**2,759**	**2,889**
Net financial items + tax paid	0	(449)	(522)	(561)	(758)	(668)	(538)	(746)	(780)	(673)	(678)	(729)	(723)	(736)
Free cash flow	**1,847**	**1,378**	**1,393**	**1,288**	**1,362**	**2,031**	**1,784**	**1,609**	**1,405**	**1,148**	**1,725**	**1,876**	**2,036**	**2,153**
Net financial investments & acquisitions	646	586	(53)	(551)	(161)	(105)	(35)	(1,475)	(805)	(484)	(1,214)	0	0	0
Other	(441)	35	244	(428)	(1,031)	(724)	81	(74)	(178)	489	(162)	0	0	0
Capital increase (decrease)	(733)	(1,436)	(1,429)	(1,085)	(392)	85	(8)	1	(11)	(112)	0	0	0	0
Dividends paid	(898)	(904)	(899)	(913)	(968)	(1,021)	(1,085)	(1,154)	(1,236)	(1,316)	(1,351)	(1,403)	(1,474)	(1,557)
Increase (decrease) in net financial debt	**(421)**	**341**	**744**	**1,689**	**1,190**	**(266)**	**(737)**	**1,093**	**825**	**275**	**1,002**	**(473)**	**(562)**	**(596)**
Cash flow, group share	**2,104**	**1,757**	**1,767**	**1,810**	**1,854**	**1,945**	**2,192**	**2,482**	**2,497**	**2,387**	**2,453**	**2,810**	**2,992**	**3,151**
BALANCE SHEET HIGHLIGHTS (GBPm)	**Jun. 05**	**Jun. 06**	**Jun. 07**	**Jun. 08**	**Jun. 09**	**Jun. 10**	**Jun. 11**	**Jun. 12**	**Jun. 13**	**Jun. 14**	**Jun. 15e**	**Jun. 16e**	**Jun. 17e**	**Jun. 18e**
Net operating assets	6,349	6,499	6,327	7,683	8,520	9,160	9,130	11,827	12,552	11,377	14,938	15,276	15,630	16,000
WCR	884	1,581	1,660	1,906	2,336	2,221	2,217	2,665	3,127	3,610	3,738	4,087	4,437	4,828
Restated capital employed, incl. gross goodw ill	**7,233**	**8,080**	**7,987**	**9,589**	**10,856**	**11,381**	**11,347**	**14,492**	**15,679**	**14,987**	**18,676**	**19,363**	**20,066**	**20,828**
Shareholders' funds, group share	3,641	4,502	3,972	3,498	3,221	4,007	5,245	5,588	7,036	6,823	7,882	9,136	10,503	11,970
Minorities	193	179	198	677	715	779	740	1,223	1,071	767	1,468	1,467	1,469	1,495
Provisions/ Other liabilities	1,731	1,920	1,445	1,647	2,598	2,510	2,158	3,168	2,895	2,632	2,835	2,814	2,730	2,614
Net financial debt (cash)	3,729	4,070	4,814	6,503	7,693	7,427	6,690	7,783	8,608	8,883	9,885	9,412	8,850	8,254
FINANCIAL RATIOS (%)	**Jun. 05**	**Jun. 06**	**Jun. 07**	**Jun. 08**	**Jun. 09**	**Jun. 10**	**Jun. 11**	**Jun. 12**	**Jun. 13**	**Jun. 14**	**Jun. 15e**	**Jun. 16e**	**Jun. 17e**	**Jun. 18e**
Sales (% change)	0.7%	7.9%	3.0%	8.1%	15.1%	5.0%	1.6%	8.3%	6.2%	(10.3%)	5.9%	4.9%	4.4%	4.8%
Organic sales grow th	3.4%	6.2%	7.0%	6.6%	(0.3%)	1.8%	4.4%	6.3%	4.8%	0.4%	(0.1%)	3.6%	4.4%	4.8%
Restated EBITA (% change) (**)	3.8%	5.1%	3.7%	8.7%	13.4%	5.3%	4.8%	10.9%	10.4%	(11.2%)	(0.5%)	5.6%	5.1%	5.4%
Restated attributable net profit (% change) (**)	(0.3%)	(1.5%)	2.6%	5.6%	6.3%	6.7%	18.2%	10.9%	13.1%	(8.4%)	(6.7%)	7.7%	6.9%	5.6%
Personnel costs / Sales	13.0%	13.1%	13.3%	13.3%	13.2%	13.0%	13.5%	11.4%	12.3%	14.4%	NC	NC	NC	NC
Restated EBITDA margin	32.1%	31.2%	31.2%	31.4%	31.0%	31.6%	32.2%	32.9%	34.0%	34.1%	32.2%	32.3%	32.6%	32.7%
Restated EBITA margin	28.9%	28.2%	28.3%	28.5%	28.1%	28.1%	29.0%	29.7%	30.9%	30.6%	28.7%	28.9%	29.1%	29.3%
Tax rate	21.0%	8.4%	32.4%	24.9%	14.5%	21.3%	14.5%	33.3%	16.9%	16.5%	20.1%	18.2%	18.3%	18.4%
Net margin	21.4%	27.1%	20.8%	19.7%	18.5%	17.8%	20.3%	19.3%	22.7%	21.3%	19.7%	22.2%	22.7%	23.1%
Capex / Sales	4.4%	3.5%	3.7%	4.1%	3.5%	3.8%	4.2%	4.5%	5.6%	6.3%	6.4%	6.4%	6.4%	6.4%
OpFCF / Sales	27.4%	25.2%	25.6%	22.9%	22.8%	27.6%	23.4%	21.9%	19.1%	17.8%	22.1%	22.9%	23.2%	23.2%
WCR / Sales	13.1%	21.8%	22.2%	23.6%	25.1%	22.7%	22.3%	24.8%	27.4%	35.2%	34.4%	35.9%	37.3%	38.7%
Capital employed (excl. gdw ./intangibles) / Sales	44.3%	48.8%	48.2%	50.2%	49.8%	47.6%	48.3%	52.7%	58.0%	69.2%	80.6%	82.9%	85.3%	87.5%
ROE	40.0%	31.9%	37.1%	44.5%	51.3%	44.0%	39.7%	41.3%	37.1%	35.1%	28.3%	26.3%	24.5%	22.7%
Gearing	108%	87%	116%	154%	188%	145%	108%	111%	104%	117%	104%	88%	73%	60%
EBITDA / Financial charges	17.2x	12.2x	11.0x	8.0x	4.9x	6.7x	8.1x	8.9x	9.2x	9.0x	7.6x	9.7x	11.3x	12.6x
Adjusted financial debt / EBITDA	1.9x	1.8x	2.1x	2.5x	2.6x	2.3x	2.0x	2.1x	2.2x	2.5x	2.8x	2.5x	2.3x	2.0x
ROCE, excl. gdw ./intangibles	49.6%	43.3%	44.0%	42.8%	43.8%	46.3%	49.6%	46.4%	43.8%	36.1%	29.2%	28.5%	27.9%	27.3%
ROCE, incl. gross goodw ill	20.4%	19.0%	19.9%	18.1%	18.7%	18.9%	21.0%	18.2%	18.5%	17.1%	13.7%	13.9%	14.1%	14.3%
WACC	8.2%	7.4%	7.3%	7.3%	8.1%	7.9%	7.8%	8.1%	7.7%	7.1%	6.6%	6.3%	6.3%	6.3%

Latest Model update: 20 Apr. 15

(a) Intangibles: GBP7,891.00m, or GBP3p per share. (b) adjusted for capital gains/losses, impairment charges, exceptional restructuring charges, capitalized R&D, pension charge replaced by service cost
(c) adj.for capital gains losses, imp.charges, capitalized R&D, am. of intangibles from M&A, exceptional restructuring, (*) In listing currency, w ith div. reinvested, (**) also adjusted for am. of intangibles from M&A, or for am. of gw ill for pre IFRS yea

PERNOD RICARD (Outperform)

Price at 30 Jun. 15 / Target Price

Distillers & Vintners | Beverages - France

EUR103.6 / EUR122 +18%

Company description

Pernod Ricard was formed in 1975 from the merger of two French anis groups (Pernod and Ricard). Through organic development and progressive acquisitions, Pernod Ricard grew into the fifth largest wine and spirits group worldwide in the 1990s. It has now become the world's co-leader in wine and spirits following the acquisition of spirits brands from Seagram in 2001, Allied Domecq in 2005 and Absolut in 2008. The group's strategy remains centered on fostering its entrepreneurial style, extracting synergies from bolt-on acquisitions, leveraging its distribution network and achieving organic growth. Its two largest markets are the US and China.

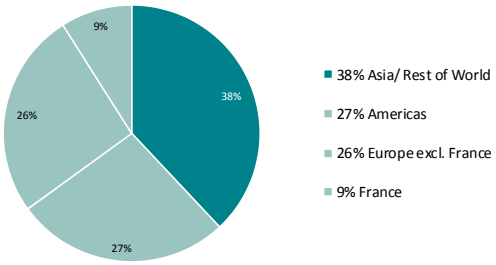
Management

Alexandre Ricard, CEO
Bogaert Gilles, CFO

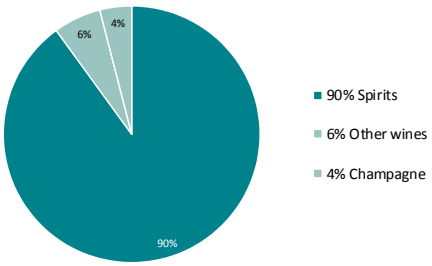
Ownership structure

Societe Paul Ricard	13.1%
Capital Group Companies	11.0%
Groupe Bruxelles Lambert	7.5%
MFS Invt Mgmt	4.9%
Pernod Ricard employees	1.2%
Mr Rafael Gonzalez-Gallarza	0.6%
Directors & management	0.3%
Other Shareholders	61.4%

FY2014 sales by region



FY2014 sales by activity



Analyst

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Sector calendar

01 Jul. 15	**Diageo plc**: Innovation day
21 Jul. 15	**Rémy Cointreau**: Q1 Sales
23 Jul. 15	**SABMiller**: Q1 2016 Sales
	SABMiller: AGM
29 Jul. 15	**Rémy Cointreau**: AGM
30 Jul. 15	**AB InBev**: H1 2015 Results
	Baron de Ley: Q2 2015 Results
	Diageo plc: FY 2015 Preliminary Results
03 Aug. 15	**Heineken**: H1 2015 Results
19 Aug. 15	**Carlsberg**: Q2 2015 Results
27 Aug. 15	**Heineken**: Heineken seminar
	Pernod Ricard: FY 2015 Results
28 Aug. 15	**MZB Group**: Q2 2015 Results
01 Sep. 15	**AB InBev**: ABInBev China seminar
22 Sep. 15	**Diageo plc**: Western Europe presentation
23 Sep. 15	**Diageo plc**: AGM
15 Oct. 15	**SABMiller**: Q2 2016 Sales
16 Oct. 15	**Rémy Cointreau**: H1 Sales
22 Oct. 15	**Pernod Ricard**: Q1 2015 Sales
27 Oct. 15	**Diageo plc**: Diageo Asia Pacific presentation
28 Oct. 15	**Heineken**: Q3 2015 Sales
30 Oct. 15	**AB InBev**: Q3 2015 Results
05 Nov. 15	**Pernod Ricard**: AGM
10 Nov. 15	**Diageo plc**: Investor conference - New-York
11 Nov. 15	**Carlsberg**: Q3 2015 Results
12 Nov. 15	**Baron de Ley**: Q3 2015 Results
	SABMiller: H1 2016 Results
13 Nov. 15	**MZB Group**: Q3 2015 Results
26 Nov. 15	**Rémy Cointreau**: Half-year earnings 2015-16
15 Dec. 15	**Diageo plc**: Diageo North America presentation
29 Feb. 16	**Baron de Ley**: Q4 2015 Results

Price at 30 Jun. 15 / 12m Target Price
EUR103.6 / EUR122 +18%
Reuters / Bloomberg: PERP.PA / RI FP

PERNOD RICARD (Outperform)

Analyst: Eamonn Ferry (+44) 207 039 9404

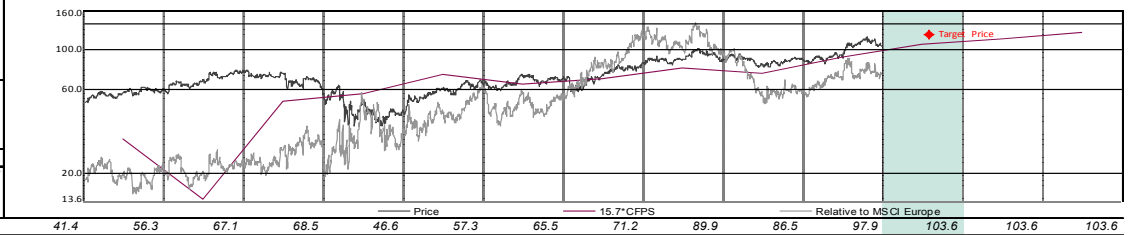
Distillers & Vintners | Beverages - France

Company Highlights	EURm
Enterprise value	36,676
Market capitalisation	27,498
Free float	21,173
3m average volume	61

Performance (*)	1m	3m	12m
Absolute	(8%)	(6%)	20%
Rel. Sector	(6%)	(4%)	(0%)
Rel. MSCI Europe	(3%)	(3%)	5%

12m Hi/Lo (EUR) : 117.3 -12% / 83.2 +25%

CAGR	1995/2014	2014/2017
EPS restated (**)	8%	11%
CFPS	7%	11%



	Jun. 05	Jun. 06	Jun. 07	Jun. 08	Jun. 09	Jun. 10	Jun. 11	Jun. 12	Jun. 13	Jun. 14	Jun. 15e	Jun. 16e	Jun. 17e	Jun. 18e
Price (yearly avg from Jun. 05 to Jun. 15)	*41.4*	*56.3*	*67.1*	*68.5*	*46.6*	*57.3*	*65.5*	*71.2*	*89.9*	*86.5*	*97.9*	*103.6*	*103.6*	*103.6*
PER SHARE DATA (EUR)														
No of shares year end, basic, (m)	182.949	203.456	237.092	224.077	258.641	264.232	264.722	265.311	265.422	265.422	265.422	265.422	265.422	265.422
Avg no of shares, diluted, excl. treasury stocks (m)	197.371	227.525	232.505	234.928	241.221	264.856	265.032	265.148	266.353	265.816	265.816	265.816	265.816	265.816
EPS reported	*2.31*	*2.87*	*3.58*	*3.82*	*4.19*	*3.78*	*4.12*	*4.53*	*4.61*	*4.46*	*5.00*	*5.70*	*6.25*	*6.79*
EPS restated, fully diluted	2.31	2.87	3.58	3.82	4.19	3.78	4.12	4.53	4.61	4.46	5.00	5.70	6.25	6.79
% change	*(43.5%)*	*86.5%*	*24.6%*	*6.6%*	*9.7%*	*(9.7%)*	*9.0%*	*9.9%*	*1.7%*	*(3.2%)*	*12.2%*	*14.0%*	*9.5%*	*8.7%*
CFPS	2.53	1.99	0.91	3.22	3.58	4.60	4.03	4.35	4.95	4.65	5.73	6.75	7.29	7.88
Book value (BVPS) (a)	16.9	28.0	26.5	28.7	28.7	34.5	35.1	40.7	42.1	43.8	41.6	45.4	49.5	54.1
Net dividend	0.83	0.97	1.17	1.22	0.50	1.34	1.44	1.58	1.64	1.64	1.75	2.00	2.19	2.38
STOCKMARKET RATIOS														
P / E (P/ EPS restated)	26.8x	19.6x	18.7x	18.0x	11.1x	15.2x	15.9x	15.7x	19.5x	19.4x	19.6x	18.2x	16.6x	15.3x
P / E relative to MSCI Europe	133%	122%	235%	189%	75%	96%	126%	104%	121%	103%	108%	114%	116%	119%
P / CF	24.5x	28.4x	74.0x	21.3x	13.0x	12.5x	16.3x	16.4x	18.2x	18.6x	17.1x	15.3x	14.2x	13.2x
FCF yield	3.2%	2.9%	(1.1%)	(0.0%)	7.7%	6.6%	5.1%	4.4%	3.2%	2.9%	3.3%	3.6%	4.6%	5.1%
P / BVPS	2.44x	2.01x	2.53x	2.39x	1.62x	1.66x	1.87x	1.75x	2.13x	1.97x	2.35x	2.28x	2.09x	1.92x
Net yield	2.0%	1.7%	1.7%	1.8%	1.1%	2.3%	2.2%	2.2%	1.8%	1.9%	1.8%	1.9%	2.1%	2.3%
Payout	35.8%	33.8%	32.5%	32.0%	11.9%	35.4%	34.9%	34.9%	35.6%	36.8%	35.0%	35.0%	35.0%	35.0%
EV / Sales	4.03x	3.30x	3.55x	3.47x	3.15x	3.73x	3.53x	3.48x	3.74x	3.87x	4.15x	3.95x	3.71x	3.48x
EV / Restated EBITDA	16.5x	14.5x	13.9x	13.5x	11.1x	13.6x	13.0x	12.5x	13.2x	13.6x	14.4x	13.4x	12.4x	11.5x
EV / Restated EBITA	19.9x	15.9x	15.8x	15.0x	12.3x	14.7x	14.1x	13.5x	14.4x	15.0x	15.7x	14.6x	13.5x	12.5x
EV / OpFCF	39.4x	22.6x	24.8x	39.8x	13.5x	16.6x	16.4x	17.3x	19.1x	20.4x	19.9x	18.6x	15.8x	14.6x
EV / Capital employed (incl. gross goodw ill)	1.6x	1.3x	1.4x	1.5x	1.1x	1.1x	1.3x	1.2x	1.4x	1.3x	1.5x	1.5x	1.4x	1.4x
ENTERPRISE VALUE (EURm)	**9,694**	**20,015**	**22,846**	**22,864**	**22,713**	**26,397**	**26,975**	**28,619**	**32,096**	**30,768**	**35,443**	**36,676**	**35,944**	**35,133**
Market cap	7,566	12,415	15,340	15,865	11,167	15,058	17,209	18,717	23,690	22,768	25,769	27,498	27,498	27,498
+ Adjusted net debt	1,991	6,351	6,515	6,143	10,888	10,584	9,038	9,363	8,727	8,353	9,313	8,807	8,064	7,241
+ Other liabilities and commitments	0	1,009	773	478	405	396	259	165	84	306	306	306	306	306
+ Revalued minority interests	162	558	450	522	378	486	576	493	342	198	208	218	229	241
- Revalued investments	25	318	232	144	125	127	107	119	747	857	153	153	153	153
P & L HIGHLIGHTS (EURm)														
Sales	**3,611**	**6,066**	**6,443**	**6,589**	**7,203**	**7,081**	**7,643**	**8,215**	**8,575**	**7,945**	**8,537**	**9,282**	**9,688**	**10,099**
Restated EBITDA (b)	**879**	**1,380**	**1,638**	**1,688**	**2,041**	**1,945**	**2,069**	**2,282**	**2,425**	**2,260**	**2,470**	**2,741**	**2,898**	**3,053**
Depreciation	(150)	(125)	(191)	(166)	(195)	(150)	(160)	(168)	(195)	(204)	(209)	(227)	(237)	(247)
Restated EBITA (b) (**)	**729**	**1,255**	**1,447**	**1,522**	**1,846**	**1,795**	**1,909**	**2,114**	**2,230**	**2,056**	**2,260**	**2,513**	**2,661**	**2,806**
Reported operating profit (loss)	745	1,129	1,467	1,441	1,757	1,707	1,853	1,968	2,106	1,816	2,190	2,513	2,661	2,806
Net financial income (charges)	(88)	(410)	(352)	(349)	(690)	(507)	(458)	(548)	(554)	(485)	(459)	(448)	(400)	(348)
Affiliates		2	1	0	0	1	2	0	1	1				
Other														
Tax	(173)	(108)	(260)	(224)	(108)	(223)	(318)	(247)	(371)	(305)	(453)	(537)	(588)	(639)
Minorities	(9)	(31)	(25)	(29)	(21)	(27)	(32)	(27)	(19)	(11)	(12)	(12)	(13)	(13)
Goodw ill amortisation														
Net attributable profit reported	475	582	832	840	937	951	1,046	1,146	1,163	1,016	1,267	1,516	1,661	1,806
Net attributable profit restated (c)	**456**	**654**	**833**	**897**	**1,010**	**1,001**	**1,092**	**1,201**	**1,227**	**1,185**	**1,329**	**1,516**	**1,661**	**1,806**
CASH FLOW HIGHLIGHTS (EURm)														
EBITDA (reported)	**910**	**1,277**	**1,661**	**1,610**	**2,098**	**1,974**	**2,055**	**2,150**	**2,365**	**2,180**	**2,400**	**2,741**	**2,898**	**3,053**
EBITDA adjustment (b)	**(31)**	**103**	**(23)**	**78**	**(57)**	**(29)**	**14**	**132**	**60**	**80**	**70**	**0**	**0**	**0**
Other items	(369)	(393)	(326)	(328)	(367)	(119)	(234)	(298)	(182)	(171)	(21)	54	43	43
Change in WCR	(33)	238	(149)	(513)	246	(48)	32	(55)	(255)	(308)	(360)	(493)	(321)	(332)
Operating cash flow	**477**	**1,225**	**1,163**	**847**	**1,920**	**1,778**	**1,867**	**1,929**	**1,988**	**1,781**	**2,089**	**2,301**	**2,620**	**2,765**
Capex	(108)	(338)	(242)	(273)	(241)	(184)	(223)	(271)	(304)	(273)	(308)	(332)	(345)	(358)
Operating free cash flow (OpFCF)	**369**	**887**	**921**	**574**	**1,679**	**1,594**	**1,644**	**1,657**	**1,684**	**1,508**	**1,781**	**1,969**	**2,276**	**2,407**
Net financial items + tax paid	(1)	(514)	(1,095)	(579)	(794)	(574)	(735)	(803)	(904)	(841)	(912)	(985)	(988)	(987)
Free cash flow	**369**	**373**	**(174)**	**(5)**	**885**	**1,020**	**909**	**854**	**780**	**667**	**869**	**984**	**1,288**	**1,420**
Net financial investments & acquisitions	(8)	(2,636)	268	80	(5,285)	689	173	22	83	(8)	20	0	0	0
Other	(155)	(1,834)	(33)	359	(1,292)	(1,346)	1,026	(873)	369	199	0	0	0	0
Capital increase (decrease)	(101)	4	9	206	1,007	(27)	(70)	(31)	24	(16)	0	0	0	0
Dividends paid	(140)	(113)	(251)	(280)	(301)	(136)	(389)	(411)	(435)	(448)	(448)	(478)	(545)	(597)
Increase (decrease) in net financial debt	**35**	**4,206**	**180**	**(360)**	**4,986**	**(200)**	**(1,649)**	**439**	**(821)**	**(394)**	**(441)**	**(506)**	**(743)**	**(823)**
Cash flow, group share	**499**	**452**	**211**	**757**	**862**	**1,219**	**1,068**	**1,154**	**1,318**	**1,237**	**1,523**	**1,795**	**1,939**	**2,094**
BALANCE SHEET HIGHLIGHTS (EURm)														
Net operating assets	3,069	13,245	13,048	12,015	18,031	19,697	18,248	19,409	18,827	18,615	18,693	18,798	18,905	19,015
WCR	2,807	2,358	3,056	3,353	3,222	3,271	2,984	3,493	4,214	4,626	4,986	5,479	5,800	6,132
Restated capital employed, incl. gross goodw ill	**6,091**	**15,840**	**16,345**	**15,608**	**21,477**	**23,153**	**21,417**	**23,052**	**23,182**	**23,381**	**23,819**	**24,417**	**24,845**	**25,287**
Shareholders' funds, group share	3,101	5,700	6,290	6,420	7,431	9,122	9,284	10,803	11,183	11,621	11,037	12,040	13,151	14,353
Minorities	34	172	168	177	185	216	190	169	168	157	169	181	193	207
Provisions/ Other liabilities	820	4,438	4,129	3,490	3,724	4,137	4,170	4,612	4,942	5,312	6,766	6,856	6,905	6,955
Net financial debt (cash)	2,144	6,350	6,530	6,170	11,156	10,955	9,306	9,745	8,924	8,530	8,089	7,583	6,840	6,018
FINANCIAL RATIOS (%)														
Sales (% change)	(31.9%)	152.0%	6.2%	2.3%	9.3%	(1.7%)	7.9%	7.5%	4.4%	(7.3%)	7.5%	8.7%	4.4%	4.2%
Organic sales growth	7.3%	3.2%	9.1%	8.5%	(0.4%)	1.8%	6.5%	7.6%	3.9%	(0.4%)	2.5%	3.7%	4.4%	4.2%
Restated EBITA (% change) (**)	(34.2%)	158.2%	15.3%	5.2%	21.3%	(2.8%)	6.3%	10.7%	5.5%	(7.8%)	9.9%	11.2%	5.9%	5.4%
Restated attributable net profit (% change) (**)	(34.4%)	114.9%	27.3%	7.7%	12.6%	(0.9%)	9.1%	10.0%	2.2%	(3.4%)	12.2%	14.0%	9.5%	8.7%
Personnel costs / Sales	16.7%	12.0%	13.4%	12.3%	10.9%	11.1%	14.2%	14.4%	14.6%	15.2%	NC	NC	NC	NC
Restated EBITDA margin	24.3%	22.7%	25.4%	25.6%	28.3%	27.5%	27.1%	27.8%	28.3%	28.4%	28.9%	29.5%	29.9%	30.2%
Restated EBITA margin	20.2%	20.7%	22.5%	23.1%	25.6%	25.4%	25.0%	25.7%	26.0%	25.9%	26.5%	27.1%	27.5%	27.8%
Tax rate	26.4%	15.0%	23.3%	20.5%	10.1%	18.6%	22.8%	17.4%	23.9%	22.9%	26.2%	26.0%	26.0%	26.0%
Net margin	13.4%	10.1%	13.3%	13.2%	13.3%	13.8%	14.1%	14.3%	13.8%	12.9%	15.0%	16.5%	17.3%	18.0%
Capex / Sales	3.0%	5.6%	3.8%	4.1%	3.4%	2.6%	2.9%	3.3%	3.5%	3.4%	3.6%	3.6%	3.6%	3.5%
OpFCF / Sales	10.2%	14.6%	14.3%	8.7%	23.3%	22.5%	21.5%	20.2%	19.6%	19.0%	20.9%	21.2%	23.5%	23.8%
WCR / Sales	116.6%	38.9%	47.4%	50.9%	44.7%	46.2%	39.0%	42.5%	49.1%	58.2%	58.4%	59.0%	59.9%	60.7%
Capital employed (excl. gdw ./intangibles) / Sales	152.7%	66.7%	74.4%	76.3%	70.2%	73.6%	64.1%	67.5%	73.3%	85.5%	84.7%	84.3%	85.2%	86.1%
ROE	9.8%	11.5%	13.2%	14.0%	13.6%	11.0%	11.8%	11.1%	11.0%	10.2%	12.0%	12.6%	12.6%	12.6%
Gearing	63%	108%	101%	93%	143%	113%	95%	85%	77%	71%	83%	72%	60%	50%
EBITDA / Financial charges	9.0x	3.9x	4.8x	5.1x	3.3x	3.9x	4.4x	4.5x	4.5x	5.1x	5.5x	6.1x	7.2x	8.8x
Adjusted financial debt / EBITDA	3.4x	4.6x	4.0x	3.6x	5.3x	5.4x	4.4x	4.1x	3.6x	3.7x	3.8x	3.2x	2.8x	2.4x
ROCE, excl. gdw ./intangibles	9.9%	23.4%	23.4%	23.6%	30.5%	27.3%	30.4%	29.2%	26.2%	22.5%	23.1%	23.8%	23.9%	23.9%
ROCE, incl. gross goodw ill	6.0%	6.0%	6.9%	7.6%	7.2%	6.1%	7.0%	7.0%	7.1%	6.5%	7.0%	7.6%	7.9%	8.2%
WACC	9.0%	7.5%	7.7%	7.8%	7.9%	7.9%	8.0%	8.3%	8.3%	7.7%	7.3%	7.1%	7.1%	7.1%

Latest Model update: 23 Apr. 15

(a) Intangibles: EUR16,449.00m, or EUR62 per share. (b) adjusted for capital gains/losses, impairment charges, exceptional restructuring charges, capitalized R&D, pension charge replaced by service cost
(c) adj.for capital gains losses, imp.charges, capitalized R&D, am. of intangibles from M&A, exceptional restructuring, (*) In listing currency, w ith div. reinvested, (**) also adjusted for am. of intangibles from M&A, or for am. of gw ill for pre IFRS yea

REMY COINTREAU (Neutral)

Price at 30 Jun. 15 / Target Price

Distillers & Vintners | Beverages - France

EUR64.7 / EUR70 +8%

Company description

Rémy Cointreau produces and markets a number of global spirits brands, which include Rémy Martin cognac, Cointreau, Passoa (a passionfruit liqueur) and Mount Gay rum. The cognac division is the major contributor to group profits (84% of FY14 operating profit). Half of cognac sales are generated in Asia (mostly China). The group has faced a sharp drop in its profitability after sales of high-end cognac in China tanked in 2013-2014.

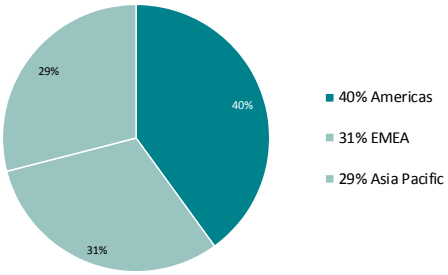
Management

Francois Hériard Dubreuil, Chairman
Valerie Chapoulaud-Floquet, CEO
Luca Marotta, CFO

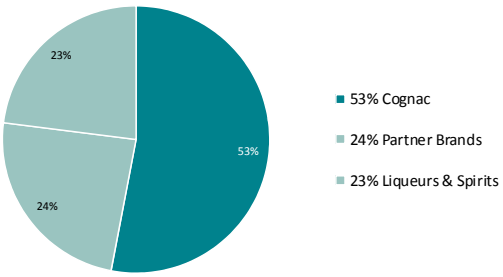
Ownership structure

Orpar (Heriard Dubreuil)	35.4%
Recopart (P Cointreau)	14.7%
Alliance Fine Champagne	2.2%
Andromede	1.2%
Treasury shares	0.4%
Other Shareholders	46.1%

2013/14 sales by region



2013/2014 sales by activity



Sector calendar

01 Jul. 15	**Diageo plc**: Innovation day
21 Jul. 15	**Rémy Cointreau**: Q1 Sales
23 Jul. 15	**SABMiller**: Q1 2016 Sales
	SABMiller: AGM
29 Jul. 15	**Rémy Cointreau**: AGM
30 Jul. 15	**AB InBev**: H1 2015 Results
	Baron de Ley: Q2 2015 Results
	Diageo plc: FY 2015 Preliminary Results
03 Aug. 15	**Heineken**: H1 2015 Results
19 Aug. 15	**Carlsberg**: Q2 2015 Results
27 Aug. 15	**Heineken**: Heineken seminar
	Pernod Ricard: FY 2015 Results
28 Aug. 15	**MZB Group**: Q2 2015 Results
01 Sep. 15	**AB InBev**: ABInBev China seminar
22 Sep. 15	**Diageo plc**: Western Europe presentation
23 Sep. 15	**Diageo plc**: AGM
15 Oct. 15	**SABMiller**: Q2 2016 Sales
16 Oct. 15	**Rémy Cointreau**: H1 Sales
22 Oct. 15	**Pernod Ricard**: Q1 2015 Sales
27 Oct. 15	**Diageo plc**: Diageo Asia Pacific presentation
28 Oct. 15	**Heineken**: Q3 2015 Sales
30 Oct. 15	**AB InBev**: Q3 2015 Results
05 Nov. 15	**Pernod Ricard**: AGM
10 Nov. 15	**Diageo plc**: Investor conference - New-York
11 Nov. 15	**Carlsberg**: Q3 2015 Results
12 Nov. 15	**Baron de Ley**: Q3 2015 Results
	SABMiller: H1 2016 Results
13 Nov. 15	**MZB Group**: Q3 2015 Results
26 Nov. 15	**Rémy Cointreau**: Half-year earnings 2015-16
15 Dec. 15	**Diageo plc**: Diageo North America presentation
29 Feb. 16	**Baron de Ley**: Q4 2015 Results

Analyst

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Price at 30 Jun. 15 / 12m Target Price
EUR64.7 / EUR70 +8%
Reuters / Bloomberg: RCOP.PA / RCO FP

REMY COINTREAU (Neutral)

Analyst: Eamonn Ferry (+44) 207 039 9404

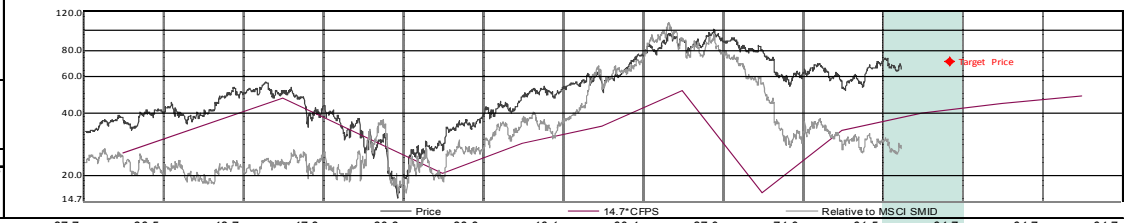
Distillers & Vintners | Beverages - France

Company Highlights	EURm
Enterprise value	3,594
Market capitalisation	3,122
Free float	1,439
3m average volume	10

Performance (*)	1m	3m	12m
Absolute	(2%)	(6%)	(2%)
Rel. Sector	0%	(3%)	(19%)
Rel. MSCI SMID	2%	(6%)	(18%)

12m Hi/Lo (EUR) : 73.1 -12% / 51.2 +26%

CAGR	1996/2014	2014/2017
EPS restated (**)	7%	13%
CFPS	9%	14%



Price (yearly avg from Mar. 05 to Mar. 15)	*27.7*	*36.5*	*42.7*	*47.9*	*30.3*	*29.9*	*46.1*	*60.4*	*87.0*	*74.0*	*61.5*	*64.7*	*64.7*	*64.7*
PER SHARE DATA (EUR)	**Mar. 05**	**Mar. 06**	**Mar. 07**	**Mar. 08**	**Mar. 09**	**Mar. 10**	**Mar. 11**	**Mar. 12**	**Mar. 13**	**Mar. 14**	**Mar. 15p**	**Mar. 16e**	**Mar. 17e**	**Mar. 18e**
No of shares year end, basic, (m)	45.023	45.481	45.975	46.554	47.267	48.495	49.407	48.201	49.461	48.287	48.287	48.287	48.287	48.287
Avg no of shares, diluted, excl. treasury stocks (m)	51.497	45.894	45.657	46.792	47.113	48.191	49.249	49.473	49.011	49.312	49.312	49.312	49.312	49.312
EPS reported	*1.46*	*1.20*	*(1.46)*	*2.00*	*1.83*	*1.78*	*2.18*	*2.50*	*3.09*	*1.63*	*1.95*	*2.21*	*2.50*	*2.75*
EPS restated, fully diluted	0.84	2.00	2.72	2.11	1.61	1.91	2.18	2.50	3.09	1.63	1.92	2.21	2.50	2.75
% change	*(52.0%)*	*138.1%*	*36.0%*	*(22.4%)*	*(23.8%)*	*18.4%*	*14.6%*	*14.7%*	*23.4%*	*(47.4%)*	*18.0%*	*15.4%*	*13.2%*	*9.7%*
CFPS	1.93	1.75	(3.43)	3.18	(1.07)	1.39	1.94	2.34	3.48	1.12	2.23	2.69	3.00	3.26
Book value (BVPS) (a)	19.3	20.2	18.6	19.6	20.6	21.0	21.5	20.2	22.1	20.9	21.9	23.1	24.6	26.4
Net dividend	1.00	1.00	1.10	1.20	1.30	1.30	1.30	2.30	2.30	1.40	1.53	1.51	1.63	1.65
STOCKMARKET RATIOS	**Mar. 05**	**Mar. 06**	**Mar. 07**	**Mar. 08**	**Mar. 09**	**Mar. 10**	**Mar. 11**	**Mar. 12**	**Mar. 13**	**Mar. 14**	**Mar. 15p**	**Mar. 16e**	**Mar. 17e**	**Mar. 18e**
P / E (P/ EPS restated)	32.9x	18.2x	15.7x	22.7x	18.8x	15.7x	21.1x	24.1x	28.1x	45.5x	32.1x	29.2x	25.8x	23.5x
P / E relative to MSCI SMID	102%	97%	235%	209%	17%	72%	88%	80%	93%	157%	116%	164%	166%	169%
P / CF	14.3x	20.9x	NC	15.1x	NC	21.5x	23.7x	25.8x	25.0x	66.1x	27.6x	24.0x	21.5x	19.8x
FCF yield	9.1%	3.6%	(8.7%)	4.3%	(5.6%)	3.8%	4.8%	3.1%	2.3%	(1.3%)	(0.2%)	2.2%	2.3%	2.4%
P / BVPS	1.43x	1.80x	2.30x	2.44x	1.47x	1.43x	2.14x	2.98x	3.93x	3.53x	2.81x	2.79x	2.62x	2.45x
Net yield	3.6%	2.7%	2.6%	2.5%	4.3%	4.3%	2.8%	3.8%	2.6%	1.9%	2.5%	2.3%	2.5%	2.5%
Payout	118.9%	50.0%	40.4%	56.8%	80.8%	68.2%	59.6%	91.8%	74.4%	86.1%	79.8%	68.0%	65.0%	60.0%
EV / Sales	2.65x	2.80x	3.02x	3.07x	2.68x	2.37x	2.79x	3.11x	3.81x	3.95x	3.65x	3.39x	3.22x	3.04x
EV / Restated EBITDA	13.8x	14.3x	14.2x	14.5x	12.6x	12.3x	14.0x	14.4x	17.3x	24.4x	20.3x	17.8x	16.2x	15.0x
EV / Restated EBITA	15.5x	15.8x	15.4x	15.7x	14.0x	13.7x	15.1x	15.4x	18.5x	27.1x	22.6x	19.7x	17.8x	16.4x
EV / OpFCF	11.3x	17.8x	NS	22.0x	NS	13.9x	16.2x	15.1x	24.1x	69.0x	56.7x	25.6x	24.2x	22.7x
EV / Capital employed (incl. gross goodw ill)	1.0x	1.4x	1.5x	1.5x	1.2x	1.2x	2.4x	2.9x	3.6x	2.9x	2.3x	2.3x	2.2x	2.1x
ENTERPRISE VALUE (EURm)	**1,980**	**2,237**	**2,373**	**2,508**	**1,916**	**1,914**	**2,530**	**3,192**	**4,543**	**4,077**	**3,518**	**3,594**	**3,572**	**3,546**
Market cap	1,224	1,652	1,948	2,218	1,420	1,436	2,256	2,977	4,253	3,637	3,025	3,122	3,122	3,122
+ Adjusted net debt	863	772	562	441	532	501	329	189	266	414	467	445	424	398
+ Other liabilities and commitments	27	25	22	20	19	24	21	22	25	27	27	27	27	27
+ Revalued minority interests		(3)	24			41	2	5						
- Revalued investments	133	153	184	171	54	88	77	0	0	0	0	0	0	0
P & L HIGHLIGHTS (EURm)	**Mar. 05**	**Mar. 06**	**Mar. 07**	**Mar. 08**	**Mar. 09**	**Mar. 10**	**Mar. 11**	**Mar. 12**	**Mar. 13**	**Mar. 14**	**Mar. 15p**	**Mar. 16e**	**Mar. 17e**	**Mar. 18e**
Sales	**748.3**	**798.3**	**785.9**	**817.8**	**714.1**	**807.8**	**907.8**	**1,026.1**	**1,193.3**	**1,031.6**	**965.1**	**1,059.5**	**1,108.8**	**1,165.1**
Restated EBITDA (b)	**143.5**	**156.4**	**167.0**	**173.2**	**151.8**	**156.1**	**181.2**	**222.4**	**261.9**	**167.3**	**173.7**	**201.8**	**220.9**	**236.9**
Depreciation	(16.1)	(14.6)	(13.2)	(13.6)	(14.8)	(16.1)	(14.2)	(14.7)	(16.5)	(17.1)	(17.7)	(19.1)	(20.0)	(21.0)
Restated EBITA (b) (**)	**127.4**	**141.8**	**153.8**	**159.6**	**137.0**	**140.0**	**167.0**	**207.7**	**245.4**	**150.2**	**156.0**	**182.7**	**200.9**	**216.0**
Reported operating profit (loss)	136.6	123.6	(89.6)	159.0	151.9	132.5	120.5	204.7	237.9	145.3	156.5	182.7	200.9	216.0
Net financial income (charges)	(55.3)	(63.1)	(37.3)	(45.8)	(31.3)	(22.3)	(29.7)	(35.3)	(20.0)	(26.2)	(29.7)	(26.8)	(24.5)	(22.5)
Affiliates	7.4	8.5	10.2	9.5	3.0	4.9	4.3	(0.4)	(15.5)	(10.9)	(0.7)	0.0	0.0	0.0
Other	(9.6)	18.6	45.2	4.6	0.0	3.0	(2.8)	(10.6)	0.0	0.0				
Tax	(23.8)	(13.7)	50.1	(28.9)	(37.5)	(29.1)	(21.7)	(47.3)	(72.0)	(45.8)	(33.5)	(46.8)	(52.9)	(58.0)
Minorities	(5.5)	3.9	(1.6)	0.0	0.0	(2.7)	(0.1)	(0.3)	0.0	0.0	0.0	0.0	0.0	0.0
Goodw ill amortisation		-	-	-	-	-	-	-	-	-	-	-	-	-
Net attributable profit reported	49.8	77.8	(23.0)	98.4	86.1	86.3	70.5	110.8	130.4	62.4	92.6	109.1	123.5	135.4
Net attributable profit restated (c)	**43.3**	**91.9**	**124.3**	**98.8**	**75.8**	**91.8**	**107.5**	**123.9**	**151.5**	**80.2**	**94.6**	**109.1**	**123.5**	**135.4**
CASH FLOW HIGHLIGHTS (EURm)	**Mar. 05**	**Mar. 06**	**Mar. 07**	**Mar. 08**	**Mar. 09**	**Mar. 10**	**Mar. 11**	**Mar. 12**	**Mar. 13**	**Mar. 14**	**Mar. 15p**	**Mar. 16e**	**Mar. 17e**	**Mar. 18e**
EBITDA (reported)	**155.8**	**138.2**	**(76.4)**	**172.6**	**166.7**	**148.6**	**134.7**	**219.4**	**254.4**	**162.4**	**174.2**	**201.8**	**220.9**	**236.9**
EBITDA adjustment (b)	**(12.3)**	**18.2**	**243.4**	**0.6**	**(14.9)**	**7.5**	**46.5**	**3.0**	**7.5**	**4.9**	**(0.5)**	**0.0**	**0.0**	**0.0**
Other items	31.0	(7.4)	(244.9)	(5.9)	(214.0)	(6.0)	(36.9)	12.9	(1.3)	(4.3)	4.5	4.0	4.0	4.0
Change in WCR	24.6	(2.1)	13.9	(26.2)	3.3	11.9	39.5	(6.7)	(46.2)	(61.7)	(79.4)	(30.5)	(40.6)	(46.5)
Operating cash flow	**199.1**	**146.9**	**(64.0)**	**141.1**	**(58.9)**	**162.0**	**183.8**	**228.6**	**214.4**	**101.3**	**98.8**	**175.3**	**184.3**	**194.5**
Capex	(24.2)	(21.0)	(25.8)	(27.3)	(31.5)	(24.8)	(27.4)	(17.2)	(26.1)	(42.2)	(36.8)	(35.0)	(36.6)	(38.4)
Operating free cash flow (OpFCF)	**174.9**	**125.9**	**(89.8)**	**113.8**	**(90.4)**	**137.2**	**156.4**	**211.4**	**188.3**	**59.1**	**62.0**	**140.3**	**147.7**	**156.0**
Net financial items + tax paid	(62.4)	(68.9)	(80.9)	(18.6)	11.7	(81.2)	(48.6)	(119.1)	(89.9)	(107.8)	(68.3)	(73.1)	(76.9)	(80.0)
Free cash flow	**112.5**	**57.0**	**(170.7)**	**95.2**	**(78.7)**	**56.0**	**107.8**	**92.3**	**98.4**	**(48.7)**	**(6.3)**	**67.2**	**70.7**	**76.0**
Net financial investments & acquisitions	2.3	51.1	158.2	57.3	60.0	(6.3)	62.5	245.7	(150.9)	37.1	1.7	1.7	1.7	1.7
Other	(71.2)	18.8	260.6	7.8	(31.8)	16.0	36.6	8.4	(8.4)	7.8	0.0	0.0	0.0	0.0
Capital increase (decrease)	13.6	9.4	11.3	9.0	(1.3)	3.3	6.8	(92.5)	2.4	(74.9)	0.0	0.0	0.0	0.0
Dividends paid	(44.1)	(45.0)	(50.0)	(48.1)	(39.2)	(38.5)	(41.2)	(113.6)	(18.4)	(69.3)	(48.0)	(47.2)	(51.1)	(51.7)
Increase (decrease) in net financial debt	**(13.1)**	**(91.3)**	**(209.4)**	**(121.2)**	**91.0**	**(30.5)**	**(172.5)**	**(140.3)**	**76.9**	**148.0**	**52.6**	**(21.7)**	**(21.4)**	**(26.0)**
Cash flow, group share	**99**	**80**	**(157)**	**149**	**(51)**	**67**	**96**	**116**	**171**	**55**	**110**	**133**	**148**	**161**
BALANCE SHEET HIGHLIGHTS (EURm)	**Mar. 05**	**Mar. 06**	**Mar. 07**	**Mar. 08**	**Mar. 09**	**Mar. 10**	**Mar. 11**	**Mar. 12**	**Mar. 13**	**Mar. 14**	**Mar. 15p**	**Mar. 16e**	**Mar. 17e**	**Mar. 18e**
Net operating assets	1,118	810	800	807	827	839	588	590	653	671	689	703	718	734
WCR	851	788	807	813	767	767	481	504	622	731	810	840	881	928
Restated capital employed, incl. gross goodw ill	**1,970**	**1,598**	**1,607**	**1,620**	**1,594**	**1,606**	**1,069**	**1,094**	**1,275**	**1,402**	**1,499**	**1,543**	**1,599**	**1,661**
Shareholders' funds, group share	869	919	854	913	973	1,018	1,063	975	1,094	1,011	1,055	1,117	1,190	1,273
Minorities	19	(3)	(2)	(2)	(2)	1	1	1	1	1	1	1	1	1
Provisions/ Other liabilities	353	321	448	459	237	249	267	129	134	140	178	182	186	190
Net financial debt (cash)	863	772	562	441	532	501	329	189	266	414	466	444	423	397
FINANCIAL RATIOS (%)	**Mar. 05**	**Mar. 06**	**Mar. 07**	**Mar. 08**	**Mar. 09**	**Mar. 10**	**Mar. 11**	**Mar. 12**	**Mar. 13**	**Mar. 14**	**Mar. 15p**	**Mar. 16e**	**Mar. 17e**	**Mar. 18e**
Sales (% change)	(15.8%)	6.7%	(1.6%)	4.1%	(12.7%)	13.1%	12.4%	13.0%	16.3%	(13.6%)	(6.4%)	9.8%	4.6%	5.1%
Organic sales grow th	5.1%	4.5%	3.7%	9.7%	(11.6%)	12.0%	6.4%	15.6%	8.8%	(10.7%)	0.6%	3.6%	4.9%	5.1%
Restated EBITA (% change) (**)	(26.6%)	11.3%	8.5%	3.8%	(14.2%)	2.2%	19.3%	24.4%	18.2%	(38.8%)	3.9%	17.1%	10.0%	7.5%
Restated attributable net profit (% change) (**)	(47.3%)	112.2%	35.3%	(20.5%)	(23.3%)	21.1%	17.1%	15.3%	22.3%	(47.1%)	18.0%	15.4%	13.2%	9.7%
Personnel costs / Sales	14.3%	13.2%	13.4%	12.8%	15.1%	13.8%	13.5%	13.2%	13.1%	14.7%	NC	NC	NC	NC
Restated EBITDA margin	19.2%	19.6%	21.2%	21.2%	21.3%	19.3%	20.0%	21.7%	21.9%	16.2%	18.0%	19.0%	19.9%	20.3%
Restated EBITA margin	17.0%	17.8%	19.6%	19.5%	19.2%	17.3%	18.4%	20.2%	20.6%	14.6%	16.2%	17.2%	18.1%	18.5%
Tax rate	29.3%	22.6%	NC	25.5%	31.1%	26.4%	23.9%	27.9%	33.0%	38.5%	26.4%	30.0%	30.0%	30.0%
Net margin	7.4%	9.3%	(2.7%)	12.0%	12.1%	11.0%	7.8%	10.8%	10.9%	6.0%	9.6%	10.3%	11.1%	11.6%
Capex / Sales	3.2%	2.6%	3.3%	3.3%	4.4%	3.1%	3.0%	1.7%	2.2%	4.1%	3.8%	3.3%	3.3%	3.3%
OpFCF / Sales	23.4%	15.8%	(11.4%)	13.9%	(12.7%)	17.0%	17.2%	20.6%	15.8%	5.7%	6.4%	13.2%	13.3%	13.4%
WCR / Sales	113.8%	98.6%	102.7%	99.4%	107.5%	95.0%	52.9%	49.1%	52.1%	70.8%	83.9%	79.3%	79.5%	79.6%
Capital employed (excl. gdw ./intangibles) / Sales	139.9%	121.3%	124.6%	121.4%	135.1%	120.8%	68.5%	63.4%	66.6%	89.3%	105.5%	100.3%	100.9%	101.3%
ROE	5.0%	10.0%	14.6%	10.8%	7.8%	9.0%	10.1%	12.7%	13.9%	7.9%	9.0%	9.8%	10.4%	10.6%
Gearing	97%	84%	66%	48%	55%	49%	31%	19%	24%	41%	44%	40%	36%	31%
EBITDA / Financial charges	2.6x	2.5x	4.5x	3.8x	4.8x	7.0x	6.1x	6.3x	13.1x	6.4x	5.8x	7.5x	9.0x	10.5x
Adjusted financial debt / EBITDA	6.0x	4.9x	3.4x	2.5x	3.5x	3.2x	1.8x	0.8x	1.0x	2.5x	2.7x	2.2x	1.9x	1.7x
ROCE, excl. gdw ./intangibles	8.6%	11.3%	9.5%	12.0%	9.8%	10.6%	20.4%	23.0%	20.7%	10.0%	11.3%	12.0%	12.6%	12.8%
ROCE, incl. gross goodw ill	4.6%	6.9%	5.8%	7.3%	5.9%	6.4%	11.9%	13.7%	12.9%	6.6%	7.7%	8.3%	8.8%	9.1%
WACC	7.6%	7.4%	7.6%	8.1%	8.7%	8.6%	9.1%	9.9%	9.6%	8.5%	7.9%	7.6%	7.6%	7.6%

Latest Model update: 17 Jun. 15

(a) Intangibles: EUR480.50m, or EUR10 per share. (b) adjusted for capital gains/losses, impairment charges, exceptional restructuring charges, capitalized R&D, pension charge replaced by service cost
(c) adj.for capital gains losses, imp.charges, capitalized R&D, am. of intangibles from M&A, exceptional restructuring, (*) In listing currency, w ith div. reinvested, (**) also adjusted for am. of intangibles from M&A, or for am. of gw ill for pre IFRS yea

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