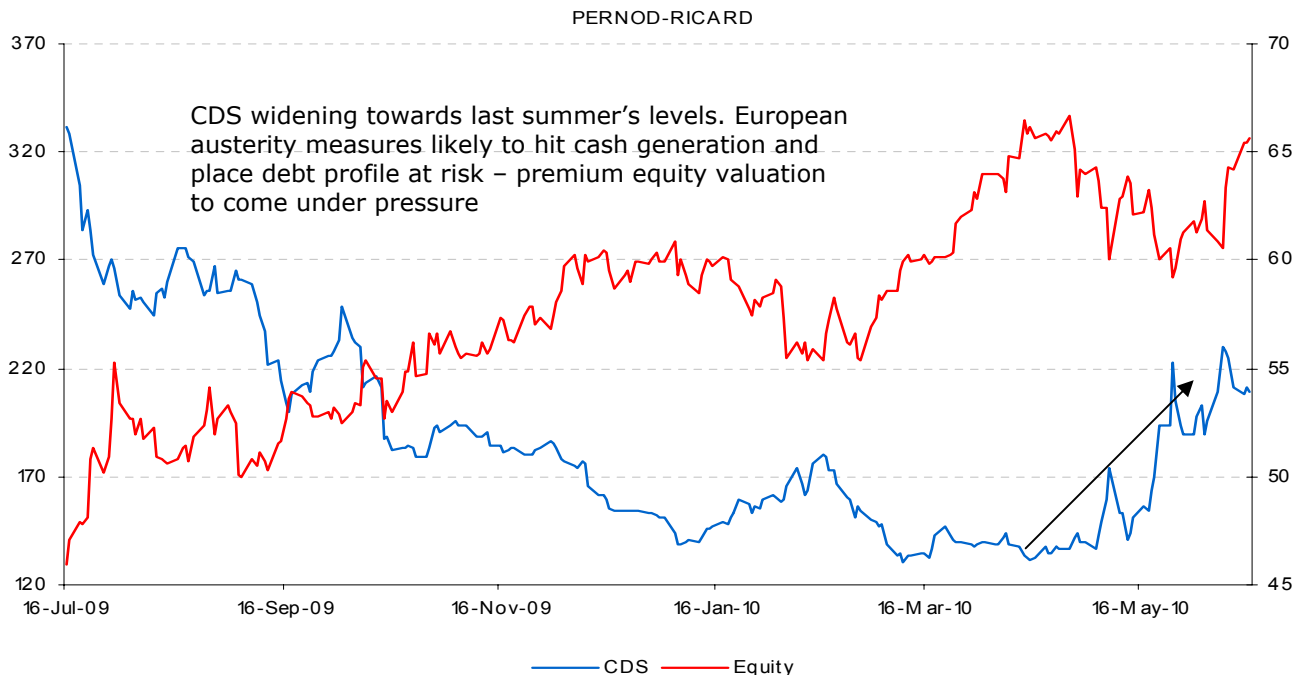


## Pernod Ricard (RI FP) – Risk of slackening demand and potential tax increases

*Sell RI FP vs. SXXP Index*



Source: CSC, Bloomberg, DataStream

- **Pernod Ricard's CDS has been moving wider over the past few months.** Currently hovering around 200bps, this is a 70bps widening from March lows, and, in our opinion, incongruent with equity strength. Our CDS implied equity pricing model supports a fair value of EUR58 for Pernod, making it one of the least attractive companies under our European CDS coverage.
- **The widening CDS suggests the outlook for Pernod is deteriorating, in our opinion.** The forthcoming austerity measures are likely to hit Pernod's premium brand positioning particularly hard, as cost-conscious European consumers switch to cheaper brands. Europe accounts for 44% of revenues, with Spain being Pernod's second largest export market after the US.
- **We are also concerned that Pernod, or alcohol manufacturers and consumers in general, could prove a soft target for governments looking to reduce their budget shortfalls.** We would not be surprised to see new budgets hitting the Wine and Spirits categories particularly hard. **We would expect the French government in particular, to aggressively seek new sources of tax revenues.** The French Sovereign CDS is trading at 86bps, 46bps wider than Germany's. This indicates substantial risks within the French economy, stemming from the nation's significant exposure to Southern European debt. In light of these growing risks, the French corporate sector could well be tapped to bolster the government's coffers.
- **We do not believe that Pernod is financially well-positioned to deal with the current economic climate.** The CDS is trading at a significant premium to its closest peer Diageo (c.80bps), a factor of the Vin & Spirit acquisition a few years ago. The company can ill afford any pressure on free cash flow, which is needed to pay down debt. Pernod has substantial debt due over the next few years – EUR2.6bn of bond principal and loans due in 2011, and EUR9.2bn due in 2013. Under normal circumstances this would be easily covered by cash generation and accommodating debt capital markets. However, we are concerned that, with poor revenue growth in Europe, potential tax increases and a risk averse financial system, financing Pernod's debt profile is not going to be easy. Under this scenario, dividend cuts and even equity issuance become distinct risks.
- **Given the risks to cash generation outlined above, we do not believe that Pernod deserves its current premium valuation. We therefore recommend selling the equity, targeting EUR58.**

**Pernod Ricard (RI FP) – Credit to Equity Analysis**

Fig1. CDS Implied Equity Fair Value

CDS Implied equity FV is at new lows – over 10% implied equity downside makes Pernod one of the least favoured names in our C2E universe.

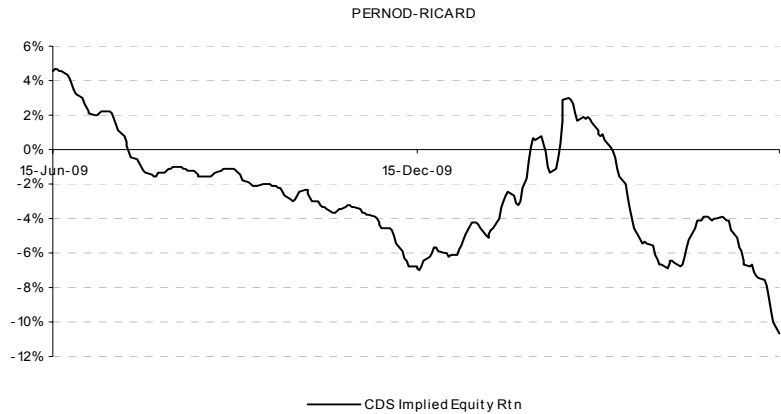


Fig2. CDS vs. Equity Regression

The C2E relationship has historically been strong. An RSQ of 0.65 suggest credit and equity are closely linked, making the recent departure unusual. We would expect asset pricing to revert to the normal relationship, with the equity pulling back to EUR58.

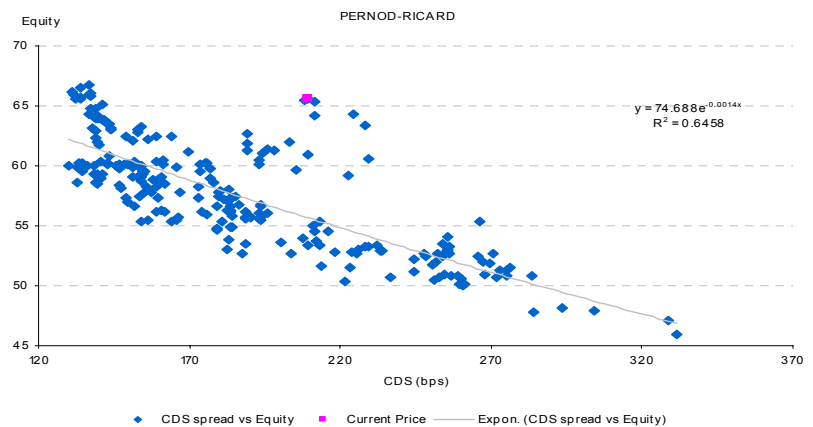
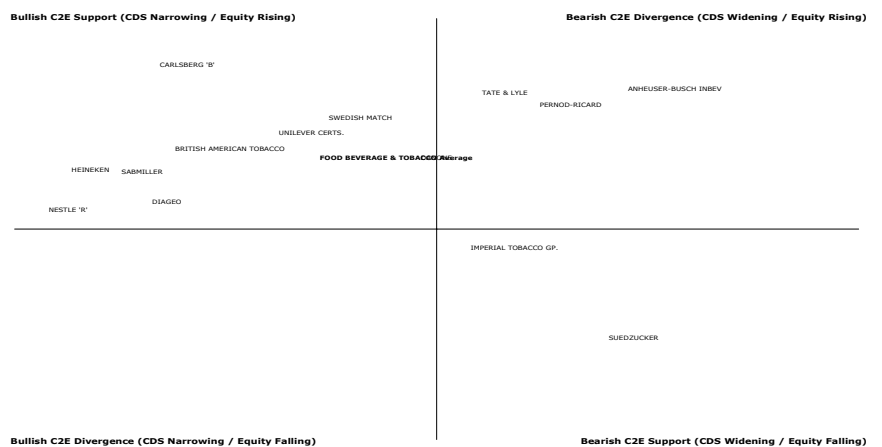


Fig3. CDS vs. Equity Momentum

Pernod is one of the few names in the Food, Beverage and Tobacco sector exhibiting any widening CDS momentum.



Source: CSC, Bloomberg, DataStream

**Pernod Ricard (RI FP) – Credit to Equity Analysis**

Fig4. Credit Metrics Sector Table

Company Name	CDS	Credit Rating	Outlook	WACC	Cost of Equity	Cost of Debt	Debt / Capital	Debt / Equity	Debt / Assets	Net Debt / EBITDA	EBIT Interest Coverage	Financial Leverage	Altman Z-Score
<b>Sector Average</b>	<b>101.6</b>			<b>10.37</b>	<b>13.37</b>	<b>3.20</b>	<b>53.71</b>	<b>182.02</b>	<b>37.09</b>	<b>2.80</b>	<b>5.05</b>	<b>0.44</b>	<b>3.32</b>
NESTLE SA-REG	45.9	AA	STABLE	8.08	9.07	0.68	30.38	43.64	21.10	1.13	17.02	1.06	4.63
UNILEVER NV-CVA	46.8	A+	STABLE	9.66	10.85	2.44	44.30	79.54	26.94	0.92	9.10	1.12	5.03
ANHEUSER-BUSCH I	60.0	BBB+	POS	10.37	14.68	3.09	59.68	148.00	43.63	3.51	2.91	1.52	2.83
BRIT AMER TOBACC	66.6	BBB+	STABLE	12.58	15.00	3.66	58.34	140.07	41.64	1.74	7.71	1.15	3.74
DIAGEO PLC	78.0	A-	STABLE	11.45	14.03	3.75	68.54	217.86	47.39	2.76	2.96	1.51	2.83
DANONE	80.8	A-	STABLE	9.45	11.47	2.56	36.53	57.56	28.50	2.31	6.75	1.17	4.68
SABMILLER PLC	97.3	BBB+	STABLE	14.11	16.92	3.45	31.37	45.70	25.10	2.05	3.52	1.98	3.05
HEINEKEN NV	98.5	-	-	8.63	11.86	2.58	60.65	154.10	43.12	3.01	2.87	1.53	2.64
SWEDISH MATCH AB	99.6	BBB	STABLE	8.52	9.80	2.67	91.11	1024.81	56.64	1.74	6.75	1.17	3.98
CARLSBERG-B	113.3	-	-	10.87	15.76	2.65	39.84	66.23	29.29	2.78	3.97	1.34	3.38
IMPERIAL TOBACCO	134.2	BBB	STABLE	10.63	14.86	3.63	64.71	183.40	37.89	3.67	0.92	-12.26	2.53
SUEDZUCKER AG	145.0	BBB	NEG	8.26	12.18	3.07	46.46	86.78	33.04	2.88	3.15	1.47	2.01
TATE & LYLE	147.1	BBB-	NEG	11.24	15.79	4.59	60.52	153.28	39.81	5.59	0.11	1.91	2.10
PERNOD-RICARD SA	209.5	BB+	STABLE	11.26	14.92	5.94	59.57	147.35	45.11	5.10	3.02	1.49	2.99

Fig5. Equity Valuation Sector Table

Company Name	Share Price	Currency	Market Cap		EV/SALES			EV/EBITDA			Price/Earnings			Dividend Yield	FCF Yield	
			Lcl	BN	Last	FY01	FY02	Last	FY01	FY02	Last	FY01	1Yr % Rnk			FY02
<b>Sector Average</b>					<b>2.55</b>	<b>2.59</b>	<b>2.47</b>	<b>11.73</b>	<b>10.33</b>	<b>9.64</b>	<b>24.85</b>	<b>14.81</b>	<b>81%</b>	<b>13.23</b>	<b>2.97</b>	<b>11.11</b>
NESTLE SA-REG	53.50	CHF	195.28	1.96	2.03	1.93	12.28	12.29	11.58	20.66	16.55	80%	15.12	3.25	7.41	
UNILEVER NV-CVA	23.37	EUR	70.07	1.75	1.79	1.69	9.99	10.50	9.71	17.98	15.71	76%	14.31	3.47	6.73	
ANHEUSER-BUSCH I	41.55	EUR	66.66	3.57	3.61	3.46	10.15	9.62	8.97	17.60	16.46	94%	13.95	1.14	8.97	
BRIT AMER TOBACC	2196.50	GBP	43.86	3.84	3.49	3.38	-	9.75	9.20	17.82	12.73	78%	11.74	5.11	7.35	
DIAGEO PLC	1117.00	GBP	27.99	3.73	3.74	3.55	13.38	11.90	11.13	18.37	15.62	91%	14.05	3.41	6.29	
DANONE	44.23	EUR	28.66	2.20	2.17	2.04	11.57	11.57	10.75	16.32	16.94	85%	15.25	2.84	5.54	
SABMILLER PLC	2001.00	GBP	31.68	3.93	2.79	2.63	13.22	11.39	10.55	24.22	16.24	91%	14.31	2.43	5.81	
HEINEKEN NV	36.37	EUR	20.95	1.68	1.79	1.63	8.54	8.69	7.70	17.49	14.90	82%	12.90	2.00	10.46	
SWEDISH MATCH AB	174.50	SEK	40.31	3.33	3.30	3.22	12.00	11.93	11.33	18.31	16.02	98%	14.47	2.75	6.94	
CARLSBERG-B	488.50	DKK	74.74	1.95	1.96	1.88	8.69	8.76	8.09	17.39	15.12	95%	12.81	0.88	22.70	
IMPERIAL TOBACCO	1949.00	GBP	19.84	2.13	3.92	3.78	10.45	9.62	9.16	13.15	10.92	68%	10.06	4.31	15.40	
SUEDZUCKER AG	14.53	EUR	2.75	0.99	0.88	0.86	8.62	7.31	7.05	13.83	11.79	3%	11.00	3.35	18.79	
TATE & LYLE	487.40	GBP	2.24	0.83	0.85	0.83	20.31	7.03	6.75	116.05	11.36	96%	10.35	4.83	24.62	
PERNOD-RICARD SA	65.63	EUR	17.32	3.85	3.94	3.70	13.33	14.27	13.00	18.67	17.01	94%	14.84	1.78	8.47	

Pernod's junk credit rating and high cost of capital is incongruent with a premium equity valuation. The equity trades slightly rich to Diageo on a PE and EV/EBITDA basis, and is significantly more expensive than the rest of the Food, Beverage and Tobacco sector. This is in spite of its riskier balance sheet. Whilst a better expected growth profile could account for this, we believe that in the current economic climate, growth expectations are too bullish, and Pernod's gearing will prove to be more of a hindrance than a help.

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