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Half Year 2019 Pernod Ricard SA Earnings Call

EVENT DATE/TIME: FEBRUARY 07, 2019 / 8:00AM GMT



CORPORATE PARTICIPANTS

Alexandre Ricard *Pernod Ricard SA - Chairman, CEO & Member of Executive Board*
Hélène de Tissot *Pernod Ricard SA - EVP of Finance, IT & Operations Director and Member of Executive Board*
Julia Massies *Pernod Ricard SA - VP of Financial Communication & IR*

CONFERENCE CALL PARTICIPANTS

Chris Pitcher *Redburn (Europe) Limited, Research Division - Partner of Beverages Research*
Dasha Afanasieva
Edward Brampton Mundy *Jefferies LLC, Research Division - Equity Analyst*
Fernando Ferreira *BofA Merrill Lynch, Research Division - Director*
Nico Von Stackelberg *Liberum Capital Limited, Research Division - Research Analyst*
Sanjeet Aujla *Crédit Suisse AG, Research Division - European Beverages Analyst*
Simon Hales - *Analyst*

PRESENTATION

Julia Massies Pernod Ricard SA - VP of Financial Communication & IR

Good morning, ladies and gentlemen, and welcome to Pernod Ricard's First Half Fiscal '19 Sales and Results. We're hosted this morning by Alexandre Ricard; and Hélène de Tissot, our CEO and Finance Operations and IT Director. We will run through the usual format, take you through a presentation, and then leave some time for your questions.

Alexandre, over to you.

Alexandre Ricard Pernod Ricard SA - Chairman, CEO & Member of Executive Board

Well, thank you very much, Julia. I wouldn't mind having the click-through device, which I'm sure is somewhere.

Thank you very much. So before we start, you had a picture of our Be A Convivialist campaign, which is our first-ever global corporate campaign. And I would very highly recommend, when and if you have time, that you watch that movie because you would fundamentally really understand throughout that movie what we mean by conviviality, which is our ethos and how we engage with consumers from that point of view.

So with that being said, let's start with our results. So the group delivered a very strong first half, which was somewhat enhanced by phasing, with 7.8% top line growth and 12.8% organic growth for our profit from recurring operations. This is the best first half we've had in almost a decade. I think it's the best first half we've had since 2011. And it is, as well, the first results of our Transform & Accelerate plan, which was launched approximately 6 months ago. So you see here continued dynamic growth, thanks to the consistent implementation of our medium-term growth in the operational excellence road map, good diversified growth. Strong price-mix of 2.3%, particularly on our Strategic International Brands, 6% there. Positive impact of the earlier Chinese New Year, which took place 2 days ago on February 5th, which will unwind in the second half. And significant progress of our fiscal year '16 to '20, our 4-year operational excellence road map. We actually expect to complete our EUR 200 million P&L savings plan by the end of this fiscal year, so by June-end, 1 year ahead of plan.

From a financial point of view, as well very strong delivery, with excellent profit from recurring operations. Organic margin improvement, enhanced again by the timing of the Chinese New Year and some A&P phasing. Negative impact from a currency point of view, specifically coming from emerging market currencies, so minus EUR 26 million on the profit from recurring operations.

Recurring free cash flow of EUR 622 million, which is close to EUR 70 million lower than last year for the same period, mainly due to increased working capital to support our business or strong business growth. And finally, continued deleveraging, with net debt reduction of roughly EUR 200 million versus December of last year. So net debt at EUR 7.2 billion and our net debt-to-EBITDA ratio at 2.6x versus 2.9 a year ago.

You here have the recap of our key figures for this first half. And so from a sales point of view, I think we can say a consolidation of our dynamic growth. If you look at Americas, we can say it's been robust performance with 4% growth in the Americas and with the U.S. as



well up 4%, growing broadly in line with the market.

Asia-Rest of the World, with strong acceleration, up 16%, thanks to the very strong performance in China, up 28%, and in India, up 24%, both markets somewhat enhanced by technical factors, and also a very strong growth in Africa/Middle East.

A stable overall European markets with continued very good momentum in Eastern Europe, Russia, but as well Poland, we'll see later on, and some contrasted performance in Western Europe.

From a portfolio point of view as well, diversification of our growth with a very strong performance across the portfolio. Our Strategic International Brands are up double digits, 10%, driven by Martell, up 23%; Jameson, up 8%, our Scotch -- strategic Scotch portfolio, up 9%; Gin, up 9%; Champagne with PJ, up 12% and so on. And very good price-mix, as I mentioned earlier, on our Strategic International Brands of roughly 6%.

Strategic Local Brands as well, up double digits, 11%, with an acceleration, thanks to our Seagram's Indian whiskies and positive pricing as well.

Specialty brands, and I'll get into that later during the presentation, which is a new section of our House of Brands, are up 11%, with very strong growth of Lillet, up 38%, monkey 47, up 29% and Altos, a very strong double-digit growth as well.

Our Strategic Wines are down 8%, clearly down due to the implementation of our value strategy, and as well a high comparison basis for Campo Viejo, which was up 23% for the same period a year ago.

Here, you have our Q2, up 5.6%, a slower Q2 again, which was enhanced by phasing and a comparison base. Remember what we said at the end of our Q1, especially, regarding India.

We go into regions. I mentioned Americas, up 4%; Asia-Rest of the World, up 16%; Europe, flat; and more details starting by Americas. So the U.S., clearly strengthening our position in the #1 market worldwide, following organizational and investment changes made throughout the last 3 years. The performance is broadly in line with the market. We estimate the market to be growing at roughly 4%. We've increased our prices on some of our key brands. And for H2, our finished goods inventory will be reduced to optimize them at wholesaler level, and this is to clearly deliver operational efficiencies across the whole supply chain as part of the new contracts we signed with our distributor partners. So you should expect an impact of roughly anywhere between 1 and 2 weeks in terms of shipments for H2 in the U.S. And the savings and efficiencies will be -- that will be generated will be redeployed in additional in-state activation and investment.

From a brand point of view, continued strong growth for Jameson, double-digit growth, and as well as some price increases across the range. For Absolut, so the flavors had a good H1, further to the successful launch of Grapefruit. But the brand remains in decline. In H2, we're launching Planet Earth's Favourite Vodka campaign and as well a new innovation called Absolut Juice. Malibu continues to outperform the category. The Pineapple and the Lime innovations are performing very strongly.

Glenlivet, we've increased as well prices across the range. And Founder's Reserve is performing quite well. We also launched a new 12-year old first fill in October a few months ago.

Our growth relays are gaining momentum. Martell continues to outperform the cognac category in the U.S., with some targeted price increases as well. Blue Swift is clearly building on its success and rolling out nationwide. The performance is accelerating. And if you look at the latest NABCA, we're up close to 50% over the last 26 weeks.

Altos and Avión our 2 premium -- super premium tequilas are also continuing to grow strongly with some selected price increases as well. Outside of the U.S., 5% growth in the rest of the Americas region, with Travel Retail Americas, up 6%, particularly driven by our Scotch portfolio and a positive pricing mix. Good growth as well in Canada, clearly driven by Absolut, Jameson and The Glenlivet and a very successful launch of Absolut's Planet Earth's Favourite Vodka campaign for the OND, October, November, December, key period

ahead of Christmas.

Brazil is up 6%. We're outperforming the market, and this is driven by our key strategic focus brands with the likes of Absolut and Chivas. And we see Beefeater and a Gin trend emerge as well in Brazil.

Mexico, there's a decline in Mexico related to high comparable base, particularly on Chivas, but the underlying trend is good, with our sellout growing as well and our market share growing on some of the key categories we'd like to focus on.

Asia-Rest of the World, I was mentioning earlier on, up 16%; China, 28%, clearly benefiting from an earlier Chinese New Year, which took place on Tuesday. Very strong performance for Martell across all qualities, double-digit increase across all of them, a positive price and mix. No surprise we had announced a year ago that we were increasing our prices for Martell. And you should further expect an additional price increase for Martell in China, which was announced in February, I think a few days ago.

The H2, let's be clear, will be impacted by inventory management of Martell to ensure growth and sustainability for the brand.

Chivas, and that is a direct impact of our investment strategy that we decided a little bit more than a year ago to reignite the Chivas brand in China, which is one of the most iconic spirit brands in China. So continued double-digit growth with the NBA sponsorship and Kris Wu, for those who know him or for those who don't, he's both an actor and a singer, his endorsement which resonates very well with our target consumers in China. So the long-term growth relaunch plan is now in its second year and continuing to build momentum.

Premium brands are growing strongly as well. And that's again a direct consequence of our reorganization in China with a second premium brands route-to-market, which was built approximately 2 years ago.

India, up 24%, with a very good performance across the whole portfolio, whether it's our scotch or whisky brands; whether it's our wines, particularly Jacob's Creek or our Seagram's Indian whisky brands, all in strong double-digit growth, partly enhanced by an extremely favorable comparison in Q1. Positive pricing as well, positive mix as well from a brand point of view, but also from state point of view. We have consolidated our market leadership position. We have close to 45% market share in India. And we expect the second half of this fiscal year to be in line with our medium-term low double-digit ambition for the market.

Africa/Middle East, as well in double-digit growth, thanks in particular to Turkey, with both strong pricing, of course, but also solid volume growth. Nigeria, which is enjoying as well very strong growth, but also South Central and West Africa. Travel Retail Asia, up 6%, driven by Martell, Chivas and with some good innovation launches over the first half. Japan, up double digits, driven by basically our Scotch brands, in particular, Chivas, Ballantine's, and our Champagne with a positive price and mix.

Korea is in decline in H1, clearly related to Imperial. The rest of our portfolio is actually growing. And we have made significant changes quite recently in our route-to-market in Korea. Imperial distribution is moving to Drinks International in March 2019. And we streamlined Pernod Ricard or we are streamlining, to be more specific, Pernod Ricard Korea to focus on our Strategic International Brands.

As for Australia, declines are driven by the wine portfolio due to the implementation of our value strategy and some destocking of one of our customers. Jameson, The Glenlivet, Ballantine's and Kahlúa by the way, are all performing quite strongly.

Stable sales in Europe, with contrasted performance, minus 3% in France in H1. The environment remains difficult and deflationary. There is pressure specifically on Scotch and Aniseed. We had strong H1 shipments specifically for Ricard as a brand ahead of our retail dispute, which already started at the end of H1. And we should expect H2 to slow as the relationship with one of our customers is a little bit tense as we speak.

Spain, down 2%, modest decline in a decelerating market. Shipments and depletions are almost stable in Q2 following some stock correction in the first quarter. And we see a continued good performance of our star gin brand, Seagram's, in Spain.

For the U.K., the decline is only driven by our value approach on wines. As I mentioned earlier, we're actually outperforming on spirits



with a double-digit sellout and with a particularly strong performance on Gin with the successful launch as well of Beefeater Pink and also a great performance of Jameson in the U.K.

Germany, while decline is clearly driven by a commercial dispute, which we expect to continue into the second half, and also some impact of some significant price increases we had for Ramazzotti in Germany. Lillet and PJ, both remain in very strong. Weaker performance in Travel Retail Europe, driven by -- the negative environment in Russia and the depreciation in the currency and some reduced promotional activity on Martell.

Continued strong momentum in Eastern Europe. Russia, up 7%, strong position there, leadership position. Outperformance in the market in Poland, up 6%. And strong performance in many other Eastern European markets like Ukraine, Romania or Kazakhstan.

Now, I mentioned it earlier on in the presentation, we have a new House of Brands, a sharpened House of Brands, which is part of our 3-year strategic plan called Transform & Accelerate, which I'll drill into later on in this presentation. We believe one of the unique positions of Pernod Ricard is our unique portfolio of premium brands. It is the most extensive portfolio of brands in the industry. And we've structured our portfolio to be able to basically have a dynamic prioritization framework. So we have our 13 Strategic International Brands, I mentioned that grew double digits. We have our 15 Strategic Local Brands, which grew double digit. We have our premium wines, but now, we are also adding something new, which is called Specialty. And this is clearly related, from a consumer lens, as a recognition of a clear incremental and complementary opportunity linked to demand for smaller-scale "craft brands", that we identify as Specialty. I don't like the word craft for the very simple reason, that I strongly believe that every single one of our brands is craft. When you have brands like Martell that go from one generation to another for more than 300 years or Jameson for more than 2 centuries and so on. And that the transmission from one last distillery to another takes an average 15 years, we cannot call them not crafted. But we do have specialty brands. These are brands that are crafted at smaller scale with a focus on where, how and by whom they are produced. They have a strong human connection and consumer confidence. They're often sold in specialty outlets and with, as I mentioned it earlier, a complementary route-to-market and in some cases, route-to-consumer approach. They roughly represent 2% of the industry in terms of spirits market value. In Pernod Ricard, we over index, they represent 3% of our business. So the answer to the ongoing question we've been having for the last few years, what did you do about market fragmentation? Is it a threat or opportunity? What are you doing with the raise of craft? Well, actually, we over index on that front with our Specialty brands.

And you have them here. So this is our new House of Brands. So we have a number of single malts with Aberlour, Longmorn, Scapa, or again Strathisla. We have our Irish single pot still whiskeys, extremely premium. By the way, our Specialty brands, on average, overindexed from a gross margin point of view versus the group average. You have our Gins with Monkey 47, Plymouth or again Ungava, our Canadian specialty gin. You have our Tequila & Mezcal portfolio with Altos, Avi3n and more recently enriched with our Mezcal Del Maguey. Our North American whiskeys principally Smooth Ambler, Lot 40 and others with Lillet, Suze, OSTOYA, Pernod and cognac Augier, the oldest cognac in the world, 1643.

So very strong H1 with diversified growth across all the key categories. One key point here. Innovation, which is strategic pillar, growth accelerator for Pernod Ricard, contributing to delivering 2% incremental growth for our top line. And I mentioned earlier, price and mix, up 2.3%.

If you look at our Strategic International Brands, which are up 10%, Martell, up 23%, with a clear diversification of the sources of growth for the brand. Martell is no longer just a Chinese play. It is becoming increasingly a global play. Excellent growth, of course, in China, double-digit volumes, but also very positive price and mix, further enhanced, of course, by an earlier Chinese New Year, and as I mentioned it earlier, price increase of 5%.

Travel Retail Asia, up double digit, very dynamic growth, I mentioned it earlier in the U.S., we do expect the second half to moderate to bring the volume growth in line with our sustainable growth targets for Martell.

Jameson is up 8%, continued very strong momentum across the world. U.S. Nielsen and NABCA, at double digit. We've increased our prices, I'd say, globally as well. Some positive mix as well in our globalization strategy is gaining momentum with double-digit growth in Asia and South America and high single-digit growth in Europe. I said it, our strategic Scotch whiskies are up 9%. Chivas, up 7%, with a

very strong price and mix. I think it's 5% on Chivas. Ballantine's, up 8%. The Glenlivet, up 11%, Royal Salute up double digit as well.

Absolut, down 1%, slightly down outside of the U.S., which now represent 60% of sales of Absolut. I think when we acquired Absolut, less than 20% was outside the U.S. Now it's more than 60% outside the U.S., growing 4%. With continued double-digit growth in Canada, in Asia, Rest of the World. Great growth rates in China, India for instance and single-digit growth in Europe, including the difficult markets such as France.

In the U.S., Nielsen, down 6%; NABCA, down 4%, so brand probably down somewhere 4% or 5%. Decline in category that remains difficult. As I mentioned, we launched Grapefruit, so successful launch in our first half. And we're launching Planet Earth's Favourite Vodka in the second half of this year, a campaign that was tested in Canada in October through to December very successfully. And we're also launching an innovation towards the end of H2 called Absolut Juice.

Other brands, good overall growth. I mentioned Ricard was somewhat boosted by earlier shipments. Malibu, down 5%, but that's mainly driven by shipment phasing in the U.S. Where the brand is actually growing single digit. We expect H2 to be stronger. Beefeater, up 9%, growing basically everywhere barring Spain. Havana Club, up 1%, driven by Cuba. Mumm, growing up 2%, driven by Americas, and particularly the U.S. and Asia-Rest of the World.

PJ, very strong performance, growing basically everywhere, up double digits. Our Strategic Local Brands as well growing double digits, 11%. Our Seagram's Indian whiskies are up 23%. Kahlúa, up 1%, with some rationalization of the range, especially on the flavors side in the U.S. Good growth for Seagram's Gin, particularly in Spain, which is offset by a weaker performance in the U.S., where the brand is not a strategic brand there. And good performance of Olmeca, particularly in Africa/Middle East.

So now our Specialty brands, as I mentioned, up double digit, but with good performance of Aberlour. Lillet, up 38%, which as we mentioned a few months ago, is now one of our big global bets riding on that wave of low ABV and fresh spirit drinks.

Monkey 47, strong growth across all regions, double-digit performance. For Altos and strong sales for Avión in Europe and Asia-Rest of the World. You'll see there's a decline in the U.S., but that's purely shipment phasing. The sellout is up 2 digits.

As I mentioned, Strategic Wines are down 8%, direct consequence of the implementation of our value strategy. We do expect a stronger H2. We have, as you can see, a very strong price and mix, up 4%. Some comparable technical reasons for Campo Viejo to be down 9% over the first half. It was up 23% a year ago. A clear value-based approach in the U.K. for Jacob's Creek, we've decided to delist the brand in a number of customers. But continued a very strong development in Asia, particularly driven by China and India. Decline for Brancott, driven by Australia and New Zealand. And finally, some shipment phasing for Kenwood in the U.S.

I mentioned it, innovation, one of our key strategic pillars, basically adding 2% to our group top line growth. But also luxury, which now represents 14%, at least for the first half, 14% of our global sales, up 19%. And that's again a direct result of our new prestige and luxury route-to-market that we've been developing over the last 3 years, 25 dedicated teams across 25 markets around the world.

I'll skip to a -- quickly through our marketing innovation, and sustainability and responsibility initiatives, whether it's around Chivas with the new Manchester United partnership, whether it's the partnership around Boiler Room with Ballantine's. I mentioned it as we started as an introduction, our Be A Convivialist, our first-ever global corporate campaign. I think we're now above 4 -- 40 million views. Again, I encourage you to watch that movie, great movie. Planet Earth's Favourite Vodka campaign launch, I mentioned it earlier. So I also mentioned Absolut Grapefruit innovation around Malibu and Kahlúa ready to drinks, some global initiatives from a sustainability and responsibility point of view.

And finally, I'll just spend 1 second here. In terms of our -- we're going to show to you later on our new platform in terms of sustainability and responsibility. We have already almost achieved our 2020 S&R road map, which was targeting 30% reduction in CO2 emissions, a 20% reduction in water usage, full reduction with 93% there in terms of waste landfill, and we're almost close to 100% of our production sites to be certified at the highest levels, and same for our vineyards.

And moving on to profit from recurring operations. Hélène?

Hélène de Tissot Pernod Ricard SA - EVP of Finance, IT & Operations Director and Member of Executive Board

Thank you, Alexandre. Good morning, everyone. So let's go back to the figures. You have here the summary of our P&L. So the strong top line growth that Alexandre just commented, at plus 7.8%, reported, plus 5%. Significant increase of our gross margin. I'll get back to that in a minute, plus 9% from organic point of view. A&P are growing by plus 5%, so a little bit lower than the net sales growth in this first half, this is mainly due to phasing, translating into a contribution after A&P growing at plus 10%. And with the profit from recurring operation, growing at plus 12.8%, as already mentioned by Alexandre, with a strong operating leverage impact, you have here the figures 148 bps.

So let's go a bit deeper into the -- this excellent performance, a very strong top line growth. No need to come back to that. I believe gross margin expansion, growing by 71 bps, partly favored by the earlier Chinese New Year. So you have here as well an interesting graph showing the trends of the gross margin improvement since 2016 and showing a strong -- the improvement is for this first half. So improvement due to an improved pricing, driven by key brands such as Martell, Seagram's Indian whiskies, as well Chivas, Jameson and Perrier-Jouët. I mentioned it, which is doing a very good performance in this first half. Some negative mix impact due to the acceleration of the Seagram's Indian whiskies. You saw the figures for India in this first half. Although, it's important to mention, their margin is improving. The price increase is able to offset the COGS increase we are having in that key market for us. So COGS inflationary pressure, mostly offset by operational excellence initiative. I'll come back to this operation's road map in a minute.

A&P, growing at plus 5%. So as I mentioned, a bit lower than the top line growth. That's why we had the reduction in the A&P ratio in the first half due to phasing. Structure cost, plus 5%, which is showing the strict discipline we're having in our structure cost and which is reducing the ratio because the growth is below our top line growth.

Then when it comes to the PRO, plus 12.8%, plus 148 bps, excellent performance in this first half. Time to draw your attention on the faster completion of the EUR 200 million operational excellence road map P&L savings, we mentioned and we announced a few years ago. This will be done by the end of the year, as Alex had mention, 1 year in advance compared to the original plan. And this is definitely helping in term of gross margin performance in this first half.

H2 margin to be softer due to some key business events of the second half that Alexandre mentioned: the management of our Martell volume growth in the second half; the optimization we're going to roll out in the U.S. with our wholesalers; and A&P phasing. So you have here the figures showing you the change in the PRO from an organic point of view, but as well from a reported point of view, with EUR 26 million negative FX impact, which is mainly driven by Turkish lira, Indian rupee and Russian ruble.

We estimate the FX impact of the full year to be positive, circa plus EUR 30 million, using the rates projected on the 24th of January. And you have here in the footnote the reference for the EUR/USD average we used for that estimate.

So if we look at the analysis by market type between mature and emerging markets, so slight increase in the weight of the emerging markets, which is obviously driven by the acceleration of Asia, Rest of the World, you see here the figures, plus 44% for the year. Their weight in our sales, which is 3 points stronger than last year at the same period, and plus 2% in term of PRO.

If we look now at the balance by region, same goes -- same segments. We have here as an increase of the Asia-Rest of the World weight both in term of sales and PRO, and it's driven mainly by the strong dynamism in China and India, sorry, with some positive technical impacts we mentioned as well for those 2 markets.

So let's go now through the year P&L by region. Starting with Americas. We have a strong PRO growth, which is driven by a robust top line growth that Alexandre commented, plus 4%. Then we have the gross margin rate which is in slight decline, and this is due to negative mix and the agave cost inflation, which is impacting us due to the performance of particular brands in that region, so growing by 3%.

A&P, minus 1%. This is clearly one of the phasing elements I was referring to in this H1. We are, obviously, investing to support our priority

brands, and there will be some increase in H2 on that line.

Structural cost increase at plus 1%, which is a very good translation of the strong discipline we're having here, giving a PRO growth of plus 8%, 142 bps. Positive FX impact in that region linked to the USD strength on this first half.

Moving to Asia-Rest of the World, so plus 16% top line growth, translating into a very strong PRO growth, plus 26%. So top line growth, obviously, with the acceleration driven by China and India. A significant gross margin expansion, you see the gross margin growing by 20%, 186 bps, mainly due to price increases. We mentioned over the -- the strong contribution of Martell in term of price improvement, but as well as Seagram Indian whiskies. So A&P growing by 13%, a bit below top line growth. We are supporting our key campaigns here, particularly on Martell and Chivas in China, but as well investing, we have now Seagram's Indian whiskies.

CAAP, plus 22%. PRO, as I mentioned, plus 26%, with structure cost growth increasing, reflecting our investment in growth relays increasing below top line growth. So 282 bps in terms of leverage in that region. Negative FX impact, that's why the PRO is growing by 22% from a reported point of view, mainly due to the weaker Turkish lira. Turkey is in Asia-Rest of the World, as you know, in our parameter. And Indian rupee as well.

Europe, a slight decline in term of PRO, driven by contrasted performance, we mentioned for the top line performance, but as well A&P phasing. I'll come back to that in a minute. So stable sales growth. Gross margin increasing, thanks to operational excellence initiative and positive mix in U.K. and Central Europe, especially as well price, particularly in Germany and U.K.

A&P, increasing by 3%, in support of Strategic brands. This is, here, the reverse trend for Europe, stronger H1 then what's going to be H2. So phasing here. CAAP, stable. And PRO, minus 2%. Structure cost as well growing by only -- sorry, plus 1%, with strong discipline here.

Negative FX impact, that's why the PRO from a reported point of view is down 6%, and this is due to the weaker Russian ruble.

So if we move now to the net profit section, starting with the group share of net profit from a recurring operation and EPS. So you can see here the figures. This -- the group share of net profit from recurring operation is growing by 11% and so is the EPS. This is mainly linked to the excellent improvement of profit from recurring operation, I was referring to before. And reported figures on that line is plus 10.6%. If we look now at the 2 other items on that slide. The financial expenses, you can see here a minor increase, plus 2%. And this is due to the higher USD interest rates over the period and to a lesser extent, to the FX effect on the financial expense.

And when it comes to the income tax, this is growing by 14% with the effective tax rate, which is close to 25%. We remind you that our view for the full year is 26% as mentioned in the August communication.

Moving now to the group share of net profits. So here, I'm going to start by the nonrecurring expenses, minus EUR 66 million expense for this first half. This is mainly driven by the Allied Domecq fund reevaluation. This is a one-off and non-cash item, which we booked in this first half. This is the estimate of the impact of the equalization reform that happened in the U.K. with the High Court decision back in October. So on that line, and I will make the same comment under corporate income tax. We are having a significant negative change, mainly due to positive nonrecurring items of last year. So corporate income tax, higher total tax charge, again mainly driven by nonrecurring positive one-off we had last year. As a reminder, those positive one-off were mainly the reinvestment of the French 3% tax on dividends and as well the positive impact of the U.S. tax reform on deferred tax asset position.

Moving now to cash flow and debt. So you have here all the cash flow statement. Our recurring free cash flow amounts to EUR 622 million. I move quickly to the next slide where we have a bit more explanation for this performance. So recurring free cash flow, minus EUR 68 million versus last year. Alexandre mentioned it in the executive summary. We have this excellent profit from recurring operation, which is translating into an increase in the working capital requirements, a negative variation in that line coming from this strong business growth. And we are, as well, on this first half increasing our strategic inventories to sustain the future of growth.

Nonrecurring free cash flow, which is below last year due to the nonrepeat of some of the items I mentioned for the P&L side. We have the cash impact as well, so the one-off sale of bulk Scotch inventory in H1 last year and the reinvestment of the French tax.

Looking now at the net debt position. So we have a decrease of the net debt position versus the position we had 1 year ago, a decrease of EUR 152 million despite the increased dividend we paid in this first half, and an increase of the net debt versus the June 30 position. You see here the EUR 585 million free cash flow I was referring to. But we have, as well, some cash out linked to M&A and as well our long-term incentive plan and the payments of the dividend, which is giving this net cash generation of minus EUR 192 million, and some translation adjustment, meaning negative FX impact linked to the strengthening of this U.S. dollar. As you know, the U.S. dollar-denominated debt represents 54% of our gross debt at the end of the fiscal year '18.

So deleveraging, we are continuing to deleverage the balance sheet with a net debt-to-EBITDA ratio decrease to 2.6.

And I hand over to Alexandre for the conclusion and the outlook.

Alexandre Ricard *Pernod Ricard SA - Chairman, CEO & Member of Executive Board*

Thank you very much, H  l  ne. Well, for the conclusion and for the outlook for this ongoing fiscal year, as we mentioned it, very strong first half. And in an environment that remains uncertain, we do expect to continue to see good and diversified sound growth across our markets. The second half growth is expected to moderate due, again, to our Martell sustainable on growth management on one side; our wholesaler inventory optimization in the U.S.; and finally, some commercial disputes that we're having as we speak in France and Germany.

Continuation as well of a good price and mix. And as I mentioned it earlier, faster completion, in other words, by the end of this fiscal year of our operational excellence road map.

We do also expect roughly 50 basis points of organic improvement for our profit of recurring operations margin. And finally, as H  l  ne mentioned it, we expect, based on January 24th, exchange rates, an impact -- a positive impact of roughly EUR 30 million on our profit from recurring operations. All of this is leading us to upgrade our guidance for this fiscal year. It was previously organic growth of our PRO between plus 5% and plus 7%. We're upgrading it to between plus 6% and plus 8%.

I just want to spend a few minutes on our 3-year strategic plan. It's fair to say that last year, which was the last year of our road map, 3-year road map that we had presented to you during Capital Markets Day of June 2015. So last year, approximately 1,000 of our senior managers across Pernod Ricard worldwide worked on that new 3-year strategic plan called Transform & Accelerate. Before diving into this plan, I just want to sit back for a second and remind you some of the key commitments we had shared with you back in 2015, in June 2015 at le Centre Georges Pompidou, if I recall correctly. When I stood up, we had barely any growth left in Pernod Ricard. I stood up saying we have a clear ambition of growing Pernod Ricard 4% to 5% medium term. I think one of you asked me what does medium term mean? To be clear, it means 3 to 5 years. 3 years down the road, the business is growing, and it's good diversified growth. I won't go through all these, but you can go on our website on Capital Markets Day 2015. But when you sit back before going into the next 3 years, it's good to see that we have achieved what we had said we would achieve.

Now looking forward, which is what we really like to do in Pernod Ricard, we have clearly worked on a strategic plan, a 3-year strategic plan called Transform & Accelerate, which is basically aiming at leveraging our successful strategy. Remember, our business model, consumer-centric, consumer-obsessed model, driven by a consumer occasions-based obsession with 4 key fundamentals: operational excellence; talent development; sustainability and responsibility; Route-to-market, route-to-consumer. And our 4 key accelerators with our portfolio management: premiumisation, luxury, innovation, and finally, digital acceleration.

So about more from the core, about what we've been doing over the last 3 years. And actually, if I had to summarize it. We've been building the foundations of our future growth over the last 3 years. So it's about acceleration, more from the core, but also about preparing the future, transformation. Pernod Ricard is on its transformational journey, endless transformational journey, if I may say so. For more from the core, I'd say 80%; and preparing the future, I'd say, 20%.

We believe, we are at the best place to really capture industry growth going forward. We have 3 key specificities in Pernod Ricard. Pernod Ricard is unique for 3 reasons. Our portfolio, we have leading brands in basically all key categories. We have a consumer-centric

approach, I mentioned it. We have redesigned our organization to be focused on moments of consumption. We do not look at the industry the old way, the segment way, tequila, gin, whiskey, vodka. We look at it through the consumer lens by moment of consumption. And we have an active portfolio management. Our unique distribution network, I'll get back into that, but basically, we have the most extensive wholly-owned distribution network in the world across 86 countries, 1/3 America, 1/3 Europe and 1/3 Asia. Half of our business roughly is emerging markets. The other half is mature markets. But we have this unique dual leadership position in China and India, and I'll get back to that. And finally, and I would say actually most importantly, our culture and values. We have highly experienced committed and renewed management team, highly engaged employees, extremely committed. And also our new sustainability and responsibility strategy, which is now fully embedded in our organization, not just at corporate level, but also at brand level.

So 3 years ago, I told you we could have as an ambition to grow our business 4% to 5% medium term. While, now we extend that kind of ambition to not just 4% to 5%, but probably 4% to 7% range.

So mentioning -- so talk about our unique premium portfolio. I won't go back into that. I presented our new House of Brands earlier on. And again, as you can see, it's approximately 20 brands, which are part of our specialty brands. And they've grown 13% in the last fiscal year and represent 3% of our group sales.

Leveraging our unique geographical exposure with a clear, particular focus on our 4 win markets. China, we presented to you at Capital Markets Day last June our 3-year strategic plan for Asia, where we believe the middle and affluent consumers in China will grow by roughly 100 million by 2021, where we have that ambition as industry leaders in China to double the industry penetration rate by 2025. So it goes beyond 3 years, of course. We have a long-term view. It's already started moving from 1% penetration rate, that's volume, by the way, to 1.1% as we speak. We have a leadership position in China, with roughly 45% market share and a second-to-none route-to-market. We said it 3.5 years ago, when China was in double-digit decline, it is a market that can sustainably grow high single, low double. There'll be better years, there'll be worse years, but the consumer dynamics are there.

India, well, the legal drinking age population is increasing by roughly 20 million a year. In addition to that, urbanization's rates, which is exactly where we operate in India, are accelerating. And in addition to that, GDP is growing 6%, 7%. So these 3 key elements lead us to believe as well, as we said it 3 years ago, that India can grow sustainably low double digit. There'll be better years, there'll be worse years, but overall, the dynamics are there. And for some reason, we enjoy the same kind of market share as we do in China. By the way, this is a specific to Pernod Ricard. It is unique. In 2018, for the first time in human history, the middle-class population now represents more than half of the total world population. We expect an additional 2 billion middle-class people by the end of 2030, globally. Our current growth engines in terms of the major emerging middle class are China, India and Eastern Europe. Our medium-term growth engines from a middle-class point of view, which will accumulate with China, India and Eastern Europe, are Latin America, specifically, Brazil, Mexico and some Southeastern Asian market. And our very long-term growth engine will be Sub-Saharan Africa. We're investing there for the very long term. It's a 15-year view.

The U.S., of course, our #1 market, we expect to grow in line with the market. The market has stabilized its growth rate at around 4%. And we're growing in line with that with what I believe a clear portfolio -- a very clear portfolio strategy with our current growth engines: Jameson, The Glenlivet, Malibu. Our growth -- medium-term growth really is with Martell cognac and our 2 tequila brands. And also looking towards the long term, seeding the long-term future in the U.S. with new brands ventures with the likes of Monkey 47, Lillet and many other brands.

Global Travel Retail. By the way, 3.5 years ago, we didn't talk about it because it did not exist as a business unit. Today, it is quite a dynamic business unit for Pernod Ricard. And I mentioned, again, leveraging our unique culture, blending performance and convivialité. We view convivialité as a performance accelerator, because convivialité means being simple, straightforward and collaborative, no silos.

So I won't dwell into all of this. But by the way, we refreshed our leadership model, focusing on 6 leadership attributes. My favorite one is growth mindset. It's really growth mindset, because everything we do as leaders is about growing, growing our performance both from a financial point of view, but also from a people point of view. So if you look at the numbers, by the way, in terms of Towers Watson, which is an independent third-party survey, I mentioned earlier on, 88% commitment rate in Pernod Ricard and 94% of our employees are proud to be associated to Pernod Ricard, and this is precisely what makes me proud.

So I briefly mentioned it earlier. We have a new sustainability and responsibility platform, bringing good times from a good place. We will launch our 2030 road map with very aggressive ambitions around these 4 key pillars early April of 2019, so in a couple of months from today.

Of course, digital is now fully embedded in our organization. Again, we have more than 150 digital experts. I won't go through these numbers. The one I like best, by the way, every single week, we send roughly 0.5 billion messages to approximately 100 million consumers. I would have said that 3 years ago, I think, some people might have said it's wishful thinking. No, it's not. It's happening every single week. Obviously, we said we have finished -- we plan to finish with 1-year anticipation our operational excellence road map, which we had shared with you back in September 2016. So part of our Transform & Accelerate plan is to launch a new operational excellence road map for 2020, 2021, so the next -- our next 2 fiscal years, touching on A&P, of course, our structure costs and as well the COGS, or cost of goods line.

So how to summarize that in terms of ambition? Well, again, as I said it as an introduction, our Transform & Accelerate plan started back in July, focusing -- really solely focusing, ruthlessly focusing on embedding the dynamic growth and delivering operating leverage in line with our objective to maximize our long-term value creation.

So basically, if I had to summarize our ambition from a numbers point of view, 4% to 7% top line growth, as I mentioned, with roughly 50 to 60 basis points of operating leverage per annum for next year and the following year. We'll focus on pricing, of course. I mentioned operational excellence with a clear A&P investment strategy, focusing on our must-win key priorities, disciplined approach on our structure costs. And finally, just a reminder of our financial policy. Number one, as we mentioned it back in April 2018, we'll increase our dividend payout to roughly 50% of net profit from recurring operations by fiscal year '20. And also, we clearly continue to commit to an active management of our portfolio, both from a buy side and the sell side and value-creating M&A, and still committed, of course, to remaining investment grade. Thank you. Julia?

Julia Massies *Pernod Ricard SA - VP of Financial Communication & IR*

Thank you, Alexandre. Ladies and gentlemen, we'll turn to your questions. We'll start with questions from the room. And just to say, you can ask questions in French or in English. Any questions from the room? Okay, in which case, we'll turn to our first callers, please.

QUESTIONS AND ANSWERS

Operator

Your first question comes from the line of Edward Mundy.

Edward Brampton Mundy *Jefferies LLC, Research Division - Equity Analyst*

Three questions, please. You find a lot of detail in the presentation on sort of the future outlook for Pernod Ricard. If you were to put your finger on exactly what's the key delta on raising the top end of revenue guidance from previously 4% to 6% to 4% to 7%, what do you think would be the key difference for the higher revenue guidance? The second is on specialty brands. Where do you think the biggest opportunity is? Is it on distribution? Is it on prices and mix? Is it on innovation? And the third question is around the U.S. inventory optimization. Can you talk a little bit more about the strategic rationale for this, and in particular, how this fits into the higher A&P spending in the second half, which is, as you said, due to phasing?

Alexandre Ricard *Pernod Ricard SA - Chairman, CEO & Member of Executive Board*

Great. Thank you for your questions. What drove us to revisit our top line ambition framework, should I say, which was 4% to 5% to, let's say, 4% to 7% is, if I had to summarize it, it's star alignment. So if all the stars are correctly aligned, and if I focus on our 4 must-win markets -- but of course, it doesn't mean the rest of the world doesn't matter, it does as well. But of course, if you have the U.S. growing mid-single digit, if you have China growing, say, low double digit, if you have India growing double digit, and if you have good growth in Global Travel Retail and all the stars are aligned, you could expect to see us perform at the upper end of that ambition. Now by the way, we do operate in an uncertain environment. The market -- the global market is somewhat volatile. Stars are not always, every year aligned. Sometimes, India works better and China less. And sometimes, it's the opposite, and so on and so forth. But if all the stars are



aligned, we can aim at growing at the higher end of that bracket. In terms of specialty brands, for many years, as I mentioned it earlier, we were challenged and asked if the emergence of craft, as it's been the case for the beer market, was a threat for Pernod Ricard. And the key point here is to say it's actually a wonderful opportunity. If you look at consumers and if you look through the consumer lens, again, in terms of occasions, consumers now have a repertoire of brands they're loyal to. They don't have single-brand loyalty aspirations anymore, but they do have a number of brands in their repertoire with which they're loyal. And there's always going to be that little specialty brand. I mentioned it quite briefly, but I'm reiterating, the average gross margin per liter metric of our specialty brands portfolio is higher than group average. We will be driving dynamically that segment of our portfolio, both through innovation, of course, and through partnership/acquisition. Del Maguey features very nicely in there. Monkey 47 features very nicely in there. These are great partnerships. Likewise, Smooth Ambler features nicely in there. But in terms of innovations as well, we have Altos that features quite nicely in there. And in terms of brands that have huge potential like Lillet, they feature quite nicely in there. And H el ene, maybe for the third question on the U.S.?

H el ene de Tissot Pernod Ricard SA - EVP of Finance, IT & Operations Director and Member of Executive Board

So on the U.S., we are currently discussing with our wholesalers about the optimization of the finished good inventory. We were mentioning before. So here the intention is as well to contribute to the operational excellence efficiency of our wholesalers. So we are discussing right now what could be the impact and the allocation as well by brands. What is obviously very important as well is that we're going to have a positive counterpart at all level in term of wholesaler's investment behind our brands and activation. So the discussion is happening right now. Obviously, execution is going to be key not to disrupt the business. For instance, we would obviously be very careful to avoid any out-of-stock situation and will be able to have a better view in the coming weeks.

Simon Hales - Analyst

Three questions, please, for me as well. Can I just ask you, firstly, about the extra EUR 100 million operational excellence savings that you've talked about this morning? Can you sort of talk a little bit more about where they'll coming from and how they'll perhaps be phased over the next couple of years? Secondly, just on Martell, and particularly in China, you're mentioning that we will see some inventory management on that brand in the second half. Can you just talk a little bit about what you're doing there and stock levels as you see them in trade as we've gone into the Chinese New Year? And then finally, just on India, you clearly, obviously, got big medium term still about the consumer dynamic there. I note also through for the second half of this year, you're still quite confident of delivering low double-digit sales growth. And your biggest competitor there has been sort of flagging a warning around potential disruptions from elections. Is that something that you don't worry about?

H el ene de Tissot Pernod Ricard SA - EVP of Finance, IT & Operations Director and Member of Executive Board

So I'll start with the first one on the EUR 100 million efficiency we are going to deliver in the coming 2 years. So first, I think it's important to put those initiative in the context of the first operational excellence road map. We announced and are going to complete the execution this fiscal year, so this is a continuity, and let's say, we're going to leverage on the first wave of the road map. So in term of initiatives, as we show that in the presentation, it's going to come from optimization of our COGS as well better efficiency of our A&P and of our structure costs. So when it comes to the phasing, it's a bit early to say exactly what could be the phasing over the next 2 years. But you can probably estimate that it could be well-balanced across those 2 years, so something close to 50-50 probably makes sense.

Alexandre Ricard Pernod Ricard SA - Chairman, CEO & Member of Executive Board

On your question on Martell in China, and by the way, on Martell, more generally speaking, by the way, we clearly need to manage our inventory. We did mention several times that Martell was that one brand in the industry that could grow high single digit from a volume point of view, to which you can add some price and mix. Now as we shipped at the end of H1 to prepare for Chinese New Year, which took place 2 years [DAYS] ago, so difficult to say how it's going to perform for Chinese New Year. But again, the objective is to finish the full fiscal year in China with normative inventory levels, and we'll have time to get there and to manage, obviously, the overall fiscal year volume performance of Martell from a sustainable point of view. So you can consider that volumes sustainably can grow high single, maybe slightly low double, but not more than, that because we want to be able to do this from a sustainable point of view. And as for India, H el ene, how confident are you in terms of delivering low double-digit second half?

Hélène de Tissot Pernod Ricard SA - EVP of Finance, IT & Operations Director and Member of Executive Board

I'm confident. I'm sure you are too. Elections are going to happen obviously in H2, but we don't see that as a threat. Very good performance in India.

Simon Hales - Analyst

Can I just follow-up. And then just on a slightly separate issue around the free cash flow generation, the deleverage we've seen, very impressive, again. Is there a sort of target level of net debt-to-EBITDA of which you think you might get to where you could consider further cash returns to shareholders?

Hélène de Tissot Pernod Ricard SA - EVP of Finance, IT & Operations Director and Member of Executive Board

Yes. So on the cash generation, first, as you know, the financial policy is the one that we were reminding in the conclusion, which is the intention to increase the dividend payout to 50% by 2020. We don't give specific target in terms of deleveraging. The cash flow generation is enabling us to deleverage, for sure, and this is giving us flexibility as well in term of, as we mentioned, financial policy and active portfolio management with value-accretive M&A, which is still one of the -- of our objective in term of active portfolio management.

Operator

Your next question comes from the line of Sanjeet Aujla.

Sanjeet Aujla Crédit Suisse AG, Research Division - European Beverages Analyst

Two questions for me, please. Just coming back to the medium-term margin guidance of 50 to 60 basis points. You seem to be more confident on pricing. The EUR 100 million of savings flowing through over 2 years basically gets you to the 50, 60 basis points if that drop through to the bottom line. And therefore, that guidance assumes no underlying operating leverage. So how conservative do you think is that margin guidance, one? And secondly, can you just talk a little bit about underlying depletions in China? And do you think underlying depletions are running ahead of what you're able to supply?

Alexandre Ricard Pernod Ricard SA - Chairman, CEO & Member of Executive Board

Maybe on the depletions in China, the underlying depletions are double-digit depletions, clearly. So the underlying momentum over the first half of our fiscal is robust. For the second half, and more specifically for Chinese New Year, which is happening as we speak, we'll have to wait for, I guess, our Q3 fin-comm to be able to give you a little taste of what Chinese New Year looked like.

Hélène de Tissot Pernod Ricard SA - EVP of Finance, IT & Operations Director and Member of Executive Board

So coming back to the 50 to 60 bps leverage target for the coming years. Well, as you mentioned, we have been working on the pricing improvement for many years, and this obviously will continue. This operational excellence initiatives are going to help us as well to mitigate COGS inflation pressure we are having. And this is already happening in H1, but we need to mention that we have increasing COGS, for sure. For instance, logistic COGS are increasing significantly we have as well. So COGS increasing in term of wet good -- dry goods, and so on. So those operational excellence initiative are going to help to mitigate those COGS increase. This is medium-term targets. Obviously, this is a strong indication in an environment that remain uncertain. And we want to keep investing behind our brands. That's why we mentioned this A&P ratio, which is probably going to be flat, stable over the years to keep investing for the future, for our growth midterm and long term. Plus the structure cost discipline that we mentioned, that's how we get to this 50 to 60 bps medium-term ambition.

Operator

Your next question comes from the line of Dasha Afanasieva.

Dasha Afanasieva

I just wanted to ask sort of if there was an overall operating margin expansion, but that didn't happen in Europe. And I just wanted to ask about the reasons for that. And then my other question was going to be about this corporate governance question. Obviously, there was

-- there were changes a couple of weeks ago. Is this something you are monitoring? And what do you sort of say to people who are worried that the board doesn't have enough independent voices? And wouldn't it be easier to sort of defend your strategy if there were more independent voices on the board?

Hélène de Tissant Pernod Ricard SA - EVP of Finance, IT & Operations Director and Member of Executive Board

Maybe I'll start with Europe. So as I mentioned in the call, the presentation, the margin decline in Europe in this first one is -- in this first half, sorry, is mainly driven by the A&P phasing, because we have a stronger A&P investment in this first half. And the top line performance, which is stable, and that's how you get to this margin deterioration. So this, again, we're going to have the opposite effect in H2 in term of A&P phasing, because A&P globally, in Europe will not grow above net sales.

Alexandre Ricard Pernod Ricard SA - Chairman, CEO & Member of Executive Board

Yes. And on your second question, by the way, the way I view a board and to an extent as well, an organization, specifically Pernod Ricard, a board is a living organism and a constant evolution. And Pernod Ricard as an organization as well as a living organism in a permanent transformational journey. When I was appointed Chairman and CEO of Pernod Ricard 3.5 years ago, I took immediately 2 decisions: number one, to create a strategic committee to oversee with me some of the key strategic topics for Pernod Ricard. And I also took the decision to enlarge the scope and responsibilities of the governance and nominations committee to be called Governance, Nominations and Sustainability and Responsibility committee. Sustainability and responsibility has been embedded in Pernod Ricard forever. But we wanted, and I wanted, to give it a lot more importance to make sure that our committee and board had oversight on S&R. Then over the last 3 years, what happened at board level? Year 1, we wanted to reinforce our board's skill set with a strong financial and insurance background, especially at the Audit Committee level, amongst others, especially with the increasing importance, for instance, of risk mapping, many, many other examples. And so Kory Sorenson joined the board as an independent director the year after. Basically, I mentioned it earlier in the presentation, one of the key accelerators, key strategic pillars of our strategy is digital. And so the board decided that it was appropriate to really enrich board expertise, especially on the digital front. And this is when the Governance Committee ran into Anne Lange's profile. Anne Lange, let me remind you, spent more than a decade in the Silicon Valley, alongside John Chambers at Cisco, and had come back to Europe with an entrepreneurial project around connected objects. By the way, Pernod Ricard was the very first company in the industry to launch a connected bottle with Mumm champagne. Now the price of a connected bottle, the cost, I'm not sure it would please Hélène if all our bottles were costly, like that was EUR 20, but that was 4 years ago. We had a vision, still have that vision one day to have all our bottles connected. The cost now is EUR 0.20. And I believe, in 3 to 5 years from now, it will go down as low as EUR 0.02. So we onboarded Anne Lange. That really adds a lot of value on the digital front. Now last year, as part of our triannual independent assessment review of the board, a few topics came up. Number one, we should consider the appointment of a lead independent director, especially in the light of the fact that 80%, roughly, of CAC 40 companies that have a unified Chairman and CEO have a lead Independent Director. And second, in terms of enriching our board's skill set, and again, I mentioned it in the presentation, one of our key strategic pillars as well is premiumization and luxury, which now represents 14% of our business, which has grown 19% over the first half. And that's where the profile of Patricia Barbizet in July popped up. Patricia had -- has an extensive experience as lead Independent Director of TOTAL and has a very strong luxury background. So we onboarded Patricia during the AGM last November. And at the first board meeting post the Annual Shareholder Meeting in January, she was quite logically appointed by the board as our Lead Independent Director. What I'm trying to say is our board is committed to continually, well, improve our governance, and this will be, let's be clear, an endless process. Opportunities move. Challenges evolve. The environments changes. And so we should expect the board to behave like a living organism, which means permanently evolving over time. And we have a clear governance calendar ahead of us for the years and years to come. And you should expect the same at Pernod Ricard level from an organization point of view.

Julia Massies Pernod Ricard SA - VP of Financial Communication & IR

Thank you. We'll turn to some questions from the room now. So we have [Marianne] here.

Unidentified Analyst

I'll have 3, please. One, on the specialty brands, is there like a limit you would put to the size these brands can reach in India and for H1? And then the second one would be on acquisition. Is there a space you would be more looking at in terms of -- in the portfolio to fit it

with? Shall we see more specialty, because that's what you've mainly done in the past few years? So are we continuing on this way? Or could there be bigger one? And then as India in the midterm is maybe going to be -- should be the fastest-growing market. Could you give us some color on the profitability trajectory in this market, because from what I remember, it was below group level?

Alexandre Ricard Pernod Ricard SA - Chairman, CEO & Member of Executive Board

The limit on specialty will be quite blunt. It's going to be value creation. Basically, as long as we see opportunities in that space that fit perfectly well from a strategic portfolio-approach point of view, both from an acquisitive point of view, but also from an innovative point of view, we will keep on. We have specific routes-to-market in many, many markets, with -- as I mentioned it earlier, it's complementary route-to-market, but also in some cases, route-to-consumer approach, and it's building quite well, for a start. So the limit is basically value creation.

Hélène de Tissant Pernod Ricard SA - EVP of Finance, IT & Operations Director and Member of Executive Board

So a very good transition for M&A. So M&A, as you rightly mentioned, has been a great contributor to the growth of this specialty brand category. It shouldn't be the only target for M&A, because obviously, as I just said, value creation is one of the key objectives of M&A, meaning that we are looking at premium brands with a high growth profile, strong brand quality and credentials, of course, and to capture growth opportunities. And as Alexandre remind us this earlier, we are really looking at that from a moment of consumption point of view and not only by category. So as you rightly mentioned, M&A could still be looking deeply into specialty brands, let's say, type of brands, but not only. India, so we don't give the exact margin, as you know, by market. As I mentioned before, even if we always -- or we often talk about India to talk about negative mix, the picture is much, much, much better than that, obviously, in term of midterm and long-term objective, but as well in term of profitability profile. Because as I mentioned, this is very true in the H1, the margin are increasing in India, meaning we have a strong value strategy and good pricing increase. Having said that, this is a country where we are in the investment mode, both in term of A&P investment, but as well organization.

Unidentified Analyst

Okay. Well, then what's the moment of consumption you're most looking at?

Alexandre Ricard Pernod Ricard SA - Chairman, CEO & Member of Executive Board

We have a very opportunistic approach. So depending on the markets, as you know, for instance, the largest moment of consumption in France from a profit point of view is l'apéritif. In China, it's the meal occasion. You can have subsections to that, such as deal over meals, so business dinners or -- and so on and so forth. Market-by-market, what we do is we map out all the different moments of consumption. We appreciate them profit pool by profit pool, and then we have a clear opportunistic approach. So we're pragmatic.

Julia Massies Pernod Ricard SA - VP of Financial Communication & IR

We have a question up here, I believe.

Unidentified Analyst

. Could you explain the reasons of the dispute with Leclerc? You did not mention Leclerc, but I'm sure it's Leclerc. What are the brands concerned? And what are the consequences in the coming months in terms of sales or loss? And more generally, could you comment upon sales negotiations?

Julia Massies Pernod Ricard SA - VP of Financial Communication & IR

And so a question about the commercial disputes in France, and is it Leclerc? And if so, what brands does it involve? And can you give a commentary on the overall negotiation framework?

Alexandre Ricard Pernod Ricard SA - Chairman, CEO & Member of Executive Board

And should I answer in French or...

Julia Massies Pernod Ricard SA - VP of Financial Communication & IR

I think you answer in English.

Alexandre Ricard Pernod Ricard SA - Chairman, CEO & Member of Executive Board

Okay. You're probably right in so far as the client you named. Commercial disputes are part of life, so let's not -- that's life. And they often happen as we approach the end of February deadline to reach an agreement. Obviously, commercial disputes rely on a different view in terms of pricing and promotional activity. And we believe Pernod Ricard is solid enough to have a negotiation. And I will not give any additional detail to that because, obviously, discussions are ongoing. But we have a clear view. We're resilient. We're solid. The good news is we do have brands that are strong, high-equity and appealing brands to our consumers. And so hopefully, we'll reach an agreement. And if we don't, so be it. The key point being that our upgraded guidance for this full fiscal year does include, by the way, commercial disputes. We have several commercial disputes every year. It's not something completely new. So we'll see. Good luck to the team. I support them.

Julia Massies Pernod Ricard SA - VP of Financial Communication & IR

Thank you. Are there any other questions from the room, please? Okay, so we'll go to our final callers, please. So you have a follow-up?

Unidentified Analyst

Could you tell us about Elliott? Have you met? Are you on speaking terms? What is going on?

Julia Massies Pernod Ricard SA - VP of Financial Communication & IR

Can you say about the Elliott Fund? And are you in discussions? Have you accepted to meet?

Alexandre Ricard Pernod Ricard SA - Chairman, CEO & Member of Executive Board

Yes, absolutely. Well, Elliott is one of our shareholders. And they've been a Pernod Ricard shareholder since, let's say, November, when they let us know. And since then, of course, we've met with Elliott. We clearly support ongoing dialogues with, by the way, not just Elliott, but all our shareholders, including, of course, Elliott. As far as details go, they are confidential. But we have a relationship, an ongoing dialogue with Elliott, of course, and with our other shareholders.

Julia Massies Pernod Ricard SA - VP of Financial Communication & IR

So final questions from callers, please.

Operator

Your next question comes from the line of Fernando Ferreira.

Fernando Ferreira BofA Merrill Lynch, Research Division - Director

I have 2 questions on your new medium-term plan, please. First one, one of the 4 key markets you mentioned is Global Travel Retail. Can you discuss how relevant that business unit is for Pernod Ricard today? And what ambitions do you have for Global Travel Retail in terms of contribution for the future growth? And then second question, when you talk about focus on pricing, can you maybe lay out some of the actions you're introducing to improve net revenue management? And where do you benchmark Pernod Ricard in this area versus other CPG?

Alexandre Ricard Pernod Ricard SA - Chairman, CEO & Member of Executive Board

Just on Global Travel Retail. If Global Travel Retail were a country -- actually, we consider it as a community, the travelers' community that don't have boundaries -- business unit boundaries. If it were a market, it would be our second-largest market from a profit point of view. So that's how important Global Travel Retail is. We expect travelers to increase in terms of numbers, mainly through airlines, of course. And this is the perfect opportunity for us, number one, to grow our business from a financial point of view, but also, it's a great showcase channel for our brands. So you should expect to see more and more pop-up stores on some of our key brands. So for instance, for the run-up to the Chinese New Year in key international airports where you see Chinese travelers, we had Martell-specific pop-up stores, and so on and so forth. We have not given any numbered ambition for Global Travel Retail. We have just stated on the slide that we expect to see Global Travel Retail in terms of all Travel Retail sales value, not just in our industry, increase by roughly 5%.



Hélène de Tissot Pernod Ricard SA - EVP of Finance, IT & Operations Director and Member of Executive Board

So far on the pricing, so revenue growth management is obviously the key pillar of our strategy. We've been working on it for many years, and we'll keep working on it definitely, short and midterm. In term of performance, last year, we're roughly around 1% pricing improvement. This in the first half is probably a bit better than that. We are committed to increase our price. We look at the price both in term of price increase, but as well, obviously, about -- we look as well at the effectiveness of our promotion to be sure that we have a good view on how effective they can be, how fast we need to adjust them to make them effective or to stop them if they are not efficient. So this is a priority, and this is going to be a priority as well in the future. In term of position, this, let's say, growth driver, well, it's difficult to say. It's fair to say that we are benefiting from a strong price increase this year. Martell is a great contributor to that. We mentioned the new price increase happening a few days ago in China. Again, I think it's showing our confidence and our ambition and I would say, our obsession on the pricing strategy, which is part of the premiumization strategy of the group.

Operator

You next question comes from the line of Nico Von Stackelberg.

Nico Von Stackelberg Liberum Capital Limited, Research Division - Research Analyst

Yes. Three questions, please. One, will you commit to growing free cash flow year-over-year for FY '19? Two, you mentioned some commercial disputes in France. Can you remind me, do you have 2 separate sales forces in France? If so, why do you have this structure? And then finally, you talked about a commitment to active portfolio management. I see that you said -- well, what I'm trying to get at here is, look, you said that you would not look to sell your champagne assets, which by all measures are certainly low-return assets. Why is the champagne disposal not on the table given that they're holding back your group ROIC? And would you agree that assets that are earning below their cost of capital actually destroy value when they grow?

Alexandre Ricard Pernod Ricard SA - Chairman, CEO & Member of Executive Board

So maybe I'll let you answer the free cash flow at the end. I'll start. We do have a commercial dispute in France, for sure. If you may recall, 4 years ago, we embarked on a project where we decided to merge our back office functions in Pernod and Ricard. Today, we do have 2 sales divisions in Pernod Ricard. And there's a project called [IN] which is looking at how we can basically try and grow in a difficult market in France, leveraging the great portfolio of brands we have and our leadership position in France, which is close to 30%. So this project is currently ongoing. With regards to champagne, let me just be quite clear, by the way, not to mention the great performance, for instance, of PJ growing, basically in all regions, double digit. But champagne is a magnificent door opener for the on-trade. If you look -- so forget a second, again, traditional segments, but if you look at the high-energy party segment, which by the way, is a huge segment, which also doesn't really have any boundaries. It focuses on high-net-worth individuals that travel from (inaudible) to St Tropez to Courchevel to Dubai, and so on and so forth. The key SKU that opens the door to the high-energy party accounts is champagne. If you want to sell vodka, you'd better have a champagne. It helps. It definitely helps. By the way, champagne is profitable as well. So that's as far as it goes for champagne. And what about our free cash flow, Hélène?

Hélène de Tissot Pernod Ricard SA - EVP of Finance, IT & Operations Director and Member of Executive Board

So coming back to your question on the cash. It's fair to say that in the first half, we have, as I mentioned, some nonrepeat of positive cash that we had last year in term of nonrecurring. So this is going to be impacting our full year performance. In term of ambition, in term of cash generation, I think we've been very clear. And by the way, thank you for asking the question so that I can remind you that we have as well EUR 200 million cash savings program, which is doing well and which would be fully delivered by 2020. So the ambition here is as well to generate good cash flow. In term of other indicators, we are roughly increasing our strategic inventory by, more or less, EUR 200 million. We were slightly below some years. We'll probably going to be a bit -- above this EUR 200 million this year. CapEx more or less accounting for -- representing, sorry, 4% of the net sales. And we don't anticipate significant change here. So ambition in term of cash flow generation, for sure, with this year, the impact of last year positive nonrecurring cash, which is impacting, let's say, our comparable basis.

Nico Von Stackelberg Liberum Capital Limited, Research Division - Research Analyst

So can I just clarify on the champagne assets? Are they -- what is the -- you guys are ROCE, right? So what is the ROCE for the champagne assets?

Alexandre Ricard Pernod Ricard SA - Chairman, CEO & Member of Executive Board

We don't disclose ROCE by brands. But I can tell you we monitor ROCE by brands and by brand-market combinations.

Julia Massies Pernod Ricard SA - VP of Financial Communication & IR

So mindful of time, we'll take our final question from the callers, please.

Operator

Your next question comes from the line of Chris Pitcher.

Chris Pitcher Redburn (Europe) Limited, Research Division - Partner of Beverages Research

Couple of questions. Firstly, on your commentary around the new management in position, high levels of employee engagement. Are you changing the executive and operating management sort of remuneration target in light of your raised top line guidance and a specific margin, i.e., moving away from just profit -- recurring profit guidance? And also, is there a deepening equity ownership amongst the operational management level as part of the new plan? And then secondly, sorry, a specific clarification. On the U.S. destocking impact in the second half, did you say 1 to 2 weeks' worth of stock? I wasn't sure if you said. And therefore, can you give us an idea of what the quantum would be H2? I know you've talked about it at the beginning of the call, and apologies if I missed the specific guidance.

Alexandre Ricard Pernod Ricard SA - Chairman, CEO & Member of Executive Board

Well, on the management incentives, every single year, we revisit the incentives for them to be clearly aligned with the kind of objectives we have in mind. And as you may be aware, we have short-term incentives, so full year incentives based on our budget. And we also have a long-term incentive plans, which we disclose openly in our reference document. In terms of employee ownership, we're actually going to be launching in April this year an employee share ownership plan in April. A lot of our employees have been asking us to do that for many, many, many years. They want to feel they're part of the Pernod Ricard journey. So we're launching this plan in April of this year.

Hélène de Tissot Pernod Ricard SA - EVP of Finance, IT & Operations Director and Member of Executive Board

For the U.S. destocking, so as we mentioned, this is roughly going to be around 1 or 2 weeks of sales in term of, let's say, global and Europe, we are discussing right now. So it's too early to be more specific than that. And it's likely to be done by the end of the year. But as I said, execution is key. So if we need to have some of this happening next year to protect the business continuity, we'll do so.

Julia Massies Pernod Ricard SA - VP of Financial Communication & IR

Ladies and gentlemen, thank you very much. Alexandre, Hélène, thank you, and have a good day.

Alexandre Ricard Pernod Ricard SA - Chairman, CEO & Member of Executive Board

Thank you.

Hélène de Tissot Pernod Ricard SA - EVP of Finance, IT & Operations Director and Member of Executive Board

Thank you, Julia.

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