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4.1 KEY FIGURES FROM THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2018

4.1.1 Income statement

€ million	30.06.2016	30.06.2017	30.06.2018
Net sales	8,682	9,010	8,987
Gross margin after logistics expenses	5,371	5,602	5,604
Advertising and promotion expenses	(1,646)	(1,691)	(1,720)
Contribution after advertising & promotion investments	3,725	3,912	3,884
Profit from recurring operations	2,277	2,394	2,358
Operating profit	**2,095**	**2,232**	**2,296**
Financial income/(expense) from recurring operations	(432)	(374)	(301)
Corporate income tax	(408)	(438)	(392)
Share of net profit/(loss) of associates	0	1	0
NET PROFIT	**1,255**	**1,421**	**1,603**
O/w:			
• non-controlling interests	20	28	26
• Group share	1,235	1,393	1,577
EARNINGS PER SHARE – BASIC *(IN EUROS)*	**4.68**	**5.27**	**5.97**
EARNINGS PER SHARE – DILUTED *(IN EUROS)*	**4.65**	**5.25**	**5.94**

4.1.2 Balance sheet

€ million	30.06.2016	30.06.2017	30.06.2018
Assets			
Non-current assets	23,310	22,557	21,737
Of which intangible assets	*17,572*	*17,152*	*16,858*
Current assets	7,282	7,521	7,821
Assets held for sale	6	10	-
TOTAL ASSETS	**30,598**	**30,088**	**29,558**
Liabilities and shareholders' equity			
Consolidated shareholders' equity	13,506	13,886	14,978
Non-current liabilities	12,137	11,946	10,838
Current liabilities	4,955	4,256	3,743
Liabilities held for sale	-	-	-
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**30,598**	**30,088**	**29,558**

4.1.3 Net financial debt

€ million	30.06.2016	30.06.2017	30.06.2018
Gross non-current financial debt	7,335	7,379	7,239
Gross financial debt from recurring operations	2,027	1,165	452
Non-current hedging instruments - assets	(77)	(9)	-
Hedging Instruments from recurring operations - assets	-	(6)	(1)
Non-current derivative instruments - liabilities	-	-	25
Derivative instruments from recurring operations - liabilities	-	(2)	-
Cash and cash equivalents	(569)	(677)	(754)
NET FINANCIAL DEBT	8,716	7,851	6,962
Free Cash Flow*	1,061	1,299	1,433

* *The calculation of Free Cash Flow is set out in the note 4.3 entitled "Net debt" of the Management Report.*

4.1.4 Cash flow statement

€ million	30.06.2016	30.06.2017	30.06.2018
Self-financing capacity before financing interest and taxes	2,315	2,493	2,535
Net interest paid	(408)	(363)	(288)
Net income tax paid	(393)	(408)	(371)
Decrease/(increase) in working capital requirement	(178)	(79)	(100)
Net change in cash flow from operating activities	**1,336**	**1,642**	**1,776**
Net change in cash flow from investment activities	**(359)**	**(293)**	**(404)**
Net change in cash flow from financing activities	**(928)**	**(1,156)**	**(1,287)**
Cash flow from discontinued operations	-	-	-
Foreign currency translation adjustments	(25)	(86)	(8)
Cash and cash equivalents at start of period	**545**	**569**	**677**
CASH AND CASH EQUIVALENTS AT END OF PERIOD	569	677	754

4.2 ANALYSIS OF BUSINESS ACTIVITY AND RESULTS

Pernod Ricard uses alternative performance indicators when conducting an analysis of its activity. These indicators are set out on page 137.

In FY18, Pernod Ricard delivered a very strong year.

Clear Sales acceleration; +6.0% vs. +3.7% in FY17, thanks to consistent strategy implementation:

- strong diversified growth, with all Regions and key brands performing well;
- improving price/mix.

Very strong financial delivery:

- Profit from Recurring Operations (PRO): +6.3%, in line with revised annual guidance;
- PRO margin improvement: +14bps, while increasing investment behind must-win brands/markets to drive future growth;
- FX mainly impacted by USD, as expected, with -€180m impact on PRO but €91m favourable impact on Net debt;
- Net Profit : +13% thanks in particular to reduction in financial expenses;
- very strong Free Cash Flow (+10%) leading to Net debt decrease of c. €0.9bn to €7.0bn and Net debt / EBITDA at 2.6x.

Dividend increased to 41% payout.

4.2.1 Presentation of results

4.2.1.1 Group Net profit per share from Recurring Operations – diluted

€ million	30.06.2017	30.06.2018
Number of shares in circulation - diluted	265,477,729	265,543,003
Profit from recurring operations	2,394	2,358
Operating margin	26.6%	26.2%
Financial income/(expense) from recurring operations	(376)	(301)
Corporate income tax on recurring operations	(509)	(520)
Non-controlling interests, discontinued operations and share of net profit from equity associates	(27)	(26)
GROUP NET PROFIT FROM RECURRING OPERATIONS	**1,483**	**1,511**
GROUP NET EARNINGS PER SHARE FROM RECURRING OPERATIONS – DILUTED *(IN EUROS)*	**5.58**	**5.69**

4.2.1.2 Profit from Recurring Operations

Group *€ million*	30.06.2017	30.06.2018	Reported growth		Organic growth*	
Net sales	9,010	8,987	(23)	0%	533	6%
Gross margin after logistics expenses	5,602	5,604	1	0%	345	6%
Advertising and promotion expenses	(1,691)	(1,720)	(29)	2%	(120)	7%
Contribution after advertising & promotion expenses	3,912	3,884	(28)	-1%	225	6%
PROFIT FROM RECURRING OPERATIONS	**2,394**	**2,358**	**(37)**	**-2%**	**155**	**6%**

* *Organic growth is defined on page 137.*

America *€ million*	30.06.2017	30.06.2018	Reported growth		Organic growth*	
Net sales	2,661	2,546	(114)	-4%	159	6%
Gross margin after logistics expenses	1,790	1,690	(99)	-6%	92	5%
Advertising and promotion expenses	(551)	(533)	18	-3%	(29)	5%
Contribution after advertising & promotion expenses	1,239	1,157	(81)	-7%	64	5%
PROFIT FROM RECURRING OPERATIONS	**790**	**735**	**(55)**	**-7%**	**55**	**7%**

* *Organic growth is defined on page 137.*

Asia/Rest of World

€ million	30.06.2017	30.06.2018	Reported growth		Organic growth*	
Net sales	3,568	3,648	80	2%	324	9%
Gross margin after logistics expenses	2,102	2,164	62	3%	207	10%
Advertising and promotion expenses	(618)	(662)	(44)	7%	(82)	13%
Contribution after advertising & promotion expenses	1,484	1,502	18	1%	125	8%
PROFIT FROM RECURRING OPERATIONS	**1,000**	**996**	**(4)**	**0%**	**74**	**7%**

* *Organic growth is defined on page 137.*

Europe

€ million	30.06.2017	30.06.2018	Reported growth		Organic growth*	
Net sales	2,781	2,792	11	0%	50	2%
Gross margin after logistics expenses	1,710	1,749	39	2%	46	3%
Advertising and promotion expenses	(522)	(525)	(3)	1%	(9)	2%
Contribution after advertising & promotion expenses	1,188	1,224	36	3%	36	3%
PROFIT FROM RECURRING OPERATIONS	**604**	**626**	**22**	**4%**	**26**	**4%**

* *Organic growth is defined on page 137.*

4.2.2 Organic net sales growth of Strategic International Brands

In millions of 9-litre cases	Volume 30.06.2017	Volume 30.06.2018	Organic growth* in net sales	Volume growth	Price/mix
Absolut	11.2	11.4	2%	2%	0%
Chivas Regal	4.2	4.4	5%	5%	0%
Ballantine's	6.7	7.1	5%	5%	0%
Ricard	4.8	4.5	-6%	-5%	-1%
Jameson	6.5	7.3	14%	12%	1%
Havana Club	4.3	4.6	6%	5%	0%
Malibu	3.6	3.8	6%	5%	1%
Beefeater	2.8	2.9	4%	4%	0%
Martell	2.1	2.4	14%	12%	2%
The Glenlivet	1.0	1.1	5%	5%	0%
Royal Salute	0.2	0.2	-2%	1%	-2%
Mumm	0.8	0.8	1%	-1%	2%
Perrier-Jouët	0.3	0.3	6%	1%	6%
STRATEGIC INTERNATIONAL BRANDS	**48.6**	**50.7**	**7%**	**4%**	**3%**

* *Organic growth is defined on page 137.*

Full-year sales were €8,987 million, representing reported decline of -0.3%, as a result of:

- organic growth of +6.0%, an acceleration vs. FY17 driven mainly by Asia;
- a currency effect of €(530) million over the year, driven primarily by the weaker US Dollar, Indian Rupee and Chinese Renminbi against the Euro;
- a negative scope effect of €(26) million.

FY18 Sales growth was broad-based and delivered by all Regions:

- Americas continued their dynamism, up 6%, with USA now growing broadly in line with the market (+4%). Within the US, Jameson continued its very strong double-digit growth (now c.3.5m cases), Malibu outperformed its category, The Glenlivet stabilised following its transition year, Martell grew very strongly and gained share, the tequila brands (Avion and Altos) as well as Del Maguey continued their strong dynamism, but Absolut remained in decline in a very difficult Vodka category. Sales in the Americas excluding the US grew +10%, thanks to Travel Retail, Mexico and Brazil;
- Asia/Rest of World accelerated, up 9%, thanks to China, India and Travel Retail. China confirmed a strong return to growth (+17%) driven by Martell (+17%), Chivas' return to growth and strong double-digit growth from Premium Brands. India had a strong performance across the portfolio (+14%), enhanced by a favourable basis of comparison. Travel retail's growth accelerated vs. FY17 (+8%) driven by Strategic International Brands, in particular Martell;

- Europe posted modest growth, up 2%, with continued dynamism in Eastern Europe (+10%) and stability in Western Europe. In Eastern Europe, Russia continued its momentum, growing double-digits in FY18 and Poland had a good performance across the portfolio. In Western Europe, Germany and the UK delivered good performances, Travel Retail returned to growth but France and Spain were difficult, declining -4% and -5% respectively.

… and a wide spectrum of brands:

- Strategic International Brands' acceleration: +7% vs. +4% in FY17;
- 11 out of 13 Strategic International Brands in growth, 6 of which improving vs. FY17;
- very strong performance from Martell (+14%) and Jameson (+14%);
- improving trends for overall Scotch portfolio (+3% vs. stable in FY17) and return to growth for Chivas (+5%);
- Absolut +2%, thanks to success outside USA (+6%), although USA still in decline;
- innovation contributing significantly to topline growth.

4.2.3 Contribution after advertising & promotion investments

The gross margin (after logistics expenses) amounted to €5,604 million, with an increase of +6% [(1)] (+15bps), due to:

- pricing improving;
- operational excellence savings limiting the impact of cost of goods' increases (in particular on Agave and GST in India);
- strong growth from Martell and Jameson but negative mix from the growth of Seagram's Indian Whiskies and the decline of Ricard.

Advertising and Promotion investments were up +7% [(1)] to €1,720 million, to prepare for future growth, with A&P/Sales ratio stable at c.19%:

- support for key innovation projects;
- internationalisation of Martell;
- support of new Chivas platform in China;
- operational excellence savings reinvested.

4.2.4 Profit from Recurring Operations

Profit from Recurring Operations was up +6.3% [(1)], or €155 million, to reach €2,358 million. Structure costs increased by 5% [(1)], (+4% [(1)] excluding Other income and expenses) thanks to strong discipline leading to an increase below that of the top line and with targeted investment in Emerging markets and growth relays to drive future growth . The currency effect (-8%, or €(180) million) was primarily due to the weaker US Dollar but also a weaker Chinese Renminbi and Indian Rupee. The scope effect remained limited (-0%, or €(11) million). Due to the impact of FX, Profit from Recurring Operations declined on a reported basis by 2%.

4.2.5 Financial income/(expense) from recurring operations

Financial expenses from recurring operations were €(301) million, compared with €(376) million the previous period. The cost of debt stood at 3.5% for the year, compared with 3.8% in FY17. For FY19, the cost of debt is expected to be 3.9%.

The debt structure at 30 June 2018 was as follows:

- the bond portion was approximately 89% of gross debt;
- the fixed rate portion was 79% of total debt;
- the maturity of gross debt at the end of June 2018 was six years and seven months;
- the Group had €0.8 billion in cash and €2.5 billion in undrawn syndicated credit facility as of 30 June 2018;
- structuring the debt by currency (USD: 53%) provides a natural hedging mechanism with debt by currency matched with cash flow by currency.

4.2.6 Group Net Profit from Recurring Operations

Tax on Profit from Recurring Operations stood at €(520) million, giving a current effective rate of tax of close to 25%, in line with FY17. Non-controlling interests amounted to €(26) million.

Group Net Profit from Recurring Operations increased by 2% to reach €1,511 million. Diluted Net Profit per share from Recurring Operations stood at €5.69, up +2%.

4.2.7 Group Net Profit

Other non-recurring operating income and expenses amounted to €(62) million. Non-current financial income (expense) amounted to a net expense of €(1) million. Corporate income tax on non-recurring item as amounted to Net income of €129 million.

Accordingly, Group Net Profit stood at €1,577 million, up +13% on FY17.

(1) Organic growth is defined on page 137.

4.3 NET DEBT

Reconciliation of Net financial debt – The Group uses net financial debt in the management of its cash and its Net debt capacity. A reconciliation of net financial debt and the main balance sheet items is provided in Note 4.9 – Financial instruments in the Notes to the annual consolidated financial statements. The following table shows the change in Net debt over the year:

€ million	30.06.2017	30.06.2018
Profit from recurring operations	**2,394**	**2,358**
Other operating income and expenses	(163)	(62)
• Depreciation of fixed assets	219	216
• Net change in impairment of goodwill and property, plant and equipment and intangible assets	75	73
• Net change in provisions	(59)	(35)
• Restatement of contributions to pension funds acquired from Allied Domecq and others **	7	14
• Fair value adjustments on commercial derivatives and biological assets	(14)	(1)
• Net (gain)/loss on disposal of assets	6	(48)
• Share-based payments	34	35
Sub-total of depreciation and amortisation, change in provisions and other	**268**	**254**
SELF-FINANCING CAPACITY BEFORE FINANCING INTEREST AND TAX*	**2,499**	**2,549**
Decrease/(increase) in working capital requirements	(79)	(100)
Net interest and tax payments	(771)	(659)
Net acquisitions of non-financial assets and other	(350)	(358)
FREE CASH FLOW	**1,299**	**1,433**
Of which recurring Free Cash Flow	1,471	1,422
Net disposal of financial assets and activities, contributions to pension plans acquired from Allied Domecq and others **	50	(60)
Change in the scope of consolidation	-	-
• Capital increase and other changes in shareholders' equity	-	-
• Dividends and interim dividends paid	(511)	(551)
• (Acquisition)/disposal of treasury shares	(36)	(23)
Sub-total dividends, purchase of treasury shares and other	**(547)**	**(575)**
DECREASE/(INCREASE) IN DEBT (BEFORE FOREIGN EXCHANGE IMPACT)	**802**	**798**
Foreign currency translation adjustments	62	91
DECREASE/(INCREASE) IN DEBT (AFTER FOREIGN EXCHANGE IMPACT)	**865**	**889**
Net debt at beginning of period	(8,716)	(7,851)
Net debt at end of period	(7,851)	(6,962)

* *Excluding investments in pension funds acquired from Allied Domecq.*
** *Of which €5 million related to pension funds acquired from Allied Domecq and €9 million related to tax on disposals in FY17 paid in FY18.*

4.4 OUTLOOK

Pernod Ricard will pursue the execution of a consistent strategy with clear resource allocation and support for must-win brands and markets.

For FY19, in an uncertain geopolitical and monetary environment, the Group expects:

- broad-based sales growth to continue;
- improved pricing;
- growing pressure on Input costs;
- very strong Q1 given the favourable base of comparison in India and an earlier Mid-Autumn Festival.

The guidance for FY19 is organic growth in Profit from Recurring Operations of between +5% and +7%.

4.5 DEFINITIONS AND RECONCILIATION OF ALTERNATIVE PERFORMANCE INDICATORS WITH IFRS INDICATORS

Pernod Ricard’s management process is based on the following non-IFRS measures which are chosen for planning and reporting. The Group’s management believes these measures provide valuable additional information for users of the financial statements in understanding the Group’s performance. These non-IFRS measures should be considered as complementary to the comparable IFRS measures and reported movements therein.

4.5.1 Organic growth

Organic growth is calculated after excluding the impacts of exchange rate movements and acquisitions and disposals.

Exchange rates impact is calculated by translating the current year results at the prior year’s exchange rates.

For acquisitions in the current year, the post-acquisition results are excluded from the organic movement calculations. For acquisitions in the prior year, post-acquisition results are included in the prior year but are included in the organic movement calculation from the anniversary of the acquisition date in the current year.

Where a business, brand, brand distribution right or agency agreement was disposed of or terminated in the prior year, the Group excludes in the organic movement calculations the results for that business from the prior year. For disposals or terminations in the current year, the Group excludes the results for that business from the prior year from the date of the disposal or termination.

This measure enables the Group to focus on the performance of the business which is common to both years and which represents those measures that local managers are most directly able to influence.

4.5.2 Free Cash Flow

Free Cash Flow comprises the net cash flow from operating activities excluding the contributions to the Allied Domecq pension plans acquired, aggregated with the proceeds from disposals of property, plant and equipment and intangible assets and after deduction of the capital expenditures.

4.5.3 “Recurring” indicators

The following three measures represent key indicators for the measurement of the recurring performance of the business, excluding significant items that, because of their nature and their unusual occurrence, cannot be considered as inherent to the recurring performance of the Group:

- **Recurring Free Cash Flow:**

Recurring Free Cash Flow is calculated by restating Free Cash Flow from non-recurring items.

- **Profit from Recurring Operations:**

Profit from Recurring Operations corresponds to the operating profit excluding other non-current operating income and expenses.

- **Group net profit from recurring operations**

Group net profit from recurring operations corresponds to the Group net profit excluding other non-current operating income and expenses, non-recurring financial items and corporate income tax on non-recurring items.

4.5.4 Net debt

Net financial debt, as defined and used by the Group, corresponds to total gross debt (translated at the closing rate), including fair value and net foreign currency assets hedge derivatives (hedging of net investments and similar), less cash and cash equivalents.

4.5.5 EBITDA

EBITDA stands for “earnings before interest, taxes, depreciation and amortisation”. EBITDA is an accounting measure calculated using the Group’s Profit from Recurring Operations excluding depreciation and amortisation on operating fixed assets.

4.6 RISK MANAGEMENT

4.6.1 Introduction

Pernod Ricard faces a range of internal and external risks that may impact its objectives. The main risks to which the Group considers itself to be exposed at this date of this document are set out below.

In view of these risks, Pernod Ricard has implemented a system of internal control and risk management to better forecast and control them. The principles and procedures of internal control and risk management are described in the Sub-Section 2.2 "*Internal control and risk management*" of the Section 2 "*Corporate governance and internal control*" of this document. As part of the Group's decentralised structure, each function and each affiliate contributes on an ongoing basis to the smooth running and improvement of this system. The coverage and insurance implemented by the Group to counter these risks is shown below.

In the future, it may be that other risks not currently known or considered insignificant could negatively affect the Group.

4.6.2 Risks relating to business activities

4.6.2.1 Risks relating to the global economic environment and geographic presence

The Group's business is sensitive to general economic conditions in its key markets, in particular the United States, China and India. In most countries, the consumption of Wines & Spirits, which is closely linked to the broader economic environment, tends to decline during periods of economic recession, unemployment, reduction in consumer spending and increases in the cost of living.

Currency fluctuations against the euro may also impact the Group's results. Due to the geographic distribution of its business activity, the Group is specifically exposed to fluctuations in the US dollar, the pound sterling and emerging market currencies against the euro (see "Analysis of business activity and results" in this management report).

In addition, Wines & Spirits consumers, including consumers of Pernod Ricard's products, also have the option of trading down to less costly products ("standard" as opposed to "Premium"), particularly during economic downturns or as a result of government measures as was the case in the Chinese market following measures to dampen conspicuous consumption in 2013/14, which hampered sales growth over several financial years.

Furthermore, the Group derives a considerable portion of its business (40% of net sales in FY18) from emerging markets in Asia, Eastern Europe and Latin America (such as China, India, and Russia). Although any country in the world can be affected, the Group's activities in emerging markets are more exposed to political and economic risks, including those resulting from regulatory changes, protectionism or changes in government or monetary policy. These risks specifically include risks stemming from inflation, problems with the repatriation of foreign earnings, dividends and investment capital, fluctuations in and management of exchange rates, changes in tax regimes, implementation of restrictions on imports, and political instability. Moreover, the Group may find itself unable to defend its rights appropriately before the courts of some of these countries, particularly in litigation with the state or state-controlled entities (see "Risks relating to litigation" in this management report). In addition, acts of terrorism or a declaration of war, the impact on consumer confidence and tourism from said acts, or any other adverse political event, or concerns relating to the threat of global pandemics could have a negative impact on consumers' propensity to make purchases in the more expensive ranges of the Group's key product categories, in Travel Retail and in other markets.

Such disruptions or other economic and political upheavals in the Group's markets could heighten volatility in Group's sales, with a negative impact on its results and outlook in these markets.

The diverse geographical distribution of the Group's businesses means that today it can seize every growth opportunity and help alleviate the difficulties encountered in a number of markets (see "Analysis of business activity and results" in this management report), although a global recession or marked or extended downturns in the Group's main markets may weigh on the Group's overall sales and adversely affect its consolidated results and outlook.

4.6.2.2 Risks relating to further consolidation in the Wines & Spirits segment

The industry is witnessing a trend towards the consolidation of distributors and retailers.

A further consolidation among spirits producers and distributors in the Group's key markets could negatively impact the sale of the Group's products as a result of, for example, fewer resources allocated to its brands. As the retail trade consolidates, wholesalers and retailers will have greater resources and bargaining power and, as a result, could seek to have the Group and other producers reduce their prices, conduct product promotions and/or accept payment terms that could reduce margins. An increase in a distributor's market share could have an adverse impact on the Group's sales and profitability. Changes in distributors' strategies, including a reduction in the number of brands they carry, the allocation of shelf space for our competitors' brands or private label products may adversely affect the Group's sales, margins, market share and outlook.

4.6.2.3 Risks relating to image due to product quality

The success of the Group's brands depends upon the positive image that consumers have of those brands. The Group's reputation and image may at any time be significantly undermined by one-off incidents at an industrial facility or relating to a specific product. For example, contamination, whether arising accidentally, or through an act of malice, or other events that harm the integrity of or consumer image of their brands, could adversely affect Group sales. The Group purchases most raw materials for the production of its Wine & Spirits from third-party producers or on the open market. Contaminants in those raw materials or defects in the distillation or fermentation process at one of our industrial facilities could lead to poor beverage quality as well as illness among, or injury to, our consumers, which could subject the Group to liability and result in reduced sales of the affected brand or all its brands.

In addition, to the extent that third parties sell products that are either counterfeit versions of the Group's brands or inferior "lookalike" brands, consumers of the Group's brands could confuse its products with those brands. This could discourage them from purchasing the Group's products in the future, which could in turn adversely impact brand equity and the Group's results.

Although the Group has implemented protection and control systems to limit the risk of contamination and other industrial accidents and has a Group Intellectual Property Department devoted to protecting its brands (for more information, see the subsection on "Risks relating to Intellectual Property"), there can be no guarantee that problems arising from industrial accidents, contamination and other factors will not compromise the Group's reputation and image on a global scale. Reputational damage could potentially have negative effects on the Group's image, financial position, results and outlook.

The net carrying value of brands and goodwill recorded in the Group's balance sheet at 30 June 2018 was €17 billion.

4.6.2.4 Risks relating to competition

The Group operates in highly competitive markets, where brand recognition, corporate image, price, innovation, product quality, the breadth of distribution networks and services provided to consumers are differentiating factors among competitors.

The Group constantly aims to strengthen the recognition of its brands, particularly its Strategic International Brands, through advertising and promotional campaigns, enhancing the quality of its products and optimising its distribution and service networks. Nevertheless, it must also face heightened competition from major international players on its Strategic International Brands and from smaller groups or local producers on its Strategic Local Brands, including the growing success of artisan production, as may be the case for vodka in the United States, the main market for Absolut vodka. This fierce competition prevailing in mature markets and the increasingly competitive nature of emerging markets could require the Group to boost its advertising and promotional expenditure, or even reduce or freeze prices, in order to protect market share.

Competitive environment

Competitive position

Pernod Ricard faces competition in its business lines, primarily from:

- large Wines & Spirits multinationals, such as Diageo, Bacardi-Martini, Beam Suntory, Brown-Forman, Campari, William Grant, Moët-Hennessy and Rémy Cointreau for international brands;
- smaller companies or producers of local brands such as Sazerac, Heaven Hill and Constellation Brands in the USA, Altia in the Nordic countries and Stock Spirits in Poland, among others.

Dependence on patents, licences and industrial agreements

The Group is not dependent on any specific patent or licence.

Pernod Ricard is not significantly dependent on its suppliers. The Group's five main industrial suppliers in the 2017/18 financial year were Verallia, Ardagh Glass, O-I, Saver Glass (glass bottles) and Guala (corks).

4.6.2.5 Risks relating to innovation and consumer expectations

The Group's performance is dependent on its capacity to satisfy consumer expectations and desires. However, changes in consumer expectations and desires is difficult to anticipate, and in many cases, is beyond the Group's control. As a result, negative changes in consumer demand could affect sales and market share.

In addition, the increasing number of campaigns aimed at discouraging the consumption of alcoholic beverages, as well as changes in lifestyle, means of distribution, consumer habits and consumers' approaches to health issues, could, over time, modify consumer habits and the general social acceptability of alcoholic beverages, and have an adverse impact on the Group's reputation, sales, financial position, results and outlook.

In order to properly cover these risks, the Group supports its brands, in particular innovations (Chivas Extra, Jameson Caskmates, etc.) and new growth opportunities (digital communications, Sub-Saharan Africa). Innovations contributed significantly to organic growth in net sales in FY18, generating incremental Group growth of approximately +2 points.

4.6.2.6 Risks relating to employees

The Group's success is dependent on the loyalty of its employees, and in particular of those in key roles, as well as its ability to continue to attract and retain highly qualified personnel. No significant impacts have been identified in this regard to date, but the Group is aware that difficulties hiring or retaining key personnel or the unexpected departure of experienced employees, including from acquired companies, could potentially slow the implementation of the Group's strategic growth plans and could have an adverse impact on its business, financial position and the results of its operations.

In compliance with freedom of association and the right to collective bargaining, strikes or other social action may take place. Any extended labour disputes could have an impact on the Group's sales. However, to date, Pernod Ricard has not had to face prolonged industrial action that could have significantly impacted Group sales.

4.6.2.7 Risks relating to information systems

IT and telecoms systems are fundamentally important in the daily performance of Group operations, in terms of the processing, transmission and storage of electronic data relating to the Group's operations and financial statements and of communication between personnel, customers and suppliers of Pernod Ricard.

At a time of constant change in computer technology and its uses, Pernod Ricard, a decentralised group whose operation is increasingly digital and dematerialised, is exposed to the risk of failure of its IT systems, due to malfunction or malicious intent, either internal or external, that may harm the availability of IT services or the integrity and confidentiality of sensitive data. The Group's information technology systems could be exposed to interruptions for reasons beyond its control, including, but not limited to, natural disasters, terrorist attacks, telecommunications breakdowns, computer viruses, hackers or other security issues. Although the Group invests a significant amount in the maintenance and protection of its IT systems, particularly in view of growing threats in terms of cybercriminality, any malfunctions, significant disruption, loss or disclosure of sensitive data could disrupt the normal course of the Group's business, and have financial, operational or image-related consequences.

A detailed description of the Group's image risks is given in the subsection "Risks relating to image due to product quality" of this management report.

4.6.2.8 Risks relating to raw materials and energy prices

Some of the raw materials that the Group uses for the manufacture of its products are commodities that are subject to price volatility caused by changes in global supply and demand, weather conditions, agricultural uncertainty and governmental controls.

An unexpected rise in the cost of raw materials or packaging materials could significantly increase its operating costs. Similarly, shortages of such materials could have a negative effect on our business. Moreover, an increase in energy costs could result in higher transportation, freight, distillation and other operating costs.

The Group may not be able to increase its prices to offset these increased costs without suffering reduced volume, sales and operating profit, which could negatively impact the Group's results.

For agricultural raw materials, hedging agreements have been entered into with banks to secure prices of a portion of wheat supplies and to limit production cost volatility. These hedges do not involve physical delivery (see Note 4.10 – *Interest rate, foreign exchange and commodity derivatives* of the Notes to the consolidated financial statements). Moreover, the Group has entered into physical supply contracts with some suppliers in order to secure the delivery price of *eaux-de-vie*, grapes, and certain grains (see Note 6.3 – *Off-balance sheet commitments* in the Notes to the consolidated financial statements).

4.6.2.9 Risks relating to external growth operations

The Group has made major acquisitions in the past (see the subsection on "A responsible business with a spirit of adventure" of Section 1 "Extracts from the Integrated Annual Report"). Pernod Ricard believes it successfully integrated these acquisitions.

In the event that Pernod Ricard decides to conduct a major acquisition in the future, successful integration of the target cannot be guaranteed. In addition to the fact that acquisitions require General Management to devote a significant amount of time to resolving organisational issues, they also require integration of new businesses, employees and products belonging to the acquired companies. The integration process involves a great many unknowns, including the impact of the integration of new entities into a new structure and the management of the Human Resources of merged businesses. The Group's financial position, results and outlook could be affected should it be unable to successfully integrate the acquired companies.

The Group has made no major acquisitions since 2008.

4.6.2.10 Risks relating to seasonal trends

Pernod Ricard makes an significant portion of its sales during the Christmas and New Year season and the Chinese New Year. The last quarter of the calendar year traditionally accounts for about a third of full-year sales. Any major unexpected adverse event occurring during this period, such as a natural disaster, pandemic, or economic or political crises, could lead to a reduction in the Group's revenues and, consequently, a deterioration in its full-year results.

4.6.3 Industrial and environmental risks

Pernod Ricard's management of industrial and environmental risks is based on a joint QSE (Quality/Safety/Environment) management approach implemented in all production affiliates worldwide. Coordinated by the Group's Sustainable Performance Department, this risk management policy is based on internal Pernod Ricard standards and on systematic risk analysis.

It is based on the guidelines setting out good practices and the minimum requirements needed in each of the relevant areas:

- product quality;
- safety of personnel;
- management of environmental impacts;
- protection of insured capital (industrial risks).

It is also supported by an ambitious QSE certification process for Group production sites according to the following four international standards:

- ISO 9001 for quality management;
- ISO 22000 for food safety management;
- ISO 14001 for environmental management;
- OHSAS 18001 for occupational health and safety.

At the end of June 2018, 90% of bottling sites were quadruple QSE-certified in accordance with these four standards, covering 99% of total bottled production.

4.6.3.1 Risks relating to industrial sites and inventory management

As for prevention of major industrial risks, an Operations Risk Manager is responsible for coordinating actions of affiliates in the implementation of preventive measures (design and maintenance of facilities, training, operating procedures, etc.) and protection mechanisms (automatic extinguishing, retentions, emergency procedures, etc.).

In cooperation with the insurer, more than 60 industrial sites are audited each year, leading to an assessment of the quality of risk and as such recommendations for improvement for each of them.

In addition, a Group monitoring programme for Business Continuity Management Systems is in place. The most strategic affiliates have identified the various scenarios that could affect their activities and have drawn up business continuity plans including the implementation of emergency solutions and access to alternative means of production.

To date, 19 industrial affiliates have established business continuity management systems. They are also regularly audited by third parties and are monitored by the Group Operations Department.

Fire hazards

As alcohol is highly flammable, fire is one of the main risks to our staff and facilities, particularly at production sites where *eaux-de-vie* are produced and stored. This risk is also present at sites where blending and bottling of alcohol take place. In some cases, a fire may be accompanied by the risk of explosion, especially if alcohol vapours come into contact with a heat source. This is a particular point of attention, and is monitored every year as part of the audit programme for our industrial sites carried out in partnership with our insurer (see previous paragraph).

Since May 2000, when a fire led to the loss of a bourbon cellar in Kentucky, no major fires have occurred on the Group's sites.

Risk related to inventory management

The Group has a substantial inventory of matured products, principally Scotch whisky, Irish whiskey, cognac, rum, brandy and wines. The maturing periods can occasionally extend beyond 30 years. The Group's maturing inventories (representing 79% of work in progress, as cited in Note 4.4 – *Inventories and work in progress* of the Notes to the consolidated financial statements) are stored at numerous locations around the world (see map of main production sites in Section 1 "Extracts from the Integrated Annual Report").

The loss of all or part of the maturing inventories or the loss of all or some of the production, distilling, blending or packaging sites as a result of negligence, an act of malice, contamination, fire or natural disaster could lead to a significant fall in or prolonged interruption to the supply of certain products, precluding the Group from satisfying consumer demand. In addition, there is an inherent risk of forecasting error in determining the quantity of maturing stock to store in a given year for future consumption. This could lead to either an inability to meet future demand or a future surplus of inventory resulting in write-downs in the value of maturing stocks. Finally, there also can be no assurance that insurance proceeds would be sufficient to cover the replacement value of lost maturing inventories or assets in the event of their loss or destruction.

4.6.3.2 Risks for consumers

Inappropriate consumption of alcohol is a health risk to the consumer. It is behind the Group's commitment to responsible drinking (see Part 3 "Sustainability & Responsibility").

Other risks for consumers relate to product quality. They mainly concern the presence of foreign objects in bottles (glass fragments) or intentional or accidental contamination by an undesirable component.

Control of these risks is based both on the application of the HACCP method, which aims to identify risks involved in the manufacturing process and to bring them under control, as well as on the implementation of specific internal guidelines. This approach is also accompanied by the implementation of management systems compliant with the ISO 22000 standard for food safety management, which is aimed specifically at controlling such risks. The Group conducts a programme of in-depth analyses covering all contaminants deemed possible. In 2017, it focused on all Strategic International Brands and the biggest Strategic Local Brands.

Active monitoring is also implemented on emerging risks, particularly those relating to components present in packaging, raw materials and water that are liable to pose a risk to consumer health.

4.6.3.3 Risks for employees

Ensuring the health and safety of its employees and on-site contractors is Pernod Ricard's top priority. Today, more than 90% of Pernod Ricard's work-related accidents result from its industrial and agricultural activities.

The Group has therefore embarked on a process to reduce workplace accidents by launching a comprehensive inventory of industrial sites with the greatest potential for improvement at the end of 2017. To date, eight sites have been assessed by an external company focusing on specific points covering both the safety culture and the OHSAS 18001 occupational health and safety management system.

These assessments have served to draft improvement plans aimed at sustainably reducing workplace accidents and developing a safety culture.

This approach will be extended to all industrial affiliates with the implementation of an internal framework built on 13 pillars such as the commitment of Management, the management of subcontractors and the investigation of accidents.

4.6.3.4 Environmental risks

Risk of accidental spillage

Accidental spillage of product (wine, alcohol or other) into the environment is liable to pollute soil, rivers or water tables. This risk is of particular concern in cases of fire following a leak or spillage of alcohol and its extinction using water and foam. This risk is identified in all risk analyses carried out on our sites, and is subject to significant preventive measures: water retention facilities in storage and unloading areas, construction of drainage systems, and drainage to storage tanks. In November 2016, a significant wine spillage occurred on the Brancott site in New Zealand resulting from damage to vats caused by an earthquake (see following paragraph).

Risk of natural disasters

Several facilities are located in areas known to be at significant risk of earthquake. They include facilities located in New Zealand, Armenia, California and Mexico. In July and August 2013, the Brancott wine production facility in New Zealand was hit by two successive earthquakes. Substantial damage to storage vats was observed. Another earthquake affected the same site in November 2016, causing a high degree of property damage and leading to the filing of a claim with the Group's insurer. Thanks to the implementation of a business continuity management system (BCMS), local teams were able to limit interruptions to business on the site by securing the harvests and vinification phases for 2016/17.

Some areas are exposed to hurricane risk. The San José plant in Cuba has taken preventive measures to cover this eventuality.

There is also a risk of flooding. For example, cellars were affected in Scotland in 2009, but there was no significant damage. All sites exposed to this risk are subject to the implementation of specific emergency plans approved by our insurer. Lastly, in January 2010, exceptionally heavy snowfalls in the northern part of Scotland caused the roofs of 40 ageing cellars at the Mulben facility to collapse. A weather event of this nature had never previously been seen in this region and was deemed extremely unlikely. The damage only concerned the buildings, as the collapse did not affect inventories of *eaux-de-vie*. Since this claim, specific attention has been paid to those sites likely to face similar weather events. Preventive measures were set out together with our insurer and implemented by the sites.

Risks relating to climate change

In 2015/16, the Group launched a specific study of its 26 production affiliates to ensure that all long-term environmental risks, whether physical, regulatory or reputational, were identified and managed. Risks relating to the procurement of raw materials and water resource management proved to be the most significant.

Thus, in terms of physical consequences, the major risk relates to the impact of climate changes on the supply of agricultural raw materials. Increasingly irregular crop yields, climatic events such as frost, hail and drought and shifting climatic boundaries can affect the quality, availability and, to a greater extent, the price of raw materials. Where grains are concerned, this effect, coupled with rising global demand, is contributing to the increasing volatility of market prices, which must be taken into account in procurement strategies and economic supply models. As regards grapes – another of the Group's key raw materials – climate models reveal the risk of an increase in wine alcohol content, changes to certain qualitative parameters and, in the longer term, a gradual shift in favourable climate areas. The affected inter-professional organisations, such as those for cognac and champagne and the corresponding organisations in Australia and New Zealand, have incorporated this issue into their research programmes in order to adapt their practices to these changes (choice of grape varieties, vine training, vinification, etc.). A similar risk exists in relation to the water supply for production sites: a number of sites use underground water tables for their water needs and these can also be affected by climate change. The availability and quality of water are therefore key factors for the quality of our products, and are monitored very closely. Responsible water management is a significant component of the Group's environmental policy: every site has to ensure that the use of groundwater or river water and the release of waste water back into the environment do not harm nature. Sites located in areas identified as high-risk in terms of their water supply are subject to enhanced monitoring so as to ensure the sustainability of the resources used (see the "Protect the planet" paragraph in Section 3, "Sustainability & Responsibility").

From a regulatory point of view, environmental issues, and in particular climate-related issues, are leading to stricter regulations on carbon emissions. In Europe, the Group's three largest distilleries are subject to the CO_2 emission quota system (EU-ETS). The direct financial impact for Pernod Ricard is negligible. However, the economic impact of regulations on energy and carbon is also felt through indirect consumption *via* our suppliers (especially with respect to glass, alcohol and transportation) and is likely to increase over the coming years.

Finally, in terms of reputation, the environment also represents a challenge due to growing awareness among consumers and public opinion, whose expectations in terms of sustainable consumption are changing rapidly: this reality is taken into account by the marketing teams and is becoming one of the elements of the Group's marketing strategy. It is reflected mainly in the focus on eco-design of products, and incorporation of the CSR dimension into brand platforms.

The existence of risks associated with various environmental aspects is reflected in the Group's environmental roadmap through specific actions in the fields of energy, carbon, water, and agricultural raw materials. The actions undertaken are set out in the subsection "Protect the planet" in Section 3 "Sustainability & Responsibility". It should also be noted that in each year since 2006, Pernod Ricard has published information on the Carbon Disclosure Project website relating to carbon emissions, water resource management and related issues.

4.6.4 Legal and regulatory risks

4.6.4.1 Risks relating to changes in the regulatory environment

The Group's businesses throughout the world are subject to a growing number of regulations, in particular with respect to the sale of alcoholic beverages. The regulatory environment governing the production and marketing of alcoholic beverages could undergo change in France, in the European Union or in the rest of the world. Similarly, advertising and promotion of alcoholic beverages are subject to increasingly stringent rules aimed at changing consumer behaviour and reducing alcohol consumption.

In particular, in its capacity as a distributor of international beverage brands, the Group is subject, in the various countries in which it operates, to numerous regulatory requirements concerning production, product responsibility, distribution, marketing, advertising, labelling and imports. More broadly speaking, it is also subject to issues relating to competition and consolidation, commercial and pricing policies, pensions, labour law and environmental concerns. In addition, the Group's products are subject to import duties and indirect taxes in the various countries in which it operates.

Regulatory decisions and changes in legal and regulatory requirements in these areas could have a negative impact on Pernod Ricard's business:

- **product recalls:** regulatory authorities in the countries in which the Group trades could be given coercive powers and subject the Group to measures including product recalls, product seizures and other sanctions, any of which could have an adverse effect on its trading or reputation, with subsequent negative consequences on its operating profit;
- **advertising and promotions:** regulatory authorities in the countries in which the Group operates could impose restrictions on advertising for alcoholic beverages, for instance by banning television advertisements or the sponsoring of sporting events, or by restricting the use of these media. Furthermore, the Group has signed several voluntary self-regulation codes, which impose restrictions on the advertising and promotion of alcoholic beverages. These limits could hinder or restrict the Group's capacity to maintain or reinforce consumer behaviour in relation to its brands and their recognition on major markets and significantly affect the Group's operating environment;
- **labelling:** regulatory authorities in the countries in which the Group trades could impose new or different requirements in terms of labelling and production. Changes to labelling requirements for alcoholic beverages, including the Group's brand portfolio of Premium Wines and Spirits, could diminish the appeal of these products in the eyes of consumers, thereby leading to a fall in the sales of these beverages. Furthermore, such changes could have the consequence of increasing costs, thereby affecting the Group's results;
- **import taxes and excise duties:** the Group's products are subject to import taxes and excise duties in most markets. An increase in import taxes and excise duties or a change in the legislation relative to duty free sales could raise the price of its products as well as lower the consumption of its Wines and Spirits brands or an increase in costs for the Group;
- **access to distribution:** regulatory authorities in the countries in which the Group operates could seek to restrict consumers' access to Group products, for instance by limiting operating hours of establishments serving alcoholic beverages or increasing the legal age for alcohol consumption.

Aside from the fact that change in local laws and regulations could in some cases restrict the Group's growth capacity by changing consumer behaviour, compliance with new laws and regulations could also require substantial investments. This could potentially have a significant negative impact on the Group's results and outlook.

Similar to other businesses, the Wines & Spirits business is highly sensitive to changes in tax regulations. In addition, in the current macroeconomic climate, regulatory authorities may resort to increasing taxes on alcoholic beverages. The effect of any future tax increases on the Group's sales in a given jurisdiction cannot be precisely measured. However, a significant increase in import and excise duties on alcoholic beverages and other taxes could have an adverse effect on the Group's financial position and operating profit. Furthermore, the Group's net profit is calculated on the basis of extensive tax and accounting requirements in each of the jurisdictions in which the Group operates. Changes in tax regulations, specifically led by the OECD, the European Union and national governments (including tax rates), accounting policies and accounting standards could have a material impact on the Group's results.

In addition, as an international group, Pernod Ricard can be subject to tax audits in several jurisdictions. The Group takes tax positions that it believes are correct and reasonable in the course of its business with respect to various tax matters. However, there is no assurance that tax authorities in the jurisdictions in which the Group operates will agree with its tax positions. In the event that the tax authorities successfully challenge the Group on any material positions, the Group may be subject to additional tax liabilities that may have an adverse effect on the Group's financial position if they are not covered by provisions or if they otherwise trigger a cash payment.

4.6.4.2 Risks relating to Intellectual Property

Recognition of the Group's brands is a fundamental element of its competitiveness. The management of the Group's brands and other owned intellectual property rights requires substantial investments both for their protection and defence.

The Group has taken very strict actions in this area. At the end of 2014, it set up a core team of 16 people (the "Group Intellectual Property Hub" or GIPH) coordinated by the Intellectual Property Department, and located at the Group's headquarters. This team is responsible for the administrative management of all portfolios of intellectual property rights on behalf of the Brand Companies. This new organisational structure responds to a need to pool the Group's resources while implementing a consistent and uniform protection policy across all portfolios of intellectual property rights.

In particular, the GIPH defends the Group's intellectual property rights against any attempt by others to lodge rights similar to ours (specifically through objections). The Brand Companies remain in charge of proceedings brought against any counterfeit goods and/or imitations that may be present in the markets.

The defence of such property is a mission involving all of the Group's personnel, who are aware of the importance of these crucial assets. For instance, sales forces are called on to identify any third-party imitation of the products and brands of the Group and to transmit all information to the Legal Department responsible for intellectual property so that the Group can respond efficiently to those actions.

However, the Group, similar to any other owner of intellectual property rights, is not in a position to guarantee that such measures will be fully sufficient to force third parties to respect its rights. In some non-European Union countries, particularly in Asia, even though satisfactory legal options generally exist, it can be difficult to persuade the local authorities to apply dissuasive sanctions on counterfeiters that reproduce in full or in part the Group's most popular brands in these countries. Yet those illicit acts are likely to have unfavourable consequences for the image of the relevant products. The Group therefore takes specific action, with objectives determined on the basis of the market and the brand, bringing together various internal departments so as to take a cross-functional approach to the problem of counterfeiting. These actions include coordinated legal responses and operations aimed at raising awareness among local authorities, field and online surveys, and technical and technological measures aimed at improving the protection of the Group's products.

Third parties can also contest the Group's ownership of certain brands.

Legal decisions could therefore affect the Group's brand portfolio, potentially having negative effects on its financial position, results and outlook.

For instance, the Group is currently involved in litigation on the Havana Club brand (see Note 6.5 – *Disputes relating to brands* of the Notes to the consolidated financial statements). In this case, an unfavourable ruling would not adversely impact the Group's current financial position, as the brand is not currently marketed in the United States, but it could constitute a lost opportunity if the embargo against Cuba is lifted.

4.6.4.3 Risks relating to litigation

In common with other companies in the Wines & Spirits sector, the Group is occasionally subject to class action or other litigation and complaints from consumers or government authorities. In addition, the Group routinely faces litigation in the normal course of business. If such litigation were to result in fines, monetary damages or reputational damage to the Group or its brands, its business could be materially adversely affected.

The provisions recorded by Pernod Ricard at 30 June 2018 for all litigation and risks in which it is involved, amounted to €548 million, compared with €566 million at 30 June 2017 (see Note 4.7 – *Provisions* of the Notes to the consolidated financial statements). Pernod Ricard provides no further details (other than in exceptional circumstances), as disclosing the amount of any provision for ongoing litigation could cause the Group serious harm.

To the best of the Company's knowledge, there are no other government, legal or arbitration procedures pending or threatened, including any procedure of which the Company is aware, which may have or have had a significant impact on the profitability of the Company and/or the Group over the last 12 months, other than those described in Note 6.5 – *Disputes* of the Notes to the consolidated financial statements.

4.6.5 Financial risks

4.6.5.1 Risks relating to the Group's indebtedness

The Net debt/EBITDA ratio was 2.6 at 30 June 2018, a decline of (0.4) compared to 30 June 2017 (Net debt converted at the average rate). For more information on the Group's indebtedness, see Note 4.8 – *Financial liabilities* of the Notes to the consolidated financial statements.

The risks related to indebtedness are:

- a reduction in the Group's ability to obtain additional financing for working capital, capital expenditure, acquisitions or general corporate purposes, and an increase in the cost of such financing;
- a reduction in the cash available to finance working capital requirements, capital expenditure, acquisitions or corporate projects, a significant part of the Group's operating cash flow being put towards the repayment of the principal and interest on its debt;
- increasing the Group's vulnerability to, and reducing its flexibility to respond to, general adverse economic and industry conditions;
- the occurrence of a breach of one of the commitments made by the Group pursuant to the contracts bearing on its financing could require it to accelerate the repayment of its debt, thereby potentially sparking a liquidity crisis.

Additional information regarding liquidity risks is provided in Notes 4.8 – *Financial liabilities* and 4.9 – *Financial instruments* of the Notes to the consolidated financial statements and in the "Significant contracts" subsection of this management report.

4.6.5.2 Market risks (currency and interest rates)

The market risks are set out in Note 4.9 – *Financial Instruments* of the Notes to the consolidated financial statements.

4.6.5.3 Liquidity risks

The liquidity risks are set out in Note 4.9 – *Financial Instruments* of the Notes to the consolidated financial statements.

4.6.5.4 Counterparty risks in financial transactions

The market risks are set out in Note 4.9 – *Financial Instruments* of the Notes to the consolidated financial statements.

4.6.5.5 Risks relating to the Group's pension plans

The Group's unfunded pension obligations amounted to €259 million on 30 June 2018. During FY18, the Group made total contributions to Group pension plans of €57 million. For more information on the Group's pension and other post-employment liabilities, see Note 4.7 – *Provisions* of the Notes to the consolidated financial statements.

The Group's pension obligations are for the most part covered by balance sheet provisions and partially covered by pension funds or by insurance. The amount of these provisions is based on certain actuarial assumptions, including, for example, discounting factors, demographic trends, pension trends, future salary trends and expected returns on plan assets. If actual developments were to deviate from these assumptions, this could result in an increase in pension obligations on the Group's balance sheet and require a substantially higher allocation to pension provisions, which could have a material adverse effect on the Group's financial results.

It may be possible to fund the increase in the Group's future obligations under its pension plans from its cash flow from operations. If the assets in the Group's funded pension plans perform less well than expected or if other actuarial assumptions are modified, the Group's contributions to these plans could be materially higher than expected, which would reduce the cash available to the Group for its business.

4.6.6 Insurance and risk coverage

For Pernod Ricard, use of insurance is a solution for the financial transfer of the major risks facing the Group. This transfer is accompanied by a policy of prevention for the purpose of reducing risk as much as possible. The Group evaluates its risks with care in order to fine-tune the level of coverage of the risks it incurs.

The Group has two types of coverage: Group insurance programmes and local policies. The programmes at Group level are monitored by an Insurance Manager, who coordinates the insurance and risk management policy, and also by a person in charge of monitoring industrial risk prevention.

4.6.6.1 Insurance policies

In order to cover the main risks, Pernod Ricard has set up international insurance programmes for all Group affiliates, barring exceptions due to local regulatory constraints in certain countries or as a result of more attractive conditions offered by the local market. These programmes provide the following coverage:

- property damage and business interruption losses;
- operating/product liability, including costs and losses incurred by the Group due to accidental and/or criminal contamination;
- environmental liability;
- Directors' civil liability;
- damage during transport (and storage);
- fraud/cyber.

Moreover, credit insurance programmes are in place, aimed at reducing the risks associated with trade receivables.

Some affiliates have contracted additional insurance to meet ad hoc needs (for example, vineyard insurance in Spain, car fleet insurance, etc.).

Coverage

Type of insurance	Coverage and limits on the main insurance policies*

Property damage and business interruption losses	• Coverage: fully comprehensive (except exclusions)
	• Basis of compensation:
	  • new value for moveable property and real estate, except for certain affiliates, which have exceptionally chosen, with the contractual agreement of the insurers, to provide for another basis of compensation;
	  • cost of sale for inventories, except for certain maturing stocks that are insured at replacement value or net carrying amount plus a fixed margin (tailored to each company);
	  • business interruption losses with a compensation period generally between 12 and 36 months depending on the Company.
	• Limits on compensation:
	  • main compensation limit of €1,050 million, covering all damage and business interruption losses. The programme includes additional limits, for example to cover natural events.
	• Furthermore, a captive insurance company provides insurance cover for an amount of €3 million per claim with a maximum commitment of €5 million per annum.

General civil liability (operating and product liability)	• Fully comprehensive coverage (except for exclusions) for damage caused to third parties for up to €220 million per year of insurance.
Product contamination	• Coverage in the general civil liability programme for recall outlay, the cost of the relevant products, business interruption and outlay on rebuilding Pernod Ricard's image following accidental or criminal contamination of products that present a threat of harm to persons or property: coverage of up to €45 million per year.
General environmental liability	• Coverage for environmental damage of €35 million
Directors' civil liability	• Coverage of up to €150 million per year of insurance.
Transport	• Coverage of up to €20 million per claim.
Fraud/cyber	• Coverage of up to €35 million per year, with a cyber-insurance sub-limit of €15 million.
Credit	• Coverage differs depending on the affiliate and the programme, with total cover rising to a maximum of €180 million. It can also be partially transferred under a programme to sell receivables.

* *The figures shown are the main limits for the year ended 30 June 2018. Changes may have been negotiated for FY19. Some contracts provide specific limits for certain aspects of coverage.*

4.6.6.2 Resources provided by the Group to manage the consequences of a claim, especially in the case of an industrial accident

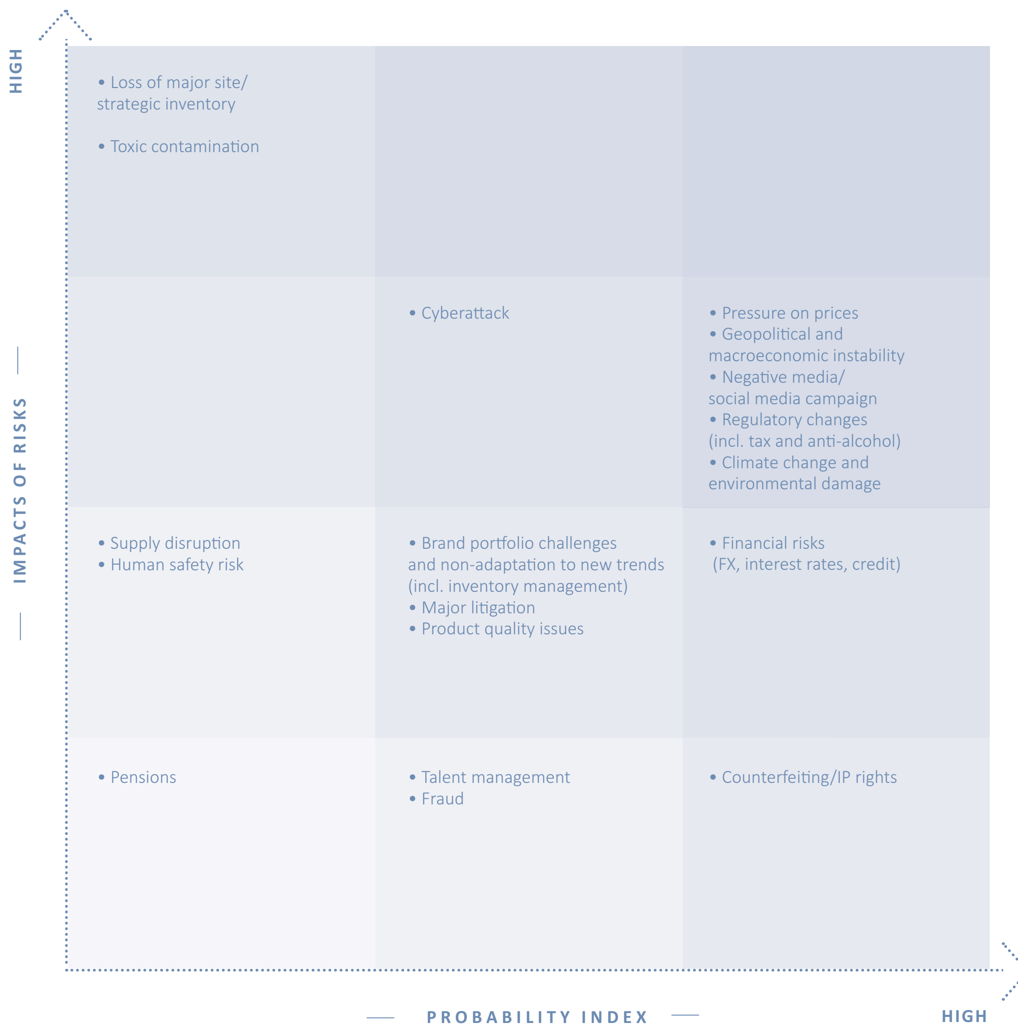
If a claim were to be filed affecting Pernod Ricard or a Group company, especially in the case of an industrial accident, it would rely on its brokers and insurers and all service providers as required to ensure the effective management and resolution of the claim. All these players have the experience and means required for managing exceptional situations.

4.6.7 Risks and disputes: provisioning procedure

As part of its commercial activities, the Group Pernod Ricard is involved in legal actions and subject to tax, customs and administrative audits. The Group only records provisions for risks and contingencies when it is likely that a current obligation stemming from a past event will require the payment of an amount that can be reliably estimated. The amount of the provision is the best estimate of the outflow of resources required to extinguish this liability. Provisions accordingly involve an assessment by Group Management.

4.6.8 2018 Risk matrix

The Group's risk matrix was updated in 2018. Every three years, the main risks facing Pernod Ricard are mapped for all Group subsidiaries and functions. The different risks are classified according to their potential impact and likelihood of occurrence. This matrix is a key risk management tool.



4.7 SIGNIFICANT CONTRACTS

4.7.1 Significant contracts not related to financing

4.7.1.1 Suntory

In 1988, Allied Domecq entered into a series of agreements with Suntory Ltd, one of Japan's leading producers and distributors of spirits. One of the provisions of these agreements concerned the creation of a joint venture company in Japan called Suntory Allied Ltd, in which 49.99% of the capital and voting rights are owned by Allied Domecq and 50.01% by Suntory Limited. Suntory Allied Ltd was granted the exclusive distribution rights for certain Allied Domecq brands in Japan until 31 March 2029.

The management of Suntory Allied Ltd is jointly controlled by Pernod Ricard, as successor-in-interest to Allied Domecq, and Suntory Ltd.

4.7.1.2 Sale and repurchase agreements

During FY18, Pernod Ricard did not conclude any sale and repurchase agreements. For further details on transactions relating to sale and repurchase agreements, please consult Note 2.1.10 "Share buyback programme", in section 2 "Corporate governance and internal control".

4.7.2 Financing contracts

4.7.2.1 Credit Agreement of November 2010

Pernod Ricard signed a Credit Agreement for €150 million with a banking institution, with effect from 26 November 2010, with the amount being allocated in full to the repayment of the 2008 syndicated loan. It was partially repaid on 26 November 2015 (15%) and 31 October 2016 (20%); the remainder was repaid on 29 September 2017. This Credit Agreement contains the customary representations, warranties and early repayment undertakings, as well as the usual restrictive covenants and commitments contained in such contracts. It also requires compliance with a solvency ratio at each half-year end – *i.e.* total consolidated Net debt/consolidated EBITDA, this being a more flexible indicator than the ratio applied to the syndicated loan.

4.7.2.2 2017 Credit Agreement (syndicated credit)

As part of the refinancing of the 2012 bank debt taken out to cover the Group's short-term financing needs, Pernod Ricard and a number of its affiliates signed a new €2.5 billion revolving credit facility (the "Credit Agreement") on 14 June 2017 for a term of five years with the option of an extension to six or seven years, one of which has been activated.

The obligations of each of the borrowers under the Credit Agreement are guaranteed by Pernod Ricard. No security interest (*sûreté réelle*) was granted under the terms of the Credit Agreement.

The Credit Agreement contains the customary representations and warranties, as well as the usual restrictive covenants contained in such contracts, notably restricting the ability of some Group companies (subject to certain exceptions) to pledge their assets as security interest, alter the general nature of the Group's activities or carry out certain acquisition transactions.

The Credit Agreement also sets out obligations, including a commitment to provide lenders with adequate information, compliance with a solvency ratio at each half-year end as mentioned hereunder (the "Solvency Ratio"), and compliance with certain commitments customary in this type of Credit Agreement (including the maintenance of the credit's *pari passu* ranking).

Solvency ratio (total consolidated Net debt/consolidated EBITDA)

The Solvency Ratio must be 5.25 or less. At 30 June 2018, the Group was compliant with this solvency ratio (see "Liquidity risks" in this management report).

The Credit Agreement incorporates the main terms of the 2012 Credit Agreement and, in addition, provides for certain cases of voluntary or compulsory early repayment obligations, depending on circumstances, which are standard practice for Credit Agreements of this kind (including non-compliance with commitments, change of control and cross default). The Credit Agreement also contains a clause under which the taking of control of the Company by any person or group of persons acting in concert (other than Société Paul Ricard or any group of persons acting in concert with Société Paul Ricard) is likely to constitute grounds for compulsory early repayment.

4.7.2.3 Debt issuance

The bonds and the interest thereon constitute direct, unsubordinated and unsecured obligations of Pernod Ricard, ranking equally amongst themselves and *pari passu* with all other unsecured and unsubordinated debt, present and future, of Pernod Ricard. In addition, Pernod Ricard has agreed not to grant any security interest (*sûreté réelle*) with regard to bonds or other debt securities that have been or may be admitted to trading on a regulated market, over-the-counter market or other exchange unless the bonds benefit from similar security interests or security interests approved by the bondholders.

These bond issues include a clause regarding change of control, which could lead to the compulsory early repayment of bonds upon request of each bondholder in the event of a change of control of the Company (benefiting a person or a group of persons acting in concert) and leading to a deterioration in the Company's financial rating.

In addition, these bonds may be redeemed early if certain customary events of default arise.

	Amount *(US$ thousand)*	Amount *(€ thousand)*	Place of issue	Nominal value *(thousands of currency)*	Maturity date	Repayment dates	Allocation of net proceeds of the issue	Rate
USD bond of 07.04.2011	1,000,000		Private placement for institutional investors, and subject to New York State (United States) law	US$150,000 (with multiples of US$1,000 in excess of this amount).	07.04.2021	Payable annually in arrears on 7 April and 7 October	Repayment of the 2008 syndicated loan in order to extend the Group's debt maturity and a part of the 2008 syndicated loan denominated in US dollars.	Annual fixed rate of 5.75%
USD bond of 25.10.2011	1,500,000		Private placement for institutional investors, and subject to New York State (United States) law	US$150,000 (with multiples of US$1,000 in excess of this amount).	15.01.2022	Payable annually in arrears on 15 January and 15 July	Repayment of part of the 2008 syndicated loan denominated in US dollars.	Annual fixed rate of 4.45%
USD bond of 12.01.2012	850,000		Private placement for institutional investors, and subject to New York State (United States) law	US$150,000 (with multiples of US$1,000 in excess of this amount).	15.01.2042	Payable annually in arrears on 15 January and 15 July	Repayment of part of the 2008 syndicated loan denominated in US dollars.	Annual fixed rate of 5.50%
USD bond of 12.01.2012	800,000		Private placement for institutional investors, and subject to New York State (United States) law	US$150,000 (with multiples of US$1,000 in excess of this amount).	15.07.2022	Payable annually in arrears on 15 January and 15 July	Repayment of part of the 2008 syndicated loan denominated in US dollars.	Annual fixed rate of 4.25%
Bond of 20.03.2014		850,000	Regulated market of Euronext Paris	100	22.06.2020	Payable annually in arrears on 20 March	Repayment of bond debt to extend the maturity of the Group's debt	Annual fixed rate of 2%
Bond of 29.09.2014		650,000	Regulated market of Euronext Paris	100	27.09.2024	Payable annually in arrears on 27 September	Repayment of bond debt to extend the maturity of the Group's debt	Annual fixed rate of 2.13%
Bond of 28.09.2015		500,000	Regulated market of Euronext Paris	100	28.09.2023	Payable annually in arrears on 28 September	Repayment of bond debt to extend the maturity of the Group's debt	Annual fixed rate of 1.88%
USD PANDIOS bond of 26.01.2016	201,000		A single counterparty	1,000	26.01.2021	Payable each half-year from 26 July 2016	Repayment of bond debt to extend the maturity of the Group's debt	Floating rate
Bond of 17.05.2016		600,000	Regulated market of Euronext Paris	100	18.05.2026	Payable annually in arrears on 18 May	Repayment of bond debt to extend the maturity of the Group's debt	Annual fixed rate of 1.50%
USD bond of 08.06.2016	600,000		Private placement for institutional investors, and subject to New York State (United States) law	US$150,000 (with multiples of US$1,000 in excess of this amount).	08.06.2026	Payable annually in arrears on 8 June and 8 December from 8 December 2016	Repayment of short-term debt and bond debt to extend the maturity of the Group's debt	Annual fixed rate of 3.25%

4.7.2.4 Europe Factoring Agreement

On 15 December 2008, certain affiliates of Pernod Ricard and Pernod Ricard Finance signed a Factoring Framework Agreement with BNP Paribas Factor, to set up a pan-European factoring programme in the gross amount of €350 million, which was increased to €400 million by an addendum dated 23 June 2009. The factoring programme, which was initially for a three-year period, was extended by an addendum dated 16 December 2011 for a further three-year period and was then renewed by an addendum dated 25 June 2014 for a four-year period from 1 January 2015. This programme was agreed in the amount of €400 million. The receivables are sold under the contractual subrogation regime under French law, except where certain local legal restrictions are in force. As substantially all of the risks and rewards related to the receivables are transferred to the purchaser in accordance with this factoring programme, transferred receivables are deconsolidated.

4.7.2.5 Securitisation (Master Receivables Assignment Agreement)

On 24 June 2009, certain affiliates of Pernod Ricard entered into an international securitisation programme arranged by Crédit Agricole CIB. The purpose of the programme was the transfer of eligible commercial receivables to Ester, in accordance with the provisions of a framework agreement dated 24 June 2009 and country-specific agreements entered into at the time that each relevant affiliate joined the programme. This programme was renewed on 19 June 2014 under the terms of an addendum to the framework agreement. The initial amount assigned to the programme was €45 million, US$130 million and £120 million.

This five-year programme includes a change of control clause that applies to each affiliate participating in the programme as a seller, which could lead to the early repayment of the programme by the affiliate concerned by such change of control. “Change of control” is defined as Pernod Ricard ceasing to hold, directly or indirectly, at least 80% of the share capital or voting rights of an affiliate participating in the programme as a seller, unless (i) Pernod Ricard continues to hold, directly or indirectly, 50% of the share capital or voting rights of such affiliate and (ii) issues, at the request of Crédit Agricole CIB, a guarantee in terms that Crédit Agricole CIB deems satisfactory (acting reasonably) for the purpose of securing the obligations of such affiliate under the securitisation transaction documents.

4.7.2.6 Factoring agreement Pacific

On 18 March 2013, a new agreement for the sale of receivables was signed between Premium Wine Brands Pty [(1)], Pernod Ricard New Zealand Limited and the Royal Bank of Scotland plc. This factoring agreement covers Australia and New Zealand and amounts to AUD128.5 million and NZD45 million. The receivables sale agreement was taken over in full by BNP Paribas on 4 December 2015, replacing The Royal Bank of Scotland plc.

Additional information on the impact of these financing contracts on the Group’s financial statements is provided in Note 4.8.1 – *Debt analysis*.

(1) Renamed Pernod Ricard Winemakers Pty.