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PERP.PA - Full Year 2022 Pernod Ricard SA Earnings Call

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CORPORATE PARTICIPANTS

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

Florence Tresarrieu *Pernod Ricard SA - Global Senior VP of Investors Relations & Treasury*

Helene de Tissot *Pernod Ricard SA - Executive VP of Finance, IT & Operations and Member of Executive Board*

CONFERENCE CALL PARTICIPANTS

Cedric Lecasble *Stifel, Nicolaus & Company, Incorporated, Research Division - Research Analyst*

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

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

Jean-Olivier Nicolai *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Jeremy David Fialko *HSBC, Research Division - Head of Consumer Staples Research of Europe*

Laurence Bruce Whyatt *Barclays Bank PLC, Research Division - Analyst*

Mitchell John Collett *Deutsche Bank AG, Research Division - Research Analyst*

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

Simon Lynsay Hales *Citigroup Inc., Research Division - MD*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to Pernod Ricard 2022 Full Year Sales and Results Conference Call. (Operator Instructions)

I would now like to turn the conference over to your speaker today. Please go ahead.

Florence Tresarrieu - *Pernod Ricard SA - Global Senior VP of Investors Relations & Treasury*

Good morning, ladies and gentlemen, and welcome in Paris at The Island for our FY '22 full year sales and results presentation, followed by Q&A.

Before I leave the floor to Helene and Alexandre, you're going to see a short movie from The Glenlivet.

(presentation)

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

Well, good morning to all of you. And I do hope you have spent a very nice summer, enjoying very convivial moments and more importantly, around the right brands.

So welcome to The Island for our fiscal year '22 full year sales and results, and let's start directly with the executive summary. Maybe Helene, if I grab yours. There we go.

So fiscal year '22 has been a historic year for Pernod Ricard with our net sales growing by 21%, hitting the EUR 10 million (sic) [EUR 10 billion] milestone, at EUR 10.7 billion, with market share gains across most markets, leveraging both our very wide portfolio of brands and our geographic breadth.

We've increased prices basically everywhere with an average mid-single-digit price increase globally. And our growth has been driven by the strong recovery of the on-trade, by the strong resilience as well of the off-trade and the rapid rebound of the Travel Retail channel.

Strong growth as well, driven by balanced and diversified sources. I think this is absolutely important. And if we start with our Must-Win markets, strong dynamism across all Must-Win markets, you see India at a whopping plus 26%. Travel Retail at plus almost 50%, the U.S. at plus 8% and China at plus 5%. Performance has been outstanding across all regions, but in particular in Europe, in Africa and Central and South America.

And finally, excellent broad-based growth across the portfolio with our Strategic International Brands growing by 18%. Our Specialty Brands growing by 24%. And finally, our Strategic Local Brands, in particular our Indian whiskeys, growing by 18%. And this has delivered a record profit from recurring operations at EUR 3 billion, driven as well by revenue growth management, as I mentioned, but as well by operational efficiencies, which have offset the impact of the inflation.

This has also allowed us to deliver gross margin expansion. And finally delivering a record operating margin of 28.3% with an expansion of 80 basis points or 52 basis points on an organic basis.

These results demonstrate the strength, the agility and the resilience of Pernod Ricard's business model. We are deploying the Conviviality Platform at pace. I hope most of you were here for Capital Markets Day before summer, where we presented the Conviviality Platform.

And by the way, I'd like to take this opportunity as well to mention that we will be announcing in the coming days, a partnership with a very emblematic French partner company regarding the data portal we have been developing over the last 3 years. So stay tuned for that new news.

So anyways, we are developing -- we are deploying our consumer-centric strategy at scale now, leveraging our portfolio of brands, leveraging our distribution network to really further stretch our growth and now accelerating things to data.

We have strengthened our portfolio of brands through additional investments, through innovations and of course, continuing our bolt-on acquisition strategy, which this year included the Whiskey Exchange, more recently, Chateau Sainte Marguerite and a minority stake in Sovereign Brands.

Our Specialty Brands portfolio is now double what it was just pre-COVID in 2019 and now represents 6% of our net sales. And this growth and the development of our strategic roadmap has been done responsibly. So we're well advanced as well on delivering our sustainability objectives within good times from a good place.

We've also delivered a record high cash generation and continuing to deleverage our business. So we have the highest ever free cash flow at EUR 1.8 billion. And finally net debt-to-EBITDA ratio at 2.4%. We are investing in the future growth of our business with increased strategic investments.

And all of these results allow us to accelerate the returns to our shareholders with a strong dividend growth of plus 32% versus last year and the announcement of a new share buyback program of roughly EUR 500 million to EUR 700 million for this fiscal year.

You will see here the key figures. I won't dwell upon them. Helene will go through them in detail. Just to underline the reported net profit up at 53%. And I think it's important to just sit back for a second and look at our willing formula or the way I like to see it, which is our unique competitive advantages, our fundamentals, which, number one, are comprised of what we believe is the widest, the largest, the most comprehensive portfolio of premium spirit brands, number one.

Number 2, our diversified global footprint and scale, which is even more so important when the environment is volatile and cycles are uneven between regions, between segments, between markets, and most importantly, our unique culture, which blends conviviality and performance where people really want to go the extra mile with a very high level of engagement. And by the way, we recently had a very successful participation to our second ever employee stock ownership plan.

This is also -- this formula is also fueled by very favorable underlying dynamics or drivers. Demographics to start with, with the legal drinking age population and the growth of middle and affluent classes in emerging countries, not just China, not just India, not just sub-Saharan Africa, not just LatAm, basically all of these markets.

Consumer trends, and that's true for the whole world with premiumization, which is an established long-term fundamental trend and the resilience, and we've seen it over the last few years of wine and spirits during economic downturns. Finally the global spirits market value growth of plus 11% versus pre-COVID 2019 shows that premium plus spirits are outperforming.

Again, and I think this is a critical diversification of the sources of growth of Pernod Ricard, which is, was, still is and is going to continue to be a very strong strategic intent, having diversified sources of growth, which is a big change versus 10 years ago, 80% of our growth comes from 6 spirits categories.

You see here by category, the contribution of each category to our fiscal year's growth and the weight in the portfolio. I'd like to stress the Scotch Whiskey performance, which has weighed for 30% in Pernod Ricard's growth, and that represents a little bit more than 20% of our net sales.

Irish Whiskey as well, a very strong contributor to our growth with 16% contribution to growth and weighing for 12% of our business. The Seagram's Whiskey as well, 11% contribution and weighing for 9% of our business. Vodka, in particular Absolut, of course, weighing 9% of our growth and 8% in our business. Gin has been a strong contributor to growth. And finally, Cognac and Brandies as well.

So really diversified sources of growth when it comes to our portfolio of brands. And by the way, with a clear skew to premium plus, 76% of our net sales are -- come from premium and above categories, and they contributes to 80% of our growth.

And likewise, not just from a portfolio standpoint, but as well from a geographical standpoint, you have here the similar analysis where you have the contribution to growth from our regions, the weight of our regions in our business and the growth of our regions for fiscal year '22.

Well, there's double-digit everywhere. I won't go through these numbers. I just think that what they clearly stress and underline is the balanced nature of our growth, the diversified sources of our growth, which is absolutely critical.

And as I mentioned, our growth, our excellent results were driven responsibly. So you have here our strategic roadmap from an S&R point of view. It is at the core of everything we do. Our S&R objectives are now embedded throughout the whole business. It's really every single function in the business is today perfectly concerned.

You have here progress to date on a number of objectives we set ourselves. As you know, this roadmap was launched back in 2018. We updated regularly. And I'm particularly proud of the recent investments we made, especially in Scotland and in Ireland with more announcements to come, so please stay tuned.

And again, this is perfectly in line with our long-term sustainable value creation strategy. This is a quick recall of what we presented to you during Capital Markets Day. Our medium-term financial framework where it's all about growing our top line between 4% and 7% growth, aiming at the up range of that interval powered by what we call the Conviviality Platform, leveraging data at scale.

Focus on pricing, of course, for sure, continuous improvement in operational efficiency as well. And as we've done this year, again, with significant investment behind our strategic priorities, in terms of brands, with efficiency on return on spend, of course, discipline, of course, on our structures and on the organization to drive operating leverage of roughly 50 bps to 60 bps on average every year.

Financial policy, as I mentioned, our objective has been and will continue to be to maintain investment-grade rating, of course. #1 -- priority #1 is to invest in the future organic growth of our business, in particular, through our strategic inventories and CapEx, which we've done this year, and we'll highlight what we intend to do in the coming year.

Continued active portfolio management, including value-creating M&A. So please expect our bolt-on acquisition strategy to continue. Dividend distribution of roughly 50% of our net profit from recurring operations and finally, share buyback when the above priorities are fulfilled.

And this is what happens. So our strategic plan 4 years ago, which was updated this year for the next 3 years. What this shows is, we say what we do and we deliver what we say we will deliver. We're perfectly in line with our plan. And just to remind you what our plan is about. It's a story that started with top line growth, focus on growth, which then became focus on profitable growth with profit margin expansion of roughly 50 bps to 60 bps per year, focus on diversifying the sources of growth and of course by delivering strong cash flow. We said we would deliver this and we have delivered this.

Very briefly, you have here our sales, as I mentioned, very strong growth, pretty well balanced and broad-based by region. Number one, a quick focus on our must-win markets with the U.S. that has grown, on average, 8% over the last 3 years, delivering again, 8% over the last fiscal year.

I would just stress maybe 2 things on the U.S. First of all, very strong price mix following basically broad-based price increases in fiscal year '22 with additional price increases to be implemented as early as -- as now, in fact, in September and October. Number 2, I would also stress the very strong performance of our Specialty Brands portfolio in the U.S. in particular, our American whiskeys, Jefferson, Rabbit Hole, TX Whiskey, Smooth Ambler, but as well our agave-based portfolio and Redbreast.

China, well, again, a 3-year average growth rate of 9%, delivering 5% over the last fiscal year. We've had a good start of the year, last fiscal year, which was a little bit impacted by strict containment measures, as you know, which impacted our Q4 at Pernod Ricard. The trend has improved since the month of June with the easing of restrictions. And so far we've had a pretty good start to the year in China.

Travel Retail, up roughly 50% with a 3-year CAGR still negative, down 13%. However, I would stress 2 things. Our value leadership has been reinforced quite significantly in Travel Retail. And for this new fiscal year, we expect Travel Retail profit to be back to pre-COVID levels, so which I believe is great news for the channel, and of course, for Pernod Ricard, given the weight of the channel.

And finally, India, which has grown on average 7% over the last 3 years with a clear acceleration over the last fiscal year where India grew 26%, where we reinforced our leadership position. And not only did the strategic local brands performed well, our strategic international brands performed exceptionally well, principally led by our scotch portfolio by Jameson Whiskey, which is becoming a cult brand in India and finally, by our vodka Absolut.

I think it's worthwhile still spending a couple of minutes on the rest of the world because there has been a very strong performance as well with pricing across all markets as well. If you look at Europe, a 3-year average growth rate of 6%. I think that's really what surprised me, strong continued growth with a whopping plus 19% for the last fiscal year.

If you look at the performance of Spain, up 36%. And again, where we've had a good start of the year with a great summer in Spain. There was some growth as well in France, albeit with a margin squeeze given the inflationary context here in France. Very strong growth in Germany, up 10% with a very strong on-trade rebound, whopping 42% in Italy, which had a great summer as well.

When it comes down to Eastern Europe, well, very strong performance in Poland. But obviously the performance is impacted by the conflict, the war in Ukraine since mid-February, and you should expect, again, a significantly subdued activity for fiscal year '23, particularly in Russia. Stronger on-trade rebound in the U.K. with great sales growth driven by Jameson, Absolut, Havana Club and more generally, our specialty brands like Monkey 47 and Malfy.

With regards to Americas, which is up 12%, with a strong CAGR, a 3-year CAGR of 8%. We just stressed the whopping 52% growth in Brazil. Asia, Rest of the World, up 19%, with a 3-year average growth rate of 4%. We just stressed, well, Korea up 33%, South Africa up 38%, Nigeria up 81%, outstanding performance in Turkey and very strong performance for our champagne and scotch in Japan.

From a category point of view, in terms of segments, as I mentioned, strong growth across all spirit categories. Soft performance, though, for our wine portfolio, which was particularly hit by a lower harvest for our Sauvignon coming from New Zealand.

I would just like to stress the excellent performance of Jameson, up 24% with a 3-year double-digit CAGR of 12%. We've broken the 10 million case milestone for Jameson this year, which is just amazing with the fastest growth rate in 30 years for the brand. Double-digit growth in the U.S. with a very successful launch of our innovation, Jameson Orange.

But I'd like to stress as well the success of the internationalization strategy of Jameson with growth accelerating to 38% outside of the U.S. with great performance in India, as I mentioned, but South Africa as well, Nigeria and many, many other markets across the world. And I'd like also to underline the very strong performance of Jameson Black Barrel, up 43%.

Absolut, up 19% with a 4% CAGR. Again we've broken the milestone with Absolut, 12 million cases this year with global expansion, driving an acceleration of the performance for Absolut. European markets are core growth drivers for the brand, where the brand grew double digit, but as well growth basically everywhere else.

Scotch is up 25% with a 5% average annual growth for the last 3 years. And this growth is driven by the entire portfolio of brands. You see Chivas, up 29%, Ballantine's up 28%, Glenlivet up 21% and Royal Salute up 38%. Martell finally, which grew 7% with good growth on the basis of a very high comparison, notably in China, excellent growth with Martell Blue Swift in the U.S. and with a very successful marketing campaign.

Some moderate growth in China, as I explained, especially between March, April and May due to some of the lockdowns and continued global expansion of the brand with particularly strong results in Sub-Saharan Africa.

As I mentioned in the introduction, Specialty Brands have now doubled in the last 3 years. You see our specialty whiskey up 23%. Our specialty agave brands, up 21%, specialty gin, 43% growth. And finally I would like to stress as well the great performance of Lillet and Italicus and that has doubled over the last fiscal year.

Finally, rest of the portfolio, I want to dwell upon it, but a good balanced growth across all brands, in particular, Beefeater. And finally I'd like to stress the very, very strong growth of our RTD portfolio, particularly in the U.S. and in a number of European markets.

Innovation has been a strong contributor to growth, perfectly in line with our strategic roadmap. Our innovation portfolio grew 45%. I mentioned the very successful launch of Jameson Orange. And we have also launched Jameson RTDs with Ginger & Lime. Avion Cristalino, great success, such a great success, we ran out of stock. So if you find any bottles of Avion on shelf, just make sure you buy them, some more to come. Great performance of our innovation around Beefeater as well and the launch of Royal Salute 21 blended grain.

And before handing over to Helene, we've really stepped up in terms of media investments and media activation. You have here a number of examples and why not introduce the Jameson campaign before handing over to Helene. So please enjoy.

(presentation)

Helene de Tissot - *Pernod Ricard SA - Executive VP of Finance, IT & Operations and Member of Executive Board*

Thank you, Alexandre. Hi, everyone. So let's look at the profit.

So this strong top line that you've been describing, Alexandre, our purposeful investments are driving margin expansion. Look at the growth of our profit from recurring operations. So it's growing by 25% from a reported point of view and plus 19% when you look at the organic performance with margin expansion of 80 basis points reported and 52 basis points organic.

So our gross margin is expanding by 12 bps as price mix and fixed cost absorption offset the COGS increase. We have maintained our A&P ratio at circa 16% of net sales with a very dynamic allocation of our resources between brands, markets and as well activities with enhanced efficiencies, thanks to the digital transformation and as well enhancing the focus on working and be the one that our consumers are exposed to.

Purposeful increases as well in structural costs, notably with recruitments to support the digital transformation and as well benefiting from a favorable FX impact of circa EUR 160 million due mainly to the USD and the Chinese yuan appreciation versus euro.

Moving now to the earnings per share. So a very significant EPS growth in fiscal year '22, a growth of 33%. And this is increased -- this increase is driven by the growth from our profit from recurring operation, but as well lower recurring financial expenses and the share buyback.

We've been successfully refinancing the bond debt, and this is driving lower financial expenses in fiscal year '22, with an average cost of debt of 2.3%. It used to be 2.8% a year ago. We have a recurring effective tax rate at 23.2% and this as well a reduction in number of shares as a result of the execution of the EUR 750 million share buyback during the year.

Moving now to the net profit. So the net profit is growing very strongly at plus 53%, net profit, which is slightly below EUR 2 billion, and this increase is a combination of the growth of our profit from recurring operation, reduced financial expenses and the positive FX impact I was just referring to.

Moving now to the cash performance and as well the evolution of our debt. So let's look first at the cash generation, a record high generation that we have delivered this year. The recurring free cash flow is at EUR 1.9 billion with an increase in strategic inventories to support the future growth of our brands, especially obviously the aged products. And this investment is expected to accelerate further in fiscal year '23.

We have as well increased strongly our CapEx, which represents roughly 4.5% of the net sales in fiscal year '22 to support key investment priorities. And this as well is expected to increase further in fiscal year '23.

There is a negative working capital requirement variation which is explained by the strong business momentum we had this year in the context of supply chain tensions and we have been increasing our finished goods inventories across the world to protect the growth of our business.

There is this reduced financial expenses that I mentioned for the P&L, which is as well impacting favorably our cash generation due to the successful refinancing. And cash tax is increasing following the business profit growth and the recovery post-COVID. Our nonrecurring items are mainly impacted by restructuring and bond debt early repayment cost. And we are delivering highest ever free cash flow at EUR 1.8 billion.

Moving now to the evolution of our debt. So this strong performance is driving our leverage down with a net debt-to-EBITDA ratio at 2.4 at the end of June. It was 2.6 at the beginning of fiscal year 2022. So an increase of the net debt of EUR 1.2 billion, which is mainly linked to the increased M&A and share buyback, so quite active year for us in terms of M&A.

You have here the exact amount of cash out, and this is obviously the execution of our transaction with Sovereign Brands, the Whiskey Exchange and Chateau Sainte Marguerite. And we have as well an increase in dividend. And you have all the numbers on that slide, a resumption of the share buyback with the execution of the EUR 750 million program in fiscal year '22 and some negative FX impacts impacting our debt.

In this context, we are accelerating the returns to shareholders in line with our financial policy with a proposed dividend of EUR 4.12 per share, which is 32% versus the previous year. This is obviously subject to the approval of our shareholders at our next shareholders' meeting.

And we are announcing today a new share buyback program for fiscal year '23 of EUR 500 million to EUR 750 million following our financial policy priorities.

Back to you, Alexandre for the conclusion and outlook.

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

Well, thank you very much, Helene. So listen, for fiscal year '22, it's been a historic year for Pernod Ricard with an excellent performance, which, as I said, really demonstrated the strength, the resilience and the agility of our business model in an environment that we can qualify as turbulent.

With regards to our medium term, over the years fiscal year '23 to fiscal year '25, we remain absolutely confident to deliver our strategic ambition, leveraging our key fundamentals, which is our portfolio, our geographical footprint, deploying at pace our consumer-centric Conviviality Platform and our ability to adapt very swiftly to volatile situations.

So for this new fiscal year, for fiscal year '23, what we expect. First of all we expect dynamic broad-based net sales growth, obviously on a normalizing comparison basis with a pretty good start to Q1. We'll continue to focus intensively on revenue growth management and pricing, of course, as well as on operational efficiencies in what we can qualify as a high inflationary environment.

We'll maintain our A&P ratio at approximately 16% of net sales with continuous improvement of return on spend or return on investment. We'll continue to invest in our structures, notably supporting the rapid deployment of the Conviviality Platform that we presented to you just before summer.

We expect as well to increase our CapEx at roughly 7% of net sales and our strategic inventories, well, to fuel our future growth, as you may have seen. As Helene mentioned, we will proceed with a share buyback of roughly EUR 500 million to EUR 750 million. And finally, and based on current spot rates, which, of course, are not locked in, but at least if we project the current spot rates, we should expect as well a very significant positive currency effect.

I think before handing over to Florence for the Q&A, I thought it quite appropriate as well just because summer is not completely over to showcase another of our media activations, and in that case, behind Absolut.

(presentation)

Florence Tresarrieu - *Pernod Ricard SA - Global Senior VP of Investors Relations & Treasury*

Thank you, Helene and Alexandre. Let's now move to the Q&A session and opening the line. (Operator Instructions) Alexandre and Helene, back to you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question from Simon Hales from Citi.

Simon Lynsay Hales - *Citigroup Inc., Research Division - MD*

So I've got 2 questions then, please. Firstly, I wonder if you could just provide a bit more color on the current situation in China. When Alex, you mentioned that trading trends have clearly improved since June, I appreciate that you were also managing inventory through your Q4. But perhaps you could talk a little bit about the underlying depletion trends you've seen in recent months and into Q1? And in particular, how you're thinking about Mid-Autumn Festival and how wholesalers are preparing for Mid-Autumn Festival?

And then secondly, on the whole issue of COGS inflation in fiscal 2023, clearly, we're seeing higher energy costs, and they'll be impacting, I suppose, your glass supply in particular. But how vulnerable are you to that ongoing energy cost volatility we're seeing? Are there any areas in your supply chain where you're experiencing disruption or could be vulnerable to disruption in the coming months? So any color there would be very helpful.

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

Thank you, Simon. I'll answer the first question, and I'll let Helene answer the second question.

Listen, on China, the answer is more or less in your question. First of all, Q4 was difficult in particular April and May because of the lockdowns to put it bluntly. As we mentioned in the presentation, since the month of June, we've seen a clear improvement in trends in China, so over the month of June, July and August.

So I would say maybe 2 things. First, we started the year, this fiscal year or we ended last fiscal year in China with very, very healthy stock levels which is very important, which allowed us to pass by the way, pretty good price increases in May. And second, the trade has been preparing quite intensively for Mid-Autumn Festival, which by the way, is next week and the sell-in to the trade has been particularly strong.

Now how will the sellout perform through Mid-Autumn Festival? I don't know is the answer. I'll have the answer in approximately -- I'll have a qualitative answer in a couple of weeks from now and a more detailed mathematical answer in 6 to 8 weeks from now, and we'll look at stock and trade. But so far so good for China.

Helene de Tissot - *Pernod Ricard SA - Executive VP of Finance, IT & Operations and Member of Executive Board*

So transition to COGS inflation. So far, not so good, I must say. That's obviously a very fair question. We've been facing inflation already in fiscal year '22, as you know. This has been probably accelerating in H2 and impacting our COGS. We are obviously expecting that ready to face that and working hard to offset the COGS inflation with all the initiatives we mentioned in terms of price increase and operational efficiency.

Back to your specific question for fiscal year '23. So we believe this is obviously something which will remain in the coming months. Your point on the glass supply is very relevant. And we believe that the high cost of energy is going to impact us in fiscal year '23 in terms of dry goods because of the impact on glass supply. And again, same focus for us to offset that and protect margin with the price increase, the revenue growth management and all the operational efficiency.

Back to the specific question on the energy and the risk in terms of having energy across the year to protect our operations. So obviously this is as well something that we are definitely monitoring very, very closely and very carefully through, first, an optimization of our plant production management, meaning what we are producing and securing the production of our finished goods as we speak and ahead of what might be much more tougher times in the coming weeks and months.

There is as well something which is, I believe, important to flag is that some countries are less exposed to that risk. For instance, U.K. and Ireland are probably less exposed than France to the Russian gas. So this is obviously a good thing for us when you know how big is our business in Scotland and Ireland. And there are even some countries for which there is some protection to get the supply of energy for all industries, among others, like, for instance, Sweden.

Simon Lynsay Hales - *Citigroup Inc., Research Division - MD*

And just to check, sort of as you were able to absorb the cost inflation that you saw in 2022 through pricing and the revenue management action you took, do you expect to be able to do a similar sort of thing therefore in 2023?

Helene de Tissot - *Pernod Ricard SA - Executive VP of Finance, IT & Operations and Member of Executive Board*

Let me answer that question a bit more broadly in terms of margin expansion. This is a key focus, as Alexandre mentioned. So we are already working hard of it -- on it, I would say. So in terms of top line dynamics, there's a lot that we've been doing in the very recent past in terms of price increase everywhere, starting in H1 fiscal year '22, probably with some acceleration as well in H2. And we will benefit from that carryover price increase in fiscal year '23.

But we are not only, let's say, leveraging that. We are working already, as you saw for 2 key markets, China and the U.S., an additional price increase in China as of May. So we'll have the full year impact in fiscal '23 in the U.S. in the coming days and weeks, and there is more to come in many markets, I would say, all the markets.

So this is obviously something that will definitely help. Again, promotional intensity is something that we will as well improve and optimize very strongly, and we have the support of our key digital program on that front. Operational efficiency is as well something which will be very intense.

And when I talk about operational efficiencies, it's very broad. It's going to impact the manufacturing, the procurement, obviously, the packaging, lots of value engineering as well and supply chain, obviously, S&OP and so on. So, all the objective of that is to protect our margin, starting with gross margin. We want to secure a deployment of solid investments in terms of A&P and structure and we have the intention to deliver some operating margin in fiscal year '23.

Operator

The next question from Edward Mundy from Jefferies.

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

Two questions from me, please. First of all, in your guidance, you're talking about broad-based growth on a normalizing comparison basis as opposed to a normalized comparison basis. When you look at Slide 15 and 16, you can see that China retail is still down on a 3-year basis relative to where it probably would have been had COVID not taken place. And Asia as well is still probably running slower than what it would have done. Could you talk to which parts of the business still have some bounce back potential in that context?

And then the second question is really around any changes in consumer behavior that you're seeing. Clearly, we read a lot about the cost of living crisis in the papers. Could you talk about either channel behavior, down trading from premium to mainstream, pack format changes, or geographical changes? Anything you can highlight?

And I guess as a second part of that question, one of your peers yesterday, your U.S. peers yesterday I was talking to spirits of an affordable luxury and affordable indulgent. Do you subscribe to this theory that could give you a degree of protection with the consumer environment?

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

Sure. Maybe you want to start with the first question.

Helene de Tissot - *Pernod Ricard SA - Executive VP of Finance, IT & Operations and Member of Executive Board*

Yes, with pleasure. So normalization, obviously, what we want to flag is that our performance this year is delivered on a favorable comparable basis and is obviously boosted by the recovery of the on-trade, which is obviously a key channel for us. And I'm sure that you saw with the excellent performance this year that we definitely benefit from that recovery and leverage that, I would say, at a pace.

So this, let's say, is almost normalized in many countries. So that's why the environment, we believe, would be normalizing for fiscal year '23. I think you flagged the 2 main geographies are channels for which there might be still some room for improvement in terms of recovery or I would say, additional dynamism.

So Travel Retail, as you mentioned, is not yet back to what it used to be pre-COVID. And obviously, this is mainly linked to the Asia situation and the gradual recovery in passenger traffic in Asia, which is happening quite recently outside China. By the way, when you think about fiscal year '22, the passenger traffic was still quite down in H1. There was some improvement, probably around October and November, then again, some additional restrictions because of the Omicron and the recovery gradually materializing, especially in Americas and Europe.

So a long story short, there is some room for recovery -- additional recovery in Travel Retail. And as Alexandre mentioned, there is already a strong performance in fiscal year '22, and we expect Travel Retail for our business to be back to what it used to be a pre-COVID in term of profit, which is obviously great news.

And then Asia and probably more specifically, China has been impacted, obviously, in H2 with the Zero-COVID policy and with some significant lock down of cities like Shanghai early spring. So we are obviously very aware of the volatility of what could still be at stake in terms of COVID restrictions in China.

The year is starting in a positive way in terms of shipments. We will be obviously monitoring the situation very closely across the year, starting with what would be the outcome of Mid-Autumn Festival in 9 days now.

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

Ed, on your second question, there are a few things I'd like to highlight in the post-COVID world. The first one and the most important one and that we have witnessed, and I'm sure you have witnessed it over summer, basically everywhere in the world is what I like to qualify as the new found appreciation for conviviality.

People getting back in the trade, people still hometaining as well. Basically people getting together around our brands, not just our brands, but our brands to celebrate what I like to call togetherness. This is more pronounced than ever before. And I think this is a clear positive and we've seen it across summer in terms of sales.

Second, and you said it, it is -- our premium plus spirits are what we like to call affordable indulgence. And we've seen a number of studies that show that premium plus spirits tend to be very resilient in difficult times. So the first thing is consumers will do when things get difficult, are not about spirits behaviors, spirits linked behaviors. We're a lot more resilient than many, many other categories. Then it all depends on which way the economy is heading and if there's a hard landing, a soft landing and so on and so forth.

And I would just stress a couple of other topics post-COVID again in terms of behavior. Convenience is increasingly big, and we're playing in that space. Hometainment is extremely resilient as well. So as people go back in the on-trade and we've recovered quite significantly in terms of on-trade. The off-trade has remained quite resilient, which means that our increased household penetration across the world is sticking to some extent, clearly. And this is led also by convenience, ready-to-serve cocktails and so on and so forth.

So listen, I don't know if there will be some trade down. I often get the question. At this stage, as far as our portfolio is concerned, we have not yet seen any kind of trade down, but it's going to be interesting to see what happens in the coming months.

Operator

The next question from Olivier Nicolai from GS.

Jean-Olivier Nicolai - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

I've got 2 questions, please. First of all, pricing was mid-single digit across the globe in fiscal '22, as you said initially. I was also looking at the strategic brands, price mix was low on 3%, and many of the key brands like Jameson Chivas, Absolut, Martell were actually below that. Should we expect more pricing power for the strategic brands in full year '23? Now I acknowledge that this table is, on Slide 37 is globally. And obviously, you have some different between countries, but that would be interesting to hear your thoughts on pricing for these key brands.

And second question on the FX guidance, could you please help us quantify the very positive FX impact that you are expecting in full year '23? Now looking at the historical sensitivity that you have provided, is it fair to expect at least EUR 200 million with the FX impact on EBIT in full year '23? Or am I -- my math is not correct?

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

Helene answers your question on price, on currency. You have the answer in the appendix at least for one currency, which is the impact of the dollar. So for every single percent of appreciation of the dollar, you have on a full year basis, EUR 14 million of additional profit from recurring operations. And that's just the dollar.

So if you take our average rate last year of 1.13%, if you take current spot rates, and again, we're not hedged. We have what we call -- we like to call a natural hedge. So nothing is locked in. But if you take one, that's a 13%, on average, 13% over the full year, assuming rates stay at this level, which, frankly, I have no clue.

But if they were to stay at this level, you already have 13x 14, and that's just for the dollar. I hope this helps for your calculation. And so Helene, what are we doing on pricing?

Helene de Tissot - *Pernod Ricard SA - Executive VP of Finance, IT & Operations and Member of Executive Board*

What are we doing? I'm not going to give such a quantified view on pricing. But let me first clarify because as you mentioned, Olivier, the price mix is what it is for strategic brands, knowing that we have as well some quite positive mix coming from specialty brands that are impacting those numbers.

So back to price, the pricing impact in fiscal year '22 is mid-single digits. I think that's really the number you should have in mind. And what to expect in fiscal year '23? So we want to work intensively on additional price increase. And we are executing that strategy quite soon in the year with China in May and with the U.S. #1 market in the coming days and weeks.

So that means that in fiscal year '23, we expect our pricing to be strong and probably, hopefully even stronger than what it was in fiscal year '22 because of the carryforward impact of fiscal '22 price increase. And additional price increase we're going to implement with, again, a focus and the excellence in the execution across the world.

Operator

The next question from Laurence Whyatt from Barclays.

Laurence Bruce Whyatt - *Barclays Bank PLC, Research Division - Analyst*

A couple from me, please. Firstly, on your Travel Retail expectations of getting back to pre-2019 profitability levels. Do you have any expectations on what might happen in the travel situation in China? Of course, at the moment, there's a quarantine period required. And of course, if the Chinese travelers were to start traveling a bit more than that would help Travel Retail. What's baked into your expectation of getting back to FY '19 profitability?

And secondly, on your net debt levels, we're now at 2.4 net debt to EBITDA. I think historically, you used to have a target of between 2.5 and 3. Just wondering, given we're below that historic target, if you could update us on any current target you have, that would be great. But given the share buyback this year is currently expected to be a little bit lower than last year. I was just wondering if you were to have net debt to EBITDA below that level, if you would consider changing your share buyback target.

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

So maybe on your first question, and I'll let Helene speak about our target or our non-target in fact, but anyways.

On GTR, yes, clearly, we expect for this new fiscal year to be back to pre-COVID profit levels. So to the profit we had delivered back in 2019. By the way, it's quite interesting to see that versus 2019 volumes will be down and value will be significantly up. And that's how we're going to be delivering a similar number of profit than pre-COVID.

For China, listen, it can only be what I would call the cherry on the cake. So far, our duty-free sales in China are focused on Hainan where the situation can be volatile as well with lockdowns and goes and no goes, et cetera. And we've -- that's our key assumption for the current year.

But irrespective of this, we will be delivering a pre-COVID level profits which I think is quite impressive. What it does show is the strong resilience of GTR if you allow people to travel. So we'll see what happens to Chinese travelers. But in the meantime, it's great to see Travel Retail coming back to pre-COVID levels in terms of profit.

Helene de Tissot - *Pernod Ricard SA - Executive VP of Finance, IT & Operations and Member of Executive Board*

So financial policy. Just to clarify, as you alluded to Alexandre, we don't have a target in terms of net debt to EBITDA. So the announcement of this share buyback program for this year is very consistent with our financial policy priorities, knowing that the share buyback is the #4 priorities.

I'm sure you remember the first 3 priorities, which are strategic investments, M&A and dividend. And by the way, this is a range, which is quite consistent with what we've been executing in fiscal year '22.

Operator

The next question is from Sanjeet Aujla from Credit Suisse.

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

A couple from me, please. Firstly, can you give us a sense of how your sell-out trends are evolving in the U.S.? Q4 seems to be a little bit soft, I appreciate that was impacted by some shipment phasing, but I'd love to get an update on underlying sell-out trends and where inventory levels are at the moment there?

And my second question is just on India. One of your competitors there has been pulling back some of the scotch portfolio to try and seek pricing. Just curious how you're handling the pricing situation there in your Scotch portfolio?

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

Yes, I'll start with India, and I'll let Helene answer on inventory levels and sell-out in the U.S.

Vis-a-vis India, we are continuing to sell our brands. And as you've seen, our performance is quite remarkable, up 26% overall in India with very, very strong double-digit growth levels of our imported brands.

Of course, we are working to increase our prices. So the way we are doing it is through discussions and dialogues with the key people there to increase our prices, and we'll see how this pans out. In the meantime, our performance is very strong in India and across the whole portfolio in the country.

Helene de Tissot - *Pernod Ricard SA - Executive VP of Finance, IT & Operations and Member of Executive Board*

So the U.S. in Q4. First, as you rightly mentioned, we have monitored our shipments. Our net sales in Q4 to land with a very healthy level of trade inventory. That's what we've been announcing back in Q3, and that's exactly what we've been doing in Q4, meaning that our sell-in performance in fiscal year '22 reflects exactly the wholesales depletion.

And when it comes to the sell-out and especially if you look at Nielsen and NABCA, as you know, the coverage is quite limited. So we are tracking that, of course, but as well using all the information our wholesalers are sharing with us to monitor our performance and to land with this very healthy level of trade inventory.

In the U.S., by the way, I use the opportunity of that question to clarify that we have very healthy level of trade inventory everywhere in the U.S., but for instance, as well in China.

Operator

The next question from Chris Pitcher from Redburn.

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

A follow-up question on the COGS and pricing comments that you said earlier, Helene. Forgive me if you did quantify this, but do you think that the mix of pricing that you've talked about is enough for you to be able to expand gross margins in fiscal '23? Apologies as I said, if you already said this, but it would be useful to understand.

And then secondly, on your higher CapEx number, 7% is significantly ahead of the long-term average. How long do you expect this to remain elevated? And can you give us a bit more color on where the extra spend is going? And is there an element of inflation within your sort of maintenance CapEx here or is it all driven for growth?

Helene de Tissot - *Pernod Ricard SA - Executive VP of Finance, IT & Operations and Member of Executive Board*

Okay. So maybe I'll take both, if that's okay with you, Alex.

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

Sure.

Helene de Tissot - *Pernod Ricard SA - Executive VP of Finance, IT & Operations and Member of Executive Board*

So on pricing and COGS evolution, I didn't quantify it. Obviously, there's a lot that can happen. What I can reiterate is our ambition and our confidence to protect gross margin, thanks to pricing and operational efficiency despite COGS inflation, which will remain quite high.

So on CapEx, you're right, it's an acceleration. It makes lots of sense when you look, by the way, at our strong performance, especially when you look at the performance of our aging portfolio, whiskeys in the -- Scotch whiskey, Irish whiskey but as well U.S. whiskey and as well, obviously, the ambition for Martell.

So the main driver of this acceleration is to protect the future growth of those brands, meaning our distillation capacity, cask and warehousing. There is some inflation impacting those numbers. But I think what is really key to have in mind is this acceleration of growth that we are protecting through those investments.

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

And perhaps to qualify that, is it a 1-year investment to make the capacity for a 5-year growth scenario? Or are you -- is it a 2 to 3-year program to sort of catch up? I'm just trying to model how elevated CapEx will be because your competitor is talking -- your main competitors talking elevated CapEx for a few years?

Helene de Tissot - *Pernod Ricard SA - Executive VP of Finance, IT & Operations and Member of Executive Board*

Yes. Thanks for the additional question. It's fair to say that when you talk about expanding your distillation capacity, things are unfortunately taking more than a few months. So there will be some increased investment over the next few years. But these guided numbers is for fiscal year '23.

Operator

And the next question from Mitch Collett from Deutsche Bank.

Mitchell John Collett - *Deutsche Bank AG, Research Division - Research Analyst*

I know you've reiterated the medium-term guidance, but I just wanted to ask for my first question, whether you expect F '23 to be within that medium-term guidance range? And then my second question is, can you maybe comment on A&P to sales in F '23? It was flat as a percentage of sales this year. Do you expect it to be flat again or potentially to go up? And do you think you're holding share of voice within spirits?

Helene de Tissot - *Pernod Ricard SA - Executive VP of Finance, IT & Operations and Member of Executive Board*

Maybe I'll start with the first one.

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

Sure.

Helene de Tissot - *Pernod Ricard SA - Executive VP of Finance, IT & Operations and Member of Executive Board*

So for the guidance, I think for fiscal year '23 obviously, we are leveraging the excellent performance of fiscal year '22, which is giving us confidence for delivering our medium-term strategic framework of the fiscal year '23 to fiscal year '25, which is obviously a 3-year strategic plan and fiscal year '23 is the first year of that plan.

So when it comes specifically to the guidance for fiscal year '23, you have what we believe is quite a solid qualitative guidance, starting with this dynamic broad-based net sales growth. And again, with this ambition intention to deliver some operating leverage.

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

And maybe on your second question in terms of A&P, we are guiding towards a similar ratio, similar, which is approximately 16%. As it's been over the last few years, I really believe and we collectively believe in Pernod Ricard that this is, at this day, the right type of ratio with which we can clearly maximize return on spend, return on investment.

And as you may have seen, during Capital Markets Day, the key digital project called Matrix is all about maximizing and optimizing this ratio. And by the way, we've gained market share basically almost, almost everywhere with that kind of ratio. We've been growing brand equity across our portfolio almost everywhere as well with that kind of ratio.

And it's always nice to give a framework to our teams because otherwise, there's never any limit. And this is typically the kind of framework, I believe, maximizes value creation over a long period of time. Maybe that ratio can move on in a few years' time. But so far, at this stage, we believe it's an optimal ratio where we can maximize return on spend through brand equity building across markets.

And by the way, we've significantly increased our media spend within A&P, just to give you that example. So that's one example we've done this year. And you saw all the new media campaigns. There's a slide on that, and we showed you 3 new commercials that have been launched or are about to be launched as we speak. So you should stay tuned to see more of that, but I think 16%, not only do I think I'm convinced, it's currently the optimal ratio to do what it is we want to do.

Operator

The next question is from Cedric Lecasble from Stifel.

Cedric Lecasble - *Stifel, Nicolaus & Company, Incorporated, Research Division - Research Analyst*

Two follow-ups on questions that have been raised already, on CapEx and on the midterm guidance, on the '23 guidance for the margin. On CapEx, maybe could you help us understand which will be the main projects where you will lift investments considerably? You mentioned [distilleries]. Maybe can you help us understand where it happens and what's the big driver for raising to some 5% to 7%? You already flagged some stronger CapEx doing your CMD, but could you be a little more precise for us to understand your day-to-day business?

And the second one on the midterm guidance, plus 50 to 60 basis points on margin expansion. Is it fair to assume that this average of the 3-year period will be more back-end loaded given all the short-term pressure? Especially if you utilize the COGS inflation through a stable plus gross margin, do you think you have enough room on operating leverage to offset the COGS inflation this year? Or does it look too ambitious? And will '24 and '25 help you to come back on the trajectory of 50 to 60 basis points?

Helene de Tissot - *Pernod Ricard SA - Executive VP of Finance, IT & Operations and Member of Executive Board*

Okay.

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

Maybe just before handing over to Helene on CapEx, we will be making a pretty significant great announcement next week. And I don't want to spoil the news for the teams who have been working on that. So I usually am very happy when we invest because it's not a cost, it's a real investment. So we will be announcing something pretty nice next week on that front.

By the way, we've already announced a number of CapEx initiatives during this past year, which are impacting this new year. We don't invest in one day. It takes time. We announced significant investments both in Scotland and as well in Ireland with the aim by the way, in Ireland to become carbon neutral in 2026.

So more to come on that front, I'm afraid to say next week, I don't want to spoil the news. But again, it's for the good cause. I mean, when you look at our growth rates and our medium-term ambition, which is a great transition to, for them, we need the strategic stock and the capacity to fuel that growth.

Helene de Tissot - *Pernod Ricard SA - Executive VP of Finance, IT & Operations and Member of Executive Board*

So I was not about to spoil anything. I would be too nervous to do so. I cannot say, I'll add to what you said, Alex, that this is our #1 priority in terms of financial policy, CapEx and strategic inventory. This is absolutely critical to protect the future growth and as well to protect our current investment because this is, as you flagged around maintenance, around expansion capacity in terms of again on distillation, cask, warehousing.

There is as well some significant investment to deliver on our sustainability road map, good time from a good place. And all of that will contribute to this circa 7% of net sales next year.

On the midterm guidance, I'm sorry, I'm probably going to repeat myself. So the fiscal '23 to '25 ambition is a 3-year ambition. The first year is fiscal year '23 at this beginning of this year '23, what I can share with you again is our ambition and our intention to deliver some operating leverage. So let's see later what would be then the exact contribution of every year to that operating leverage target. What I believe matter is our confidence and focus to deliver that by fiscal year '25.

Operator

And the next question is from Jeremy Fialko from HSBC.

Jeremy David Fialko - *HSBC, Research Division - Head of Consumer Staples Research of Europe*

A couple of questions from me, a bit more detail on some parts of the business we haven't discussed. So firstly, if you could give your views on Cognac in the U.S. and how you think that category (technical difficulty) really and the second area of great strength has been Latin America, phenomenal growth from that business. And so again, would you think that sort of (inaudible) but the dynamism that you had in markets like Brazil can continue into next year or whether there's some elements which you think could end up reversing?

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

Do you want to talk about Cognac in the U.S?

Helene de Tissot - *Pernod Ricard SA - Executive VP of Finance, IT & Operations and Member of Executive Board*

Yes, I would love to. So I think this is obviously a very exciting category for us. We have a fantastic brand, Martell. We have as well a solid strategic inventory. We've been building over the years back to the previous question, to support the growth of Martell and the growth of Martell not only in Asia.

And obviously, U.S. is a very exciting market for Martell. We had quite an active year in fiscal year '22 with as well some great media campaign. And this is as well a key contributor to the growth in fiscal year '22 back to what we said, a very broad-based growth coming from many strong brands and especially in the U.S.

This is as well, again, a key contributor to growth together with Jameson together with the Glenlivet, together with U.S. whiskey, together with the agave portfolio and with Malibu and Kahlua. So a lot to be excited about for us. Solid investment, acceleration of those investments to deliver as well future growth in the U.S.

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

And with regards to LatAm, we don't give specific guidance by region. But what I can tell you is we do expect dynamism to continue across Latin America, driven by our scotch whiskey portfolio, in particular, Chivas, Ballantine's and to a lesser extent, Jameson and Absolut, and Absolut vodka. So across LatAm.

And I think that is it. Yes, I'm being told that. Unfortunately we need to stop here. So again, thank you for joining us this morning, and wishing you a great day.