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Mergers and Acquisitions

Pernod Ricard and Beam

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Abstract

The spirits industry is consolidating with more than 40 M&A deals in 14 years. Organic growth is not the only priority major players have. In order to maintain their position on top, big producers and marketers of spirits have long been following a regular strategy of acquisitions and divestitures that allows them to create value for shareholder. In this study, an overview of a potential deal between Pernod Ricard S.A. and Beam Inc. is conducted by taking into consideration this deal's place within the academic literature on Valuation and M&A, this industry and companies' characteristics and value drivers, and how these are reflected in the assessment of value creation from the deal. According to the study's conclusion, Pernod Ricard and Beam could create value for its shareholders by merging in a debt financing deal that would involve Pernod paying a 19% premium over last year average share price of Beam, which in turn would generate net synergies corresponding to around 8% of Pernod current enterprise value. The study concludes with further insights on how this deal could generate more value, and how different conditions could affect the viability of the merger.

Keywords: Merger, Valuation, Pernod Ricard, Beam, Premium Spirits, Synergies

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1. Introduction

The following dissertation proposes a merger between Pernod Ricard S.A. based in France and Beam Inc. headquartered in the United States, both major players on the worldwide spirits industry. The purpose underlying such proposal is to analyze a concrete case where an M&A deal would be possible and to closely study the major steps associated with an operation like this.

The first section of this paper introduces the topics of Valuations and M&A by offering a literature review in which the classical studies of these two topics by academics is evaluated as well as state of the art approaches which have been gaining territory within the finance community. Some of the main characteristics of Valuations and M&A are then critically reviewed and the contextualization of the proposed deal within literature is presented.

In the subsequent section, a thoroughly analysis on the current, as well as historically, state of the spirits industry is commenced to afterward fit both of the companies in the context of its industry and economic environment. Also, both companies are comprehensively studied in order to assess what their value drivers are and how their characteristics can impact each company, as well as, ultimately, both firms together.

The valuations chapter performs the valuation of each standalone company in order to as realistically as possible model the key value drivers and opportunities present in each firm, to arrive at a fair value of their equity. For that, extensive Valuation methodology was applied and compared to real market estimates as to check on whether the models were being realistically capturing the public information and estimates made.

Finally, in the last section, the merger between Pernod Ricard and Beam is valued, relying heavily on the inputs given in previous chapters. An M&A operation can be a complex deal and distortions to what the deal output may be are common. Therefore, a careful analysis to what these companies have to offer to each other was completed, and an in depth analysis on the strategic and operational side of the deal was performed.

2. Literature Review

The following literature review offers the possibility to appraise how in recent years the study of M&A has been conducted and how revealing it has been. It is not as obvious as it may seem that two similar companies merging together will form a better, bigger company. Many times they will not. It seems to be about measuring the value of the firms separately, the value of the firms together, and as a consequence the added value by the deal that one can assess the impact of an M&A transaction.

The first section will perform an overview on some of the most influential literature on valuation approaches, as well as state of the art studies that have been trying to improve standard valuation models. Throughout the second section it will be offered the opportunity to review some of the main characteristics of M&A deals in literature: how they are classified, what is their focus, their contribution to the shareholders, their strategy, motives, history and trends that most contribute for how M&A deals are conducted and evaluated in recent years.

2.1 Valuation Overview

2.1.1 Valuation Purposes

Along with some other subjects in Finance literature, valuation has been a "hot topic" for the past decades. Research on valuation is extremely vast; however, some methodologies have prevailed in detriment of others, although not in a consensual manner. For instance, according to Kaplan & Ruback (1996), investment bankers and dealmakers typically price firms and transactions using multiples of current earnings or cash flow for comparable companies or transactions, while financial academics usually estimate market values of companies and transactions by recurring to the discount value of the expected future cash flows.

There are a multitude of reasons why there is not a single and unique path to value firms and transactions, as it could be expected since valuation plays such an important and common role in Finance. It should be noticed that valuation is not an exact science with an exact purpose and that is why academics and professionals differ in their valuation approaches. Valuation can be performed through different methods, with different assumptions, requirements, inputs and outputs having nonetheless one final and common goal, which can then serve different purposes and reasons. That common goal is to measure value and identify sources of economic value creation and destruction within a firm and/or transaction (Fernandez, 2007). The identification and measure of the value drivers can then supply a variety of functions

depending on who is performing the valuation and which routes and assumptions is using to get there. In this sense, it is natural that some methods can be simple, quick and straightforward while others can be quite complex (Damodaran, 2002).

Among the many purposes served in different contexts by valuation methods, some of them are naturally more relevant than others. In its overview of Valuation studies, Fernandez (2007) described, from the wide range of purposes, the main ones as follows: (1) Public offerings ("The valuation is used to justify the price at which the shares are offered to the public"); (2) Valuation of listed companies ("The valuation is used to compare the value obtained with the share's price on the stock market and to decide whether to sell, buy or hold shares"); (3) Buying and selling operations (For the buyer and for the seller, the valuation will indicate them the highest price he should pay and the lowest price he should sell, respectively); (4) Compensation schemes based on value creation ("The valuation of a company or business unit is fundamental for quantifying the value creation attributable to the executives being assessed"); (5) Identification of value drivers ("The valuation of a company or business unit is fundamental for identifying and stratifying the main value drivers"); and (6) Strategic decisions on company's continued existence ("The valuation of a company or business unit is a prior step in the decision to continue in the business, sell, merge, milk, grow or buy other companies").

Valuation in the context of M&A will naturally serve several of the purposes illustrated by Fernandez, and as previously mentioned; there are several methods and approaches to perform valuations that have been the subject of debate in the literature.

2.1.2 Valuation Models

Authors like Damodaran (2002) and Fernandez (2007) used similar classifications to wrap-up the many approaches, described in the literature and used by professionals, based on their basic methodologies. The authors classify the models, in a summarized way, as follows:

Main Valuation Methods	
Balance Sheet	E.g., Book Value, Liquidation Value, Substantial Value
Relative Valuation (Multiples)	E.g., PER, EV/EBITDA, EV/Sales, PBV
Cash Flow Discounting	E.g., FCFE, FCFF, DDM, Capital Cash Flow, APV
Value Creation	E.g., EVA, Economic Profit, Cash Value Added
Options	E.g., Black and Scholes, Investment Options

Table 1: Main Valuation Methods (source: adapted from Fernandez, 2007)

Notice that these classifications are useful to organize and to be a starting point in studying the models used by financiers, however, many authors have different perspectives for each of the

models presented, demonstrating how rich the variety of options one can have when performing valuation depending on his needs.

Young et al. (1999) argues that one of the reasons for such an extended variety of approaches in valuation is that different models make different features of the valuation clearer at the expense of diminishing others, and for this reason, this author offers a way to cut through this complexity. In his study, Young affirms that "virtually every popular valuation approach is simply a different way of expressing the same underlying model". Starting off by considering four of the main models (Dividend Discount Model, Discounted Cash Flow, Economic Value Added and Dynamic ROE), the author of "All roads lead to Rome", studies the possibility of re-expressing one model in terms of another in search for the desired common valuation approach. His main conclusion seems to be the recognition of similarities among valuation approaches, and that there is a trade-off when using different models in the sense that all of them offer a partial picture of the valuation.

In the same line of thought as Young et al. (1999), for instance Oded & Michel (2007), concluded that the significant inconsistencies, that occur in valuation literature about discounted cash flows approaches such as APV, FCFE, FCFF and Capital Cash Flows, lie on the assumptions made about debt rebalancing and when the debt rebalancing policy is applied consistently, all valuation methods produce equivalent results.

There seems to be a well defined place for Discounted Cash Flow variants and approaches in Finance literature. The notion that the value of a firm does not lies entirely in its balance sheet, that it is not static and therefore takes into account the company's possible future evolution, or money's time value, contrasts the methods based on Cash Flow discounting with those based on Balance Sheet (Fernandez, 2007). Similarly, in its 2001 study "EVA and Cash Value added do not measure shareholder value creation", Fernandez argues that both Income Statement and Balance Sheet are historical data and for that reason, it is impossible for accounting-based measures, such as EVA or cash value added, to measure value creation, which in turn is determined by the changes in expectations regarding the growth of the firm's cash flows and also by the changes in the firm's risk. This view is largely shared and accepted by the Finance community that considers growth and return on invested capital (thus implying the perceived riskiness of the firm) to be the drivers of value (Koller, Goedhart, & Wessels, 2010). Options based models however, are not the mainstream approaches used in valuation due to its nature. These methods are mostly applied to value companies or investments whose underlying assets are quickly valued by capital markets such as commodities that require a

totally different risk treatment from the cash flow restatements (such methods are notably used to value oil reserves for example), (Froot & Kester, 1995).

As stated before, literature on valuation is extremely complete and continues on lengthening. One of the conclusions of this valuation overview is that there is no unique conclusion regarding the way one can conduct a valuation, except, that there is no exclusive method or path in valuation. Literature seems to be consistent with the idea that one should adapt its valuation methods to his constraints and needs. With this in mind, even if the Cash Flow Discounting method prevails to be the mainstream approach to be studied by scholars, if there is one thing authors would agree on is that when performing an evaluation one should consider the type of company, transaction, the industry he is looking to value, the information available, and the purpose he wants to emphasize. For this reason, the literature review will highlight from this paragraph on, some of the Cash Flow Discounting variants and multiples analysis more relevant in a context of M&A in the Consumer Staples sector.

2.1.2.1 Cash Flow Discounting

Discounted cash flow (DCF) analysis, the widely recognized methodology for valuing companies, assets or projects has its origin in the notion of time value of money. All discounted cash flow methods involve forecasting future cash flows and then discounting them to their present value at a rate that reflects their riskiness, that is to say, the investors' opportunity cost of taking that investment (Luehrman, 2007). However, DCF itself can be split into a variety of different approaches having all of them the same fundamental concept.

The most common DCF approach in the literature is the Weighted Average Cost of Capital (WACC) approach in which the expected future cash flows are discounted at a risk adjusted discount rate (cost of capital) to compute the present value (PV) of that stream of cash-flows. For equity valuation methods, the cost of capital will purely be the cost of equity which is also employed when using the Adjusted Present Value (APV) approach, first investigated by Modigliani & Miller (1963), presented in its contemporary appearance by Myers (1974), and argued to be the best valuation tool in today's technological era by Luehrman (1997). APV mechanics starts by considering the company as unlevered, when discounting the future cash flows, and then compute the PV of financial maneuvers separately and add both values. There has been a rising debate on the literature about which tool is better for valuing operations, the WACC based DCF or the APV, which will be discussed further on.

2.1.2.1.1 DDM and Free Cash Flow Approach – Equity and Firm specific

The mainstream DCF model can either be applied to value a business as a whole (Free Cash Flow to the Firm - **FCFF**) or to value the firm to the shareholders (Free Cash Flow to Equity - **FCFE**), which is to say the cash available to shareholders after funding capital requirements, working capital needs, but also, debt financing requirements (Stowe, Robinson, Pinto, & McLeavey, 2007).

This second approach has, according to the literature, its roots in the work of Williams (1938) and Durand (1957) who found evidence of a close correlation between the stock price and the present value of the dividend stream. This correlation is the basis of another method frequently referred by Finance scholars, the Dividend Discount Model (DDM). As Stowe et al. put it in its 2007 CFA Institute scholar book "Equity Asset Valuation", "DDM is the simplest and oldest present value approach to valuing stock". Although, one of the most popular methods used in valuation, a significant number of authors have argued and provided evidence against the link between prices and dividends. Shiller (1981) has demonstrated how stock price volatility clearly surpasses that of dividends while Fama & French (1988) have similarly provided evidence that dividend yields[1] fluctuate, on average, a lot more than dividends.

Furthermore, in cash flow discounting approaches as the ones just mentioned - FCFF, FCFE and DDM - the first step required is to estimate what the assets will generate in the future, which involves creating expectations about return on invested capital (ROIC), growth rate (g) and growth period. Moreover, in the DDM method, assumptions must be made about growth rates of earnings and pay-out ratios in order to determine the long term growth rate (g) of dividends. The pay-out ratio is assumed to be stable (Gordon, 1962), but as Damodaran (1994) points out "The focus on dividends in this model can lead to skewed estimates of value for firms that are not paying out what they can afford in dividends. In particular, we will under estimate the value of firms that accumulate cash and pay out too little in dividends.". This assessment can be of special importance for growing companies that usually pay lower dividends relative to earnings than mature ones, because reinvestment needs are higher for a startup. Even multi-stage growth models like that of Fuller & Hsia (1984) engage on the same risk as they also assume a constant pay-out ratio.

The common alternative to DDM will be the FCFE that as Vernimmen et al. (2005) classified, is a direct method, through which one can directly value the equity capital, as opposed to the

1 $\frac{Dividends}{Stock\ Prices}$

FCFF in which first, it is calculated the value of the firm as a whole (the enterprise value, EV), and then subtract the value of net debt.

Given this, the Free Cash Flow Valuation inputs, including both FCFF and FCFE, will continue to be further analyzed in this section as literature coverage of the DDM method will not be the focus of the rest of the review.

2.1.2.1.2 Free Cash Flow Inputs

As already mentioned before, the Free Cash Flow models estimate the value of the firm, or equity of the firm, as the present value of future Free Cash Flows discounted at a rate that reflect their cost (cost of capital for FCFF (WACC), or just the cost of equity (K_E) for FCFE since this method is only measuring how much cash a firm can afford to return to its stockholders) (Stowe, Robinson, Pinto, & McLeavey, 2007):

Firm Value $$\sum_{t=1}^{\infty} \frac{\text{FCFF}_t}{(1+\text{WACC})^t}$$

Equity Value $$\sum_{t=1}^{\infty} \frac{\text{FCFE}_t}{(1+K_E)^t}$$

Free cash flows, period of estimation and Terminal Value

The definition of FCFF is generally regarded as the cash flow available to the company's suppliers of capital after all operating expenses (including taxes) have been paid and necessary investments in working capital (e.g., inventory) and fixed capital (e.g., equipment) have been made. The company's suppliers of capital include common stockholders, bondholders and preferred stockholders (Stowe, Robinson, Pinto, & McLeavey, 2007). FCFE is, as already mentioned, the cash flow available to the company's shareholders after funding capital requirements, working capital needs, but also, debt interest and principal payments have been made (but, plus receipts from debtholders) (Stowe, Robinson, Pinto & McLeavey, 2007). FCFF and FCFE are advantageous relative to other earnings measures such as net income, EBIT or EBITDA, in the sense that these measures can either double-count or omit cash flows in some way.

Given the definition of FCFs, a consensual topic in the literature, one must then define a period of estimation which, on the other hand, is not a subject that gathers agreement amongst scholars and practitioners. The formulas above (for Firm Value and Equity Value) are depicted as if the company would generate cash-flows for an indefinite time, which is one of the assumptions of the model, however it would not be possible to discount infinite cash-flows.

Fernandez (2007) clearly illustrates that there should exist two distinct periods of time within the DCF method: the explicit forecast horizon, where cash-flows are distinctively estimated and the post-horizon period, or Terminal Value, where cash-flows are assumed to grow at a steady rate in perpetuity (Gordon Model). The fact that the explicit period is usually between 5 to 15 years, commonly being 10 years (Jennergren, 2008), contributes for the Terminal Value to generally represent well over 75% of the market value estimate (Young et al. 1999). Conversely, the assumption of constant growth in perpetuity, widely accepted in the computation of the Terminal Value, generated a long debate in literature regarding the verisimilitude of such assumption. Authors like Ohlson & Zhan (1999) analyzed how a horizon date affected valuation, and concluded that errors arising because of the horizon tend to vanish as the horizon approaches infinity and, in fact, every increase in the horizon reduces the error.

Cost of Capital

In order to compute the weighted average of the after-tax costs of different sources of capital (WACC) one needs estimates for the relative amount of Debt and Equity in the capital structure (Luehrman, 1997):

WACC $(W_E \times K_E) + [(W_D \times K_D \times (1 - \text{Tax rate})]$

W_E and W_D stand for weight of market value of equity and weight of market value of debt in terms of total capital in market values, respectively. It is considered more appropriate to use market values since the WACC is a forward-looking measure that reflects the expectations of investors and how a company can raise new capital (Damodaran, 2012).

The **cost of Debt** (K_D) is observable in the market, and for the computation of cost of capital one must take into account the tax deductibility of Debt (Damodaran, 2002). Nonetheless, a company can have all sorts of debt obligations making it difficult to get to a precise rate, thus Damodaran (2012) suggests that the cost of debt can be determined by adding to the risk-free rate, a default spread that reflects the default risk of the company.

Now, regarding the **cost of Equity** (K_E), or also known as the required rate of return on common stock, literature has long been showing a different enthusiasm about this discount rate. The required rate of return for investors in the equity market has been enlightened by the Capital Asset Pricing Model (CAPM) which was first introduced by Sharpe (1964), Lintner (1965), Mossin (1966), and Treynor (1965). It is a one period model which affirms that in

equilibrium, the expected return of any asset or portfolio varies linearly with its covariance with the market portfolio.

CAPM Model $E(r_i) = r_f + \beta_i\big(E(r_m) - r_f\big)$ $\beta_i = \frac{Cov\ (r_i, r_m)}{Var\ (r_m)}$

From the above regression, it is assumed that the risk premium $[E(r_m) - r_f]$ of an asset depends on the betas, which represent an individual asset's correlation with a market portfolio. From an investor's perspective, if the market was to be in equilibrium, he could in fact expect that the return he would get from a stock would only have the market risk as a source, the systematic risk. In this situation, he would be able to diversify the specific stock risk away. CAPM is in fact a very popular model to determine a theoretically appropriate rate of return of an asset, due to its simplicity. But aligned to this, it is also a much criticized model. Roll (1977) for instance has stated that the market portfolio in which the excess asset returns are regressed is only a proxy of the true market; therefore it might seem to be mean-variance efficient when the true market is not. Also the proxy may not be efficient, leading to an inconsistent β estimate.

Other authors have grant valuation literature with alternatives to the CAPM. Fama-French (1992) Three-Factor model, for instance, provides an alternative to the CAPM, and tries to explain the CAPM anomalies. In their model, apart from the excess market return, two additional factors are included in the effort of explaining an asset's excess return. These are the return on a portfolio of small stocks minus the return on a portfolio of large stocks (SMB), and the return on a portfolio of stocks with high book to market values minus the return on a portfolio of stocks with low book to market values (HML) which are important for describing the returns on growth-stock funds.

Three-Factor Model $E(r_i) - r_f = \alpha + \beta_{1i}\big(E(r_m) - r_f\big) + \beta_{2i}SMB + \beta_{3i}HML + e_i$

The debate about the computation of the equity discount rate has still many pages to go. However, it seems that CAPM continues to be the most popular asset pricing model among the Finance community with several studies proving the effectiveness of CAPM against the Fama-French Model. One of those studies was led by Kaplan & Ruback (1996) who examined 51 highly leveraged transactions and looked for the relationship of the implied risk premia not only to systematic risk measures, but also to firm size and book-to-market ratios, concluding that the implied risk premia were not significantly related to firm size or pre-transaction book-to-market ratios, but were positively related to firm and industry betas.

Regarding the estimation of **Beta** for the CAPM, a relative measure of systematic risk (Koller, Goedhart & Wessels, 2010), one must understand its drawbacks and criticisms. The first drawback is that there is no entire market portfolio of all equities available to easily assess beta. For this reason, practitioners use a proxy of the market, usually a broad stock market index such as the S&P 500. Moreover, the estimation of beta can follow a number of methods illustrated in the literature by several authors:

- Raw Beta – probably the most common, and suggested by several authors such as Damodaran (2012), it is computed by running a simple regression with the company's monthly excess stock returns as the dependent variable and the monthly excess returns in the market as the independent variable (Hitchner, 2006);

- Unlevered (β_U) and Levered Beta (β_L) – $\beta_L = \beta_U \times [1 + (1 - T_c)(\frac{D^2}{E})]$ – knowing that the unlevered beta removes a company's financing decision from the beta calculation (Hitchner, 2006);

- Adjusted Betas – suggested by Vasicek (1973), the adjusted beta is a weighted average of the company's regression beta and its peer group beta, based on the theory that over time a company's beta tends toward its industry's average beta. The motivation behind this calculation is to make a forecast of the true beta in the future which can be used to estimate the expected return.

- Industry Betas – the "Full-Information" (FIB) approach, first suggested by Ehrhardt & Bhagwat (1991), estimates industry betas by using a cross-sectional regression that includes from all companies, the betas and their percentage of sales in all of the industries. Ehrhardt & Bhagwat (1991) performed the regression using OLS, so their industry betas were equally weighted across companies. Kaplan & Peterson (1998) however, obtained market capitalization-weighted industry betas by developing a capitalization-weighted regression technique. The FIB approach according to Kaplan & Peterson (1998) seems to be gaining more relevance in the literature than Ehrhardt & Bhagwat's one.

- Peer Group Beta – "it takes into consideration the industry betas of all industries in which a company is involved. It is the sales-weighted average of the betas for each industry in which a company has sales." (Hitchner, 2006).

[2] Book Debt

Now, the **risk free rate** affects both the cost of equity and the cost of debt, but it is normally given little attention in academic research. According to Pratt & Grabowski (2010), the risk-free rate should reflect three components (a real return for lending the funds over the investment period, thus forgoing consumption for which the funds otherwise could be used; expected rate of inflation during the period of the investment; and the risk that the investment's principal market value will rise or fall during the period to maturity as a function of changes in the general level of interest rates). All three of these economic factors are embedded in the yield to maturity for any given maturity length. Damodaran (2008) classifies an asset as risk-free when its actual return equals the expected return and there is no uncertainty or variance related to its actual return. The author also suggests that the risk-free rate should be consistent with the currency and duration of the cash-flows under analysis. Practitioners frequently use ten-year government bonds, even for companies with higher cash-flow duration, given the lack of liquidity of longer-maturity instruments.

Finally, the **risk premium** $[E(r_m) - r_f]$, last component of the CAPM, quantifies the return of the market over risk-free assets. Risk premium is commonly computed by recurring to historical averages and forward-looking estimates (Koller, Goedhart & Wessels, 2010). Nevertheless, other methods to estimate the market risk premium include the use of regression analysis to link current market variables (i.e. dividend-to-price ratio) to project the expected market risk premium and, the use of DCF valuation, along with estimates of return on investment and growth, to reverse engineer the market's cost of capital (Koller, Goedhart & Wessels, 2010). While arguments about the methods to estimate the risk premium are common in academic Finance literature, other arguments concerning the risk premium computation are also present in the literature disregarding the method used. One of the disagreements lies on the fact that analysts often add a premium to account for the country risk in some markets while literature argues that the country risk, like the specific risk, can be diversified away if the investor holds a geographically diversified portfolio (Stulz, 1999). Goedhart & Haden (2003) on the other hand, advocate that this is a subjective matter and that on a short term valuation it may make sense to add a country risk while on a long term analysis its effect would not be relevant.

Numerous studies on the CAPM have been published addressing and modifying the original CAPM. Most recently, Bali et al. (2009) examined the cross-sectional relationship between conditional betas and expected stock returns for a sample period from 1963 to 2004. The authors found that it explained between 2.02 percent and 2.13 percent of the cross-sectional variation in returns. Addition of size and book-to-market ratio increased the R^2 values to

between 4.7 percent and 4.87 percent. No matter how negatively this low explanatory power can be viewed by the Finance world, one must take into account that markets are not perfect and a stock's return cannot be predicted relying 100% on explainable variables. If both CAPM and Three-Factor Model were to work out perfectly, this would mean they would have a zero alpha, the alpha is the stock's specific risk, therefore what is not explained by the market.

APV vs. WACC

The Adjusted Present Value is an alternative approach to the WACC method in which financial maneuvers, including interest tax shields, costs of financial distress (include direct costs such as lawyers expenses, and indirect costs such as loss of clients and brand damage), subsidies, etc… are separately valued and added to the base-case valued (value of the project as if it were financed entirely with equity) (Luehrman, 1997). This approach is argued to better value a business when its capital structure is complex and financial side effects are not reliably addressed by the automatic WACC method (Koller, Goedhart & Wessels, 2010). The APV method is also advocated to provide a more complete picture and help managers perceive not only the value of an asset but where the value comes from (Damodaran, 2006). The main argument defended by Luehrman (1997) is that the APV is still a DCF methodology and some of the limitations that the WACC approach demonstrates (poorly suited to value projects that are essentially options), are also present in the APV, however some of them are not ("[…] APV always works when WACC does, and sometimes when WACC doesn't, because it requires fewer restrictive assumption […]). In addition, Luehrman (1997) states that the fact that WACC can still be more popular than APV is due to the fact that WACC's virtue, only one discounting operation, was a great advantage in the days of "calculators and slide rules", but nowadays it has become irrelevant.

When using APV though new concerns arise: which discount rate to use when discounting interest tax shields for instance? Authors like Myers (1974) defended the use of the cost of debt to discount tax shields, years later however, Miles & Ezzel (1980) and Harris & Pringle (1985) advocated the use of the cost of equity as the discount rate. More recently, Luehrman (1997) assumes that academics do not agree on how risky tax shields are. The author defends that tax shields are as uncertain as principal and interest payments, yet "[…] there may come a time when you can afford to make your interest payments but can't use the tax shields […]". For this reason, Luehrman (1997) suggest that tax shields are riskier than Debt and should be discounted at a higher rate than Debt, nonetheless, the author fails at quantifying how much higher the discount rate should be.

Despite all different views in the literature regarding the discount rates used to value the PV of financial side effects and the efficiency of using one approach over the other, one argument of the APV advocators seems to gather consensus amidst the academics: “Rather than model the effect of capital structure changes in the weighted average cost of capital, APV explicitly measures and values the cash flow effects of financing separately.” (Koller, Goedhart & Wessels, 2010).

To sum up, cash flow discounting analysis have a variety of alternatives that have drawn the attention of more and more academics due to its relevance in practical Finance. There are many debatable subjects regarding DCF analysis which in turn is fueling scholars to better complement the initial studies carried by academics, and it seems this dynamic literature is here to stay.

2.1.2.2 Relative Valuation

As already stated in the commencement of this overview, there is the idea that cash flow discounting methods are usually applied by academics while in the “real world” analysts typically resort to relative valuation to price securities, transactions or other financial assets. In fact, the use of relative valuation – comparing a firm’s multiples with those of comparable companies (Koller, Goedhart & Wessels, 2010) – is widespread and most equity research reports and valuations are based upon the use of some multiple. The fact this method gathers so much popularity among analysts does not comes as a surprise once one understands the advantages of multiples valuation in regard to other valuation methodologies. Damodaran (2002) enumerates some of the reasons of such a success:

- Fewer assumptions are needed, and far quicker than DCF valuation;
- Simpler to use and to present to clients and investors than DCF;
- More likely to reliably represent the market’s direction.

Even so, the use of multiples in valuation must be carefully and properly executed. When performing a valuation using multiples one must bear in mind that all companies are different from each other, and that “any analysis is as accurate as the forecasts it relies on”. Koller, Goedhart & Wessels (2010) refer that multiples are often misunderstood and misapplied by overlooking well-known facts. The authors exemplify with the use of the multiple P/E (price-to-earnings) where analysts commonly multiply the industry average P/E by a company’s earnings to obtain a fair price estimate, and thus totally overlooking the fact that companies within an industry can have very different expected growth rates, returns on invested capital, and capital structures. Koller et al. (2010) conclude that a carefully designed multiples analysis can be of

great value, in accordance with Kaplan & Ruback (1996) who recommends using both DCF and multiples approaches in practical valuation where comparable values are available. Kaplan & Ruback (1996) empirical study also contributes to the literature by suggesting that one should use multiples based on EBITDA to make the values estimated with multiples comparable to those estimated using cash-flow discounting.

In order to compare the values of similar firms in the market, Damodaran (2002) standardized values as follows:

- Earnings multiples – the value of the firm as a multiple of the operating income or EBITDA for instance;
- Book value or Replacement value multiples – the value of the firm as a multiple of the book value of all assets, or as an alternative, the replacement cost of the assets (Tobin's Q);
- Revenue multiples – far less accounting influence, the value of the firm as a multiple of revenues such as sales;
- Sector-Specific multiples – the value of the firm as a multiple of some sector-specific characteristic (i.e., number of hits generated by a firm's website in the Internet sector).

Koller et al. (2010) advocate the use of forward-looking multiples to be consistent with the principals of valuation (PV of future cash-flows), the use of Enterprise-Value multiples (EV/EBIT) to avoid price-earnings major flaws (effect of capital structure, the effect of non-operating gains and losses and manipulation via depreciations) and the adjustment of Enterprise-Value multiples because even though EBIT is superior to earnings for multiples calculation purposes, it still needs to be adjusted for non-operating items (excess cash and other non-operating assets, operating leases, employee stock options, pension liabilities). On the other hand, Liu, Nissim & Thomas (2007) support the higher accuracy of earnings multiples over any other multiples based on their empirical analysis.

Although there is no general agreement on which multiples are better fit at providing a reliable relative valuation, literature seems to agree on the role multiples analysis play in valuation – a useful and relatively simple methodology that when cautiously applied can be very consistent and a great ally of the DCF models.

2.2 M&A Overview

Mergers, and acquisitions, of firms have always been a natural strategy used by businesses with the intent to grow, prosper and deliver value for its investors and customers. The concept of creating alliances between similar entities that will result in a stronger entity that benefits all of the intervenient, or, the integration of a smaller entity in a bigger one with that same purpose – to strengthen both entities – is not new, it is in fact ancient and it has been part of every dimension of life. However, this natural concept is nonetheless one of the most important shapers of evolution, with its decisions dictating many times the route development will take. In the global era the world lives nowadays, the mergers and acquisitions (M&A) of businesses has been, and will continue to, be a shaper of the global economy's future.

Identically to literature on valuation, literature on M&A is immense and some of its topics are far from scholars and analysts' consensus. The fact that deals like M&A are an inherently way for businesses to expand in an incessantly globalized world, in addition to the foggy assessment of such deals' outcomes, have provided Finance scholars with many resources to write. To further understand the role played by M&A transactions a look into its main characteristics and history shall be conducted.

2.2.1 Types of Deals

Literature distinguishes Mergers and Acquisitions transactions into several types of deals. Damodaran (2002) points out the difference between a firm's acquisition led by another firm or by its own managers or outside investors (usually a tender offer). The latter are named management buyouts (managers' involvement) or leveraged buyouts when the funds for the tender offer are mainly composed by Debt. As for an acquisition led by another firm, the author classifies into four different categories: **merger**, when two firms agree to combine, usually 50% of both firms' shareholders have to agree to the merger, and the target firm ceases to exist and becomes part of the acquiring company; **consolidation**, when a new firm is created after a merger and the shareholders from both firms receive a stake in the new company's common equity capital; **tender offer**, when one firm makes an offer for the outstanding stock of another firm at a specific price directly to the shareholders of the company, thus enabling the target firm to continue existing as long as there are dissident stockholders; and finally, acquisition of assets, when one firm purchases the assets of another company conditional on its shareholders' approval.

2.2.2 History and Patterns

One of the major features of M&A present in the literature is its "wave pattern". Martynova & Renneboog (2009) classified the term "takeover wave" as the pattern of the number and total value of takeover deals over time. This phenomenon means that there are short periods of very intense merger activity (Town, 1992). Martynova & Renneboog (2009) states that five completed waves have been examined in the academic literature – early 1900's, 1920's, 1960's, 1980's and the 1990's – being the most recent particularly remarkable in terms of size and geographical dispersion. The author's study argued that M&A activity is: (a) typically interrupted by an abrupt decline in stock markets and a subsequent economic recession; (b) usually takes place in periods of economic recovery coinciding with rapid credit expansion and stock market booms; (c) often fuelled by regulatory changes; (d) frequently driven by industrial and technological shocks; and (e) significantly influenced by managers' personal objectives.

Accordingly, another main literature concern is whether M&A deals have been having the desired profitable effect throughout history. Gaughan (2004) stated that many of the largest deals in the 90's M&A wave were "colossal failures". The author claims that "some of the more prominent failures of the 1990s, such as the AOL Time Warner (now Time Warner) fiasco, the Daimler-Chrysler merger, the acquisition programs of Tyco and WorldCom, and Vivendi's and AT&T's unsuccessful forays into fields outside of their core businesses" can all be traced to insufficiently diligent board of directors. This fact lead to a recurrent issue in M&A texts: whether the focus of M&A activity should be a diversified or a related acquisition strategy. Authors like Morck et al. (1990) have suggested that managers' motivation to engage on diversified acquisitions is to make up for poor performance, reduce risk and assure survival of the company. The authors, in agreement with Gaughan (2004), assert that few companies have been able to successfully pursue a diversification strategy. Other authors like Berger & Ofek (1995), Maquieira, Megginson & Nail (1998) and DeLong (2001) also found evidence of value destruction from diversification and that the degree of relatedness between the businesses and geographical location of the acquirer and acquiring company are positively correlated with returns. However, Morck & Yeung (1997) found that not all companies are subject to value destruction from diversification and that information-intensive (e.g. R&D) companies, can benefit from this strategy.

2.2.3 Synergies and value creation

Damodaran (2005) defines synergy as the additional value produced by two combining firms that together create opportunities that would not otherwise been created. Synergies are the 'Holy Grail' of mergers and acquisitions and as just mentioned above, M&A deals can easily destroy value and turn out to be authentic failures. For that reason, the interest academics nurture for the creation of synergies and its measurement is significant. Synergies are created from different sources which Damodaran (2005) categorized as operating and financial synergies. Operating synergies relate to the operations of the post-transaction firm and include economies of scale, increased pricing power and higher growth potential (higher expected cash flows). Financial synergies include tax benefits, diversification, higher debt capacity and uses for excess cash (higher expected cash flows and/or lower discount rates).

Synergies however need to be valued prior to the deal has occurred leading one more time to projections and expectations. That is where the "fog" is. As Warren Buffett once said, "In some mergers there truly are major synergies – though often times the acquirer pays too much to obtain them – but at other times the cost and revenue benefits that are projected prove illusory". Damodaran (2005) stresses how important it is to keep the value of the synergy apart from the value of control, when valuing the synergies (in which according to the authors' steps one should firstly value the firms involved in the merger independently, then value the combined firm, with no synergy and finally, value the combined firm with synergy). In a summarized way, to value control, Damodaran (2005) suggests a revaluation of the target firm with a presumably better management in place and then to compare the value obtained with the valuation with the existing management in place.

As Sirower & Sahni (2006) argue, the truth of the matter is that literature agreement that, on average, acquiring companies increase value and acquirer's destroy value for their shareholders, has little or no impact on the course M&A activity will take on the future. The good boards and managers will always go for a deal when they spot a good opportunity, whether it will materialize or not. A study on synergies that can relate to this view, and can provide an explanation for the creation or destruction of value within M&A related companies was conducted by Houston et al. (2001) where the authors suggest that expected synergies are important drivers of the wealth creation through M&A. By studying the relationship of the present value of the synergies with the deal's announcement day, Houston et al. (2001) have found evidence that the market discount the value of synergies associated with the deal with a greater discount rate for revenue-enhancing synergies, and with a smaller discount rate for cost-reduction synergies, thus influencing the actual wealth creation of the transaction.

2.2.4 Performance fundamentals of M&A

Sirower & Sahni (2006) examined a sample of 302 large deals from the 90's merger wave with the purpose of effectively oversight the decisions that lie behind years of difficulty in creating value through M&A. The key results of the study are as follows:

- "On average, acquirers underperform their industry peers." Note, however, that together with this average there was a wide variance of outcomes in the sample with one-year returns ranging from -151% to 281.5%;

- "Initial reactions are persistent and indicative of future returns." The authors affirm that the majority of deals that had an initial negative response presented negative returns one year after the deal, while half of the deals that began positively maintained a strong positive return after the same period;

- "Delivering results after a good start pays off big." Following last argument, the authors conclude that deals that began with a positive reaction by investors, and that continued to receive a positive response outperformed in 58% deals that began and continued to be perceived negatively;

- "Price matters." The study conducted by the two authors found that the average premium paid by the initially negative responded deals was around 8% higher than the positive deals. The deals performing negatively, after one year, had around the same difference in premium paid and, more prominent was the difference found in the premium paid between persistent negative performers and positive ones (around 15%);

- "Cash deals outperform stock deals." This finding reiterates the extensively documented evidence on the underperformance of stock deals;

- "Sellers are the biggest beneficiaries of M&A transactions." Shareholders of the buyer company lost on average, while shareholders of the selling firm earned on average 20% from the week before the deal announcement and the week after;

- "M&A transactions create value at the macroeconomic level." The combined value creation (even though shareholders of the buyer company loses, shareholders of the selling firm win) was on average 1% at announcement, thus creating value for the economy. The stock deals however presented negative combined value creation, but

on the other hand cash deals had a positive combined return compensating for the observed value destruction of stock deals.

2.2.5 Cross Border M&A. New wave? More value?

Zenner, Matthews, Marks & Mago (2008) studied how the growing integration of the global markets for labor, capital, goods, and services has been fueling cross-border M&A in a stagnated developed economy. The authors refer how in 2007 cross-border transaction quintupled in dollar volume, attaining an historical high volume. Zenner, Matthews, Marks & Mago (2008) identify and focus on globalization, diversification and deregulation as the long-term factors driving the current cross-border M&A wave while the short-term catalysts are recognized to be the high relative valuations, cheap USD, sovereign wealth funds influence and reduced domestic competitions.

Dobbs, Goedhart & Suonio (2006), in a previous study, had already studied the new boom in M&A activity circa 2006. Their study did not impact on whether the activity was taking place across borders or inside border, but on how shareholders were doing compared to the previous waves researched in the literature. According to the researchers, the value added by the deals in the current boom was around 6% when the average value creation in the previous boom was a bit more than 1%. The authors mention the fact that the value creation through M&A is at a ten-year record high. One of the explanations presented by the authors for the more favorable market reactions is the fact that the percentage of cash-deals to total deals has increased in this boom. However, researchers note that both cash and stock deals performed best in the current boom. Another shift in performance observed by the authors is the value acquiring companies' shareholders are getting from this current boom in M&A activity. Accordingly, Dobbs, Goedhart & Suonio (2006) argue that buyer's firms' shareholders are keeping more value and that the proportion of acquirers overpaying has decreased. Both the lower premiums paid and also the proportion of cash deals are indicated as plausible justifications for the observed acquirer firms' shareholders' gains.

Conclusion

Both Valuation and M&A are extensively researched subjects by academics. The fact that valuation is the basis of Finance these days, and M&A activity plays such an important role at micro and macroeconomic levels have made it this way. Valuation literature keeps on growing with the conscience that the models applied do not truly reflect reality. Academics desire to improve these models while dealing with the paradox between complexity and reality-faithful models have kept literature on valuation dynamic. M&A activity patterns and its much debated

value creation/destruction phenomenon have also kept scholars very interested in this topic with the intention of deciphering the secrets of a successfully transaction. A glance on some of the work conducted by scholars and academics over the years was provided in this section with the purpose of illustrating how researchers have been approaching both Valuation and M&A subjects and how their main questions have been addressed.

3. Companies and Industry

This paper presents a hypothetical merger between Beam Inc. (US) and Pernod Ricard S.A. (French), two companies operating in the Distilled Beverage (also known as Wines & Spirits, liquors or distillers & vintners) industry.

This section provides an overview on the Wines & Spirits industry worldwide, followed by separately analysis on both Beam Inc. (Beam) and Pernod Ricard S.A. (Pernod Ricard). The purpose of such analysis is to contextualize the proposed deal within the macro and micro environment in which the participant companies are involved, to identify trends, specific characteristics, and value drivers that can influence the way the merger should be structured.

3.1 Alcoholic Beverage Industry

The industry in which both Beam and Pernod Ricard operate is classified according to the GICS (MSCI 2010) as Distillers & Vintners. The GICS (MSCI 2010) classifies the Distillers & Vintners sub-industry of Food, Beverage & Tobacco, as the distillers, vintners and producers of alcoholic beverages that are not classified in the Brewers sub-industry which in turn include the producers of beers and malt liquors (high alcohol content beer).

The Distillers & Vintners industry can be sub-divided into two main industries: spirits and wine industries. However, companies in the Wines & Spirits industry compete for market share in an exceptionally competitive environment. Competition within this industry is not only between brands but also between categories and includes other alcoholic beverages such as beer. Products like Heineken beer competes not only against Budweiser beer, but also against Ballantine's scotch or Bacardi rum (ICAP, 2002). Under this circumstances, this industry overview section will not be confined to the analysis of the specific Distillers & Vintners industry category but will, on the other hand, highlight the main characteristics of the whole alcoholic beverage sector that can play a determinant role in the assessment of the context in which the merger between Beam and Pernod Ricard will eventually take place, with a special emphasis on the US market, in which most of the pre-determinants and outcomes of the deal will have an effect.

Competition and major players

Alcoholic beverages include beer, cider, ale, wine (including sparkling, barley, and rice wine) and spirits such as rum, whiskey, brandy and vodka. In 2011, almost 40% of the world's

alcoholic beverage consumption involves branded drinks that are usually large companies operating at an international level and investing heavily in marketing to promote image and encourage consumer loyalty (ReportLinker, 2011). This happens because demand is driven by consumer preferences in alcohol consumption and demographic trends. The profitability of individual companies depends on effective sales operations and maintaining low operating costs. Large companies have advantages in exclusive distribution rights in large markets. Small operations can compete effectively by distributing rare and expensive products. At a general level, the world's top five alcohol beverage companies (thus including wine, spirits and beer players) are, according to its market cap, as listed below:

Figure 1: Top Five Alcohol Beverage Companies by Market Cap

Rank	Company	Country	Market Cap ($ M)
1	Anheuser-Busch Inbev	Belgium	155,675.75
2	AMBEV	Brazil	122,635.46
3	Diageo	UK	75,527.39
4	Heineken	Netherlands	41,727.84
5	Pernod Ricard	France	32,100.63

Source: Bloomberg (17-April-2013)

Notice that, of these five, only Diageo and Pernod Ricard are major players in the wine and spirits industry.

The beer wholesale industry is fragmented: the top 50 companies account for about a third of industry revenue. The wine market is also very fragmented. The top 10 companies accounted for just 13.5% of total sales by volume in 2010. The largest player in the wine industry is Constellation Brands, which has a 3% market share. The spirits industry, in contrast with the beer and wine industry is characterized by a high degree of concentration, with major US players Diageo, Brown Foreman, Beam and Pernod Ricard accounting for much of domestic production. The top players often buy and sell brands among each other, thus leading to considerable reallocation of market share and brands. For instance, in 2008, Fortune Brands acquired the Cruzan Rum brand from Pernod Ricard and later in that year sold Pernod Ricard its Absolut vodka brand. Even though it is difficult to indicate exactly the market share of the major players operating in the spirits industry, the top five spirits' players in the world by volume are, according to an ImpactBank study in 2011, as follows:

Figure 2: Top Five Distilled Spirit Marketers Worldwide in 2010 (millions of nine-liter cases)

Rank	Company	2010 Volume	1995 Volume	1995 Rank
1	Diageo	115.9	109.0	1
2	United Spirits	110.7	15.1	9
3	Pernod Ricard	97.0	24.4	7
4	Bacardi	36.4	27.4	5
5	Beam	33.5	24.7	6

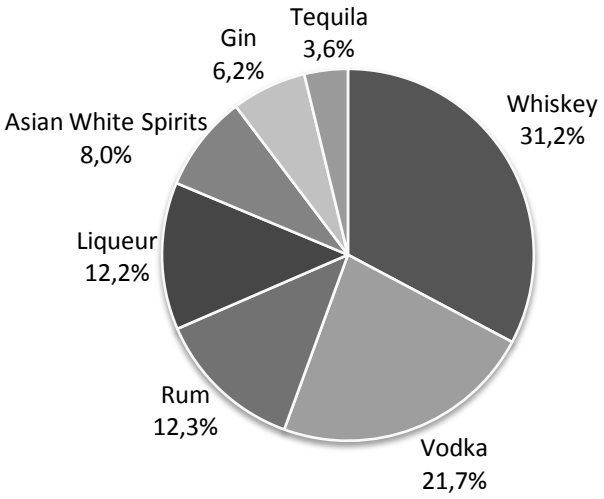
Source: ImpactBank, 2011

Growth and key segments in the Distillers & Vintners Industry

"While consolidation has been these companies' long-term M&A strategy, players have recently tweaked their approach in order to lessen the impact of the recession. Their discount brands have been selling well. However, this segment is very competitive with a number of unbranded and private label wines available in many markets." (M&A International, 2011). As a result, global alcoholic beverage companies like Pernod Ricard, its main competitors (e.g. Diageo, Bacardi), and major wine producers such as Constellation Brands have recently experienced margin degradation. In order to counteract this, producers have begun to divest their lower-end offerings to focus on premium brands, i.e. over $12/liter (M&A International, 2011).

There is indeed the perception that the wine market can lose ground to alternatives such as beer and spirits, especially as consumptions trends change, however, the global wine industry is expected to generate almost $292 billion in 2014. The EU leads with a 75% share of the global market (ReportLinker, 2011). On the other hand, the global spirits industry was worth almost $263 billion in 2010, having recorded yearly growth of over 2.5% between 2006 and 2010 (ReportLinker, 2011). Market growth is expected to accelerate to exceed a yearly growth rate of 3% between 2010 and 2015 to hit $306 billion (ReportLinker, 2011). The global spirits industry refers to the manufacturing of spirits, with companies involved in distilling and blending liquors, blending and mixing liquors with other ingredients, and distilling potable liquors. Worldwide, in 2012, the spirits category distribution according to global volume is as follows:

Figure 3: Spirits Category in % of Global Volume



Source: Distilled Spirits Council of US, 2013

While in the US market, Vodka is the Spirits' leader accounting for 32% of all volume and 26% of revenue in 2012 (Distilled Spirits Council of US, 2013), in a global level, whisky represents the leading market segment, generating almost $70 billion in sales in 2010 and accounting for almost 27% of the overall market in terms of value (ReportLinker, 2011). The vodka industry recorded strong global growth prior to the economic recession, which negatively impacted the market. Though vodka sales plummeted in 2009, the market recovered in 2010, with a particularly strong rebound in Russia (ReportLinker, 2011). The world gin market reached a volume of almost 47 million cases in 2010, with the US leading the market with almost 38% market share (appendix 1, 2 and 3).

Trends in the Spirits Industry

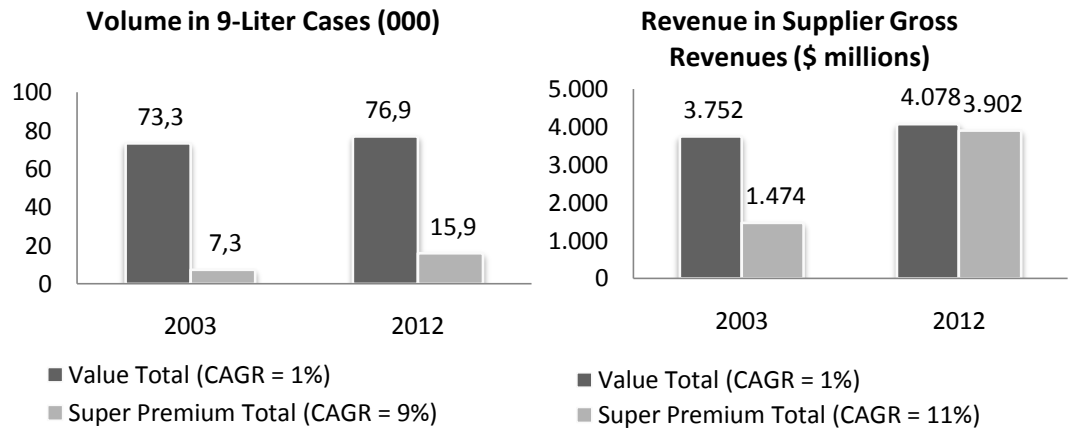
Among the factors contributing for the continuous growth of the spirits industry, the following four trends have played an important role during the 2000's decade, with special incidence on the US market (Distilled Spirits Council of US, 2013):

- Product innovations and sophisticated line extensions. For instance, in 2012 over 40% of products had a flavor (e.g. orange, cherry, lemon) component beyond traditional categories (e.g. vodka, rum, tequila);

- "Premiumization" - Spirits' products are segmented on supplier prices, even though the range varies by product category, into four classes: Value, Premium, High End, and Super Premium (being Value the cheapest and Super Premium the most expensive) (Distilled Spirits Council of US, 2013) (see Appendix 1 for the distribution by Volume and Gross Revenue of the four categories of spirits). As illustrated in Figure 4, while

Value category has grown steadily, Super Premium has skyrocketed, in a phenomenon named “Premiumization”;

Figure 4: Evolution of Value Spirits vs. Super Premium Spirits



Source: Distilled Spirits Council of US, 2013

- Modernization drive expands consumer access and “premiumization”. The increased advertising played an important role for the modernization and “Premiumization” effect. The new media (e.g. Facebook, YouTube, Twitter) allows spirits, beer and wine to have a whole new visibility in different market segments;

- Global fascination with American Whiskey drives 3rd year of record exports. American Whiskeys (most notably the Bourbon) represents 68% of total US spirits exports.

3.2 Pernod Ricard SA

Description

According to Forbes (2013) description, Pernod Ricard SA is a France-based producer and distributor of spirits and wines. The Company is active in eight principal beverage sectors: whiskies, aniseed spirits, liqueurs, cognacs and brandies, white spirits and rums, bitters, champagnes and wines. Pernod Ricard operates through 75 affiliates and has chosen to focus on sustainable growth through a large portfolio of international brands and a high-end strategy, known as “Premiumisation”. Pernod Ricard SA's flagship brands include ABSOLUT, Ricard, Havana Club, Ballantine's, Malibu, The Glenlivet, Chivas Regal, Beefeater, Kahlua, Martell, Royal Salute, Mumm, Perrier-Jouet and Jameson, among others. The wine category includes, Jacob's Creek, Brancott Estate, Campo Viejo and Graffigna. It operates as holding company, with the structure divided between brand owner subsidiaries, such as The Absolut Company, Havana Club International and Chivas Brothers, which produce and develop marketing strategies for the brands, and regional distribution subsidiaries, such as Pernod Ricard Europe, Pernod Ricard Americas and Pernod Ricard Asia, distribute local brands. As of December 31, 2010, the Company owned 107 production plants.

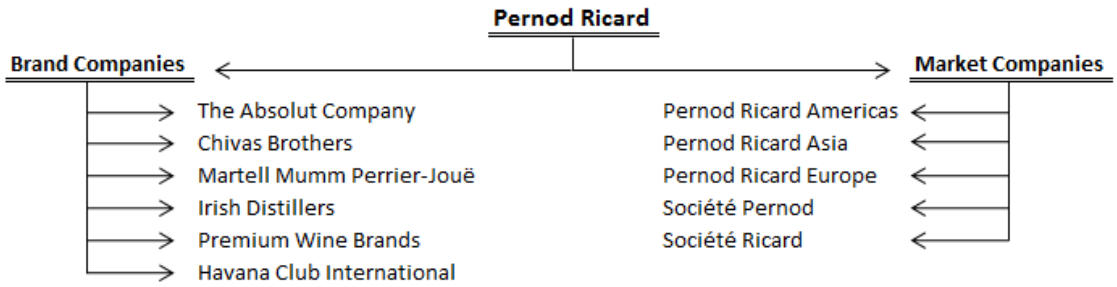
History and Strategy

Pernod Ricard was born in 1975 out of the merger of two companies, Pernod SA and Ricard SA and ever since the group was able to take advantages of new resources and expand globally by pursuing an acquisition strategy, common to its industry peers. Pernod Ricard gave priority to whiskey, the most consumed spirits in the world, and the United States, the world’s biggest market for the industry. Following a series of successful acquisitions around the globe, in the late 90’s Pernod Ricard “embarked on a reorganization, aimed primarily at decentralizing its activities” (Pernod Ricard Annual Report, 2012). With a strong financial and commercial performance, Pernod refocused on its core business, starting to divest from the non-alcoholic food and beverage segment and continuing its acquisition strategy of major spirits companies as can be elucidated by the successful acquisition in 2008 of Vin&Sprit Group, owner of ABSOLUT Premium vodka, the world leader in its category. In late 2000’s Pernod Ricard, despite the difficult economic context, continued to demonstrate a rise in its profits with the successfully integrated ABSOLUT brand, and continued with the strategic refocusing with a series of disposals, particularly in the wine segment accompanying the industry trends and with the purpose of deleveraging its balance sheet.

Organization, key segments and brands

As illustrated in Figure 5 below, the general organization of the Group is based around Pernod Ricard which holds companies referred to as "Brand Companies" and, either directly or indirectly through holding companies referred to as "Market Companies". Some companies combine both Brand Company and Market Company activities as it is the case with the ABSOLUT brand, for which Pernod Ricard set up two new operational structures following its acquisition in July 2008: The ABSOLUT Company, a Brand Company responsible notably for the ABSOLUT brand throughout the world (including production), and Pernod Ricard Nordic, a "cluster", under Pernod Ricard Europe, in charge of selling Pernod Ricard's local and international brands on the Swedish, Danish, Finnish, Norwegian, Baltic and Icelandic markets (Pernod Ricard Annual Report, 2012).

Figure 5: Pernod Ricard's Organization

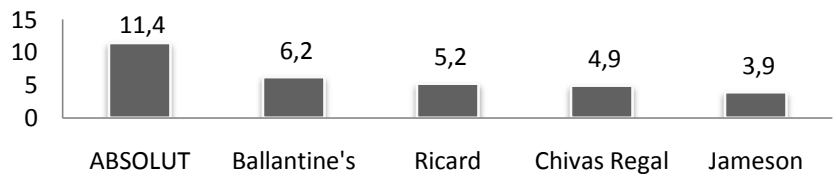


Source: Pernod Ricard Annual Report, 2012

The company relies on its decentralized organizational structure, which employs almost 19,000 people in more than 70 countries, to pursue its current strategy of: (a) investing foremost on its world-class strategic brands (14 of those brands); (b) add Premium Brands to the company's portfolio; (c) expand in the U.S. and emerging markets; and (d) continue to grow through acquisitions to remain a dynamic player in the consolidation of the Wines & Spirits sector.

Regarding Pernod Ricard's portfolio, the company owns one of the industry's most prestigious brand portfolios which include the following strategic brands:

Figure 6: Top 5 Strategic Brands[3] (2011/2012 volumes in millions of 9-liter cases)



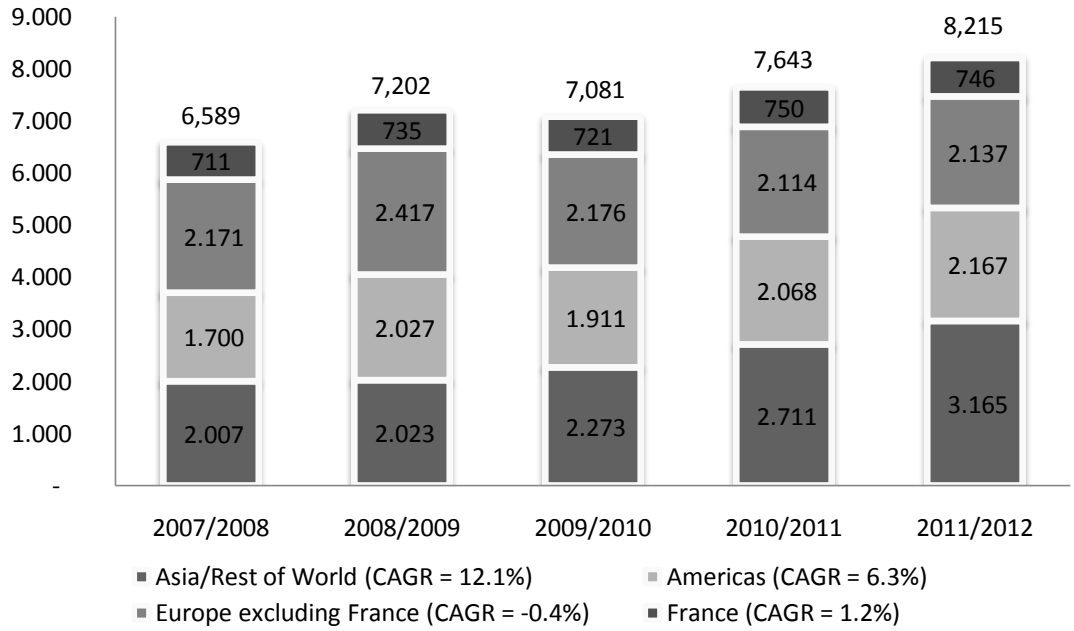
Source: Pernod Ricard Annual Report, 2012

[3] Excluding wine brands

Among the top 5 brands, ABSOLUT, Chivas Regal and Jameson have shown a positive growth both in volume and organic sales from 2011 to 2012, particularly Jameson with a 15% volume growth from one period to another while ABSOLUT and Chivas Regal have grown 3% and 7% respectively. Ballantine's and Ricard's volumes have decreased around 1% and 3%, correspondingly.

In concern to region, Pernod Ricard's net sales growth has been following different directions in different parts of the globe, as illustrated in figure 7, mainly due to the increasing demand of wines & spirits in developing countries and the successfully positioned ABSOLUT brand within the U.S. market which is the biggest market for the vodka category.

Figure 7: Net Sales by Region (in millions of euros)



Source: Pernod Ricard Annual Report, 2012

Net sales (excluding duties and taxes) in Americas have grown an average of 6.3% per annum in the past 5 fiscal years mostly due to the acquisition of the brand ABSOLUT (vodka) and the continuing success of Jameson. Asia/Rest of World recorded a CAGR of 12.1% over the same period of time, and remains the Group's main growth engine, especially due to Asia (in particular China, India, Vietnam, Taiwan and Travel Retail). Growth is also very strong in Africa/Middle East. The segmentation of net sales, as represented in figure 7, will be especially important for the valuation of Pernod Ricard as it will be conducted mainly by directing the identified value drivers for each geographical region instead of using the branding segmentation, since most of the value drivers identified in this paper can better suit projections for regions than brands.

Regarding competition in its business lines, Pernod Ricard faces competition mostly from large multinationals in the Wines & Spirits segment, such as Diageo, Bacardi-Martini, Brown-Forman, Moët-Hennessy, Beam, Constellation Brands, Gallo, Campari and Rémy Cointreau for international brands and from smaller companies or producers of local brands (for example, UB Group in India, CEDC in Poland).

Financial Information

Key statistics

Figure 8 presents an overview of the financials of Pernod Ricard's group. Notice that Pernod Ricard's fiscal year ends at the end of June, however, for comparison purposes with Beam, and Pernod's competitors, the financial metrics are also presented for December of 2012.

Figure 8: Key Financials (in Millions of Euros, except per share items)

	12 Months Jun-30-2010	12 Months Jun-30-2011	12 Months Jun-30-2012	12 Months Dec-31-2012*
Total Revenue	7,081	7,643	8,215	8,508
Growth over prior period	(1.7%)	7.9%	7.5%	6.7%
Gross Profit	4,218	4,610	5,046	5,280
Margin %	59.6%	60.3%	61.4%	62.1%
EBITDA	2,006	2,040	2,168	2,307
Margin %	26.3%	26.7%	26.4%	27.1%
Net Income	951	1,045	1,146	1,193
Margin %	13.4%	13.7%	14.0%	14.0%
Diluted EPS[4]	3.59	3.94	4.32	4.48
Growth over prior period	(7.5%)	9.7%	9.6%	0.6%

Source: Pernod Ricard Annual Report, 2011/2012

*Source: Pernod Ricard Interim Report, 2012/2013

The company's gross margin rates were high (always around 60%) in the last three years, and have been advancing significantly to reach 61.4% in 2011/2012 compared to 60.3% the previous year and 59.6% in 2010. This is the result of a favorable mix effect related to an increase in share of the Top Premium brands, price increases (averaging 3% for the Top 14, in the last year) and effective cost control (up 2% excluding mix effects). Net income and diluted EPS has grown on average around 10% per year from 2009/2010 to 2011/2012.

Capitalization

As for mid April of 2013, Pernod Ricard's common equity was priced by the market at around € 24.9bn while the enterprise value, which reflects the market value of the whole business, was priced approximately € 34.2bn. Regarding the company's capital structure, Pernod Ricard has

[4]Profit per share from recurring operations adjusted for net interest expense relating to ordinary activities, corporate income tax, profits of equity-method companies and profit from assets held for sale (excluding discontinued operations)

been deleveraging its Balance Sheet and according to its latest financial information (Interim Financial Report 2012/2013), 46.8% of the capital was constituted by Debt (short-term and long-term). Figure 9 sums up the key figures of Pernod Ricard's capitalization at the end of April 2013:

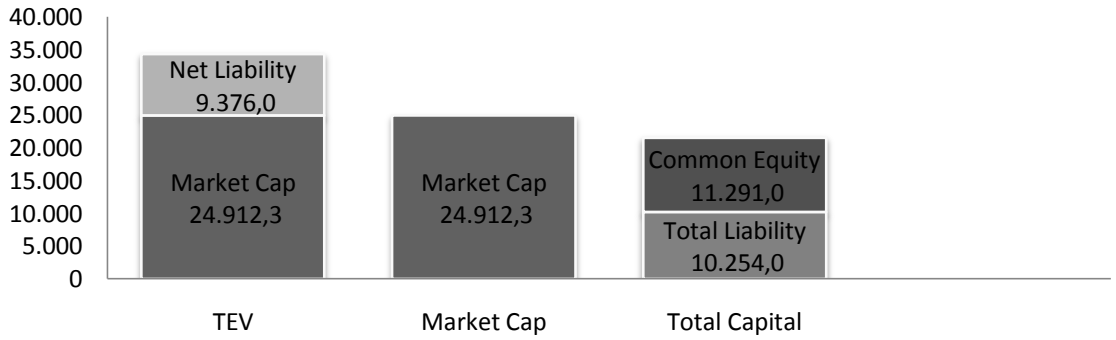
Figure 9: Capitalization at 19.04.2013 (in Millions of Euros, except per share items)

	Apr-19-2013
Share Price	€ 94.53
Shares Outstanding	263.5
Market Capitalization	**24,912.3**
- Cash & Short Term Investments	878.0
+ Total Debt	10,087.0
+ Pref. Equity	-
+ Total Minority Interest	167.0
= Total Enterprise Value (TEV)	**34,288.3**
Book Value of Common Equity	11,291.0
+ Pref. Equity	-
+ Total Minority Interest	167.0
+ Total Debt	10,087.0
= Total Capital	**21,545.0**

Source: Bloomberg (Apr-19-2013) and Pernod Ricard Annual Report, 2011/2012

Figures 9, and 10, present a summary of Pernod Ricard's capitalization resorting to two fundamental metrics in business valuation - Enterprise Value and Market Cap – and, to Total Capital according to accounting numbers. The market is valuing the company, and its equity, higher than accounting is.

Figure 10: Capitalization at 19.04.2013 (in Millions of Euros)



Source: Bloomberg (Apr-19-2013) and Pernod Ricard Annual Report, 2011/2012

Valuation Multiples

As already discussed in the Literature Review section, valuation multiples can be very useful in valuing a business by using data somewhat likely to reliably represent the market's direction.

In this sense, figure 11 presents some of the main Pernod Ricard's multiples which will be of valuable use when comparing Pernod Ricard's to its target and competitor, Beam.

Figure 11: Valuation Multiples based on capitalization at 19.04.2013

For the Fiscal Period Ending	12 Months Jun-30-2012	12 Months Dec-31-2012
TEV/Total Revenue	4.2x	4.1x
TEV/EBITDA	16.0x	15.0x
TEV/EBIT	17.4x	16.2x
P/Diluted EPS	22.1x	21.3x
P/BV	2.3x	2.2x

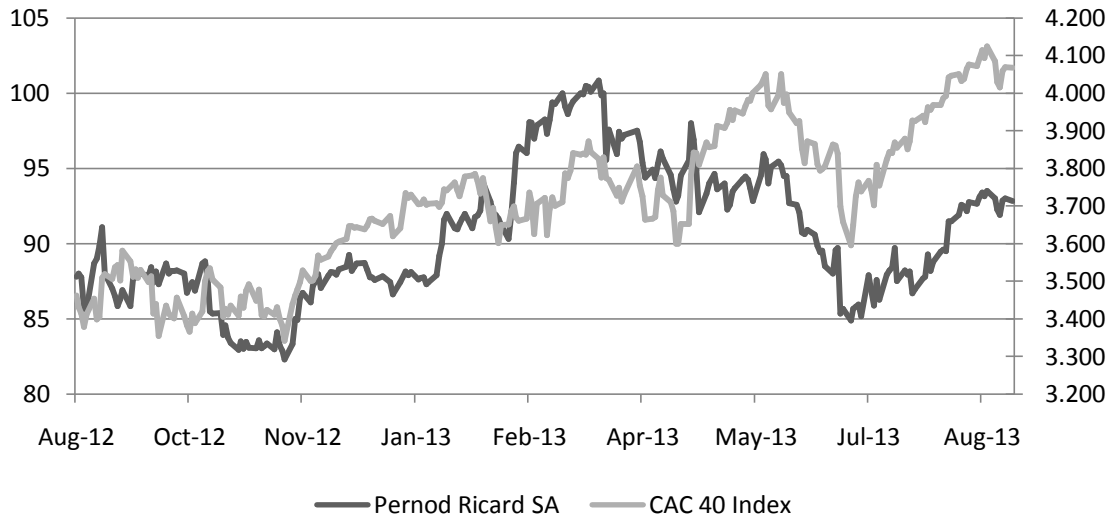
Source: Bloomberg (Apr-19-2013) and Pernod Ricard Annual Report, 2011/2012

Because EV is a capital structure-neutral metric, multiples such as TEV/EBITDA are useful to compare returns between equivalent companies on a risk-adjusted basis. The values presented by the P/E and P/BV ratios suggest that the market believes in Pernod Ricard's business future grow.

Stock Performance

Pernod Ricard's share performance in the market has been accompanying the overall company's trajectory of good performance and growth (52 week return of 7.1%). The 52 week (between August 2012 and August 2013) high was € 101.15 while the 52 week low was € 82.31, as depicted in figure 12 below.

Figure 12: Pernod Ricard S.A. - ENXTPA:RI - Share Pricing



Share Price Performance (%)	3 month	6 month	12 month
Absolute	(0.2)	(5.5)	7.1
Rel. to S&P 500	(0.9)	(10.2)	(4.0)

Source: Bloomberg (Aug-26-2013)

Even though Pernod Ricard's shares have yield a 7.1% capital gain over the last 52 weeks (as of August 2013), the stock has underperformed the market (CAC 40 Index used as the reference) by 4% during the same period.

3.3 BEAM Inc.

Description

Beam Inc. manufactures and sells distilled spirits worldwide, and unlike Pernod Ricard, Beam is not in the wines business. The company's principal products include bourbon whiskey, tequila, Scotch whisky, Canadian whisky, vodka, cognac, rum, cordials, and ready-to-drink pre-mixed cocktails. It offers its products under several brands identified by the company as Power Brands, Rising Stars, Local Jewels and Value Creators. The Power Brands are the core brand equities, with global reach in premium categories and large annual sales volume. Rising Stars are smaller premium brands in priority markets that Beam believes to have excellent growth profiles and receive substantial brand investment to drive expansion. Brands identified as Local Jewels act as Power Brands in local markets. Value Creators include a variety of brands providing scale and profit across multiple categories. The company sells its products to wholesale distributors, state governments, third party distributors, global or regional duty free customers, other spirits producers, and joint ventures. The company was formerly known as Fortune Brands, Inc. and changed its name to Beam Inc. in October 2011. Beam Inc. was founded in 1904 and is headquartered in Deerfield, Illinois.

History and Strategy

The company started its business in 1986 following the merger between American Brands, Inc. and The American Tobacco Company in December 1985 in which the shares of the principal first-tier subsidiaries formerly held by American New Jersey were transferred to the newly formed firm. The firm then assumed all liabilities and obligations in respect of the public debt securities of American New Jersey outstanding immediately prior to the merger. In May 1997, the Company's name was changed from American Brands, Inc. to Fortune Brands, Inc. (BEAM Annual Report, 2012). After the separation of the Company's Home & Security, Golf and Spirits business segments in 2010, the firm sold the Golf business and completed the tax-free spin-off of the Home & Security business in 2011, thus becoming a standalone spirits company under the name Beam Inc. Likewise Pernod Ricard, and its industry spirits, Beam has also been pursuing a dual strategy, in its short life, both focused in internal growth, and shareholder value enhancement through acquisitions and divestitures, joint ventures, alliances, and other strategic initiatives. In May 2012, Beam has acquired the Pinnacle vodka and Calico Jack rum brands and certain related assets for approximately $ 608 million, in a well-succeeded transaction which significantly increased Beam's U.S. presence in the vodka category while creating opportunities to drive cost savings and expand distribution (BEAM Annual Report,

2012). Beam has also engaged in two similar thriving acquisitions in 2011 and also 2012 of Cooley Distillery plc, an award-winning independent Irish whiskey producer and Skinnygirl, a ready-to-drink cocktail business, thus allowing the firm to enter in two of the industry's fastest growing categories.

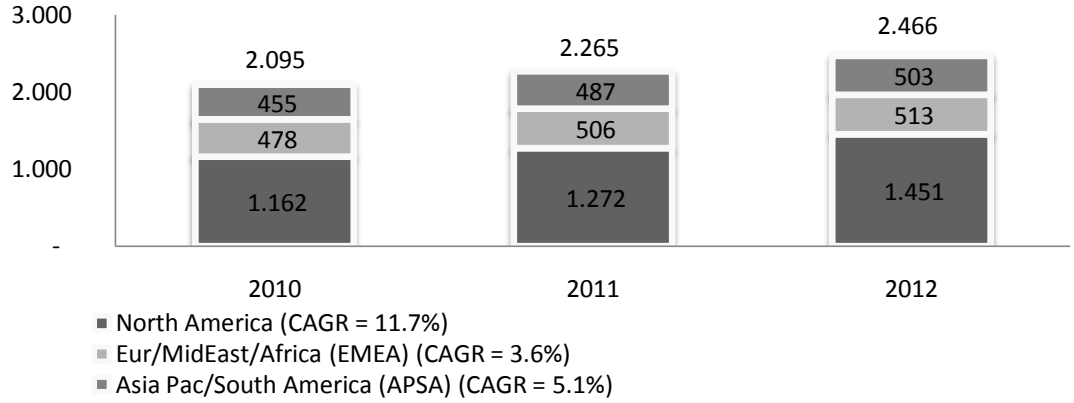
Organization, key segments and brands

Beam's three reportable segments are the geographic regions of North America, EMEA (Europe/Middle East/Africa) and APSA (Asia Pacific/South America). Each segment is engaged in the manufacture and sale of distilled spirits products. Approximately 55% of the consolidated net sales were generated in the U.S. (based on country of destination) in the year ended December 31, 2012.

As already mentioned, Beam divides its products under several brands identified by the company as Power Brands, Rising Stars, Local Jewels and Value Creators. Power Brands, Rising Stars, and combined Local Jewels/Value Creators (including non-branded sales) represent approximately 60%, 15%, and 25%, respectively, of the company's net sales. The Power Brands and Rising Stars, which are the focus of the brand investment, include Jim Beam Bourbon, Maker's Mark Bourbon, Sauza Tequila, Courvoisier Cognac, Canadian Club Whisky, Teacher's Scotch, Pinnacle Vodka (all Power Brands), Laphroaig Scotch, Knob Creek Bourbon, Basil Hayden's Bourbon, Kilbeggan Irish Whiskey, Cruzan Rum, Hornitos Tequila, Skinnygirl Cocktails, and Sourz Liqueurs (all Rising Stars).

Regarding each one of the geographic regions segmented by the company, sales have growth at a different pace between 2010 and 2012, as depicted in figure 13.

Figure 13: Net Sales by Region (in millions of US Dollars)



Source: Beam Annual Report, 2012

Beam has seen its net sales growing the most in the North America region (CAGR of 11.7%) followed by the APSA region and finally the EMEA region. It is important to refer that Beam's

evolution of sales clearly illustrates some of the trends identified in the spirits industry, in particular the fascination of the American Whiskey Bourbon (powering most of the growth in the EMEA and especially in the APSA region) as well as the "Premiumization" (most of Beam's portfolio is constituted by premium spirits which explains the high growth experienced by Beam in past years). Similarly to Pernod Ricard's method of valuation, also Beam top line forecasts will be made according to its geographical allocation (revenues will be forecasted separately for North America, EMEA and APSA).

Financial Information

Key statistics

As presented in figure 14 below, total revenues of Beam range between $ 2.1bns and $ 2.5bns (CAGR = 8.5%) from 2010 to 2012 which is less than half of the revenues of Pernod Ricard during that period (€ 7.1bns and 8.5bns – CAGR= 9.6%).

Figure 14: Key Financials (in Millions of U.S. Dollars, except per share items)

	12 Months Dec-31-2010	12 Months Dec-31-2011	12 Months Dec-31-2012
Total Revenue	2,095	2,311	2,466
Growth over prior period	5.8%	10.3%	6.7%
Gross Profit	1,234	1,346	1,439
Margin %	58.9%	58.2%	58.4%
EBITDA	745	768	738
Margin %	35.6%	33.2%	29.9%
Net Income	487	911	382
Margin %	23.3%	39.4%	15.5%
Diluted EPS	2.01	0.84	2.48
Growth over prior period	29.7%	(57.9%)	193.2%

Source: Bloomberg (Apr-22-2013) and Beam Annual Report, 2012

Beam's gross margin rates were high (around 58%) in the last three years just like Pernod Ricard's, eventhough Pernod's margins are slightly higher (around 60%). Similarly to Pernod's, this is the result of a favorable mix effect related to an increase in share of the Top Premium brands, price increases, and effective cost control. Diluted EPS has grown on average around 11% per year from 2010 to 2012, 1% higher than Pernod Ricard's diluted EPS growth.

Capitalization

Beam's market capitalization is, in April 2013, around $ 10.4bn (less than half of Pernod Ricard with € 24.9bn) while the enterprise value, which reflects the market value of the whole business, was priced approximately at $ 12.5bn while Pernod Ricard's was $ 44.4bn (considering an exchange rate of $1.30/€ - source ECB on 22nd April 2013). The big difference,

of about $ 32bn, between the two enterprise values is further exacerbated by the different capital structure of both companies: Beam has relatively low debt, with 35.2% of the capital being constituted by debt while Pernod has a Debt-to-Capital ratio of 46.8%, besides that, Pernod has almost three times the value in cash than Beam does. The key figures of Beam's capitalization at the end of April 2013 are presented below in figure 15:

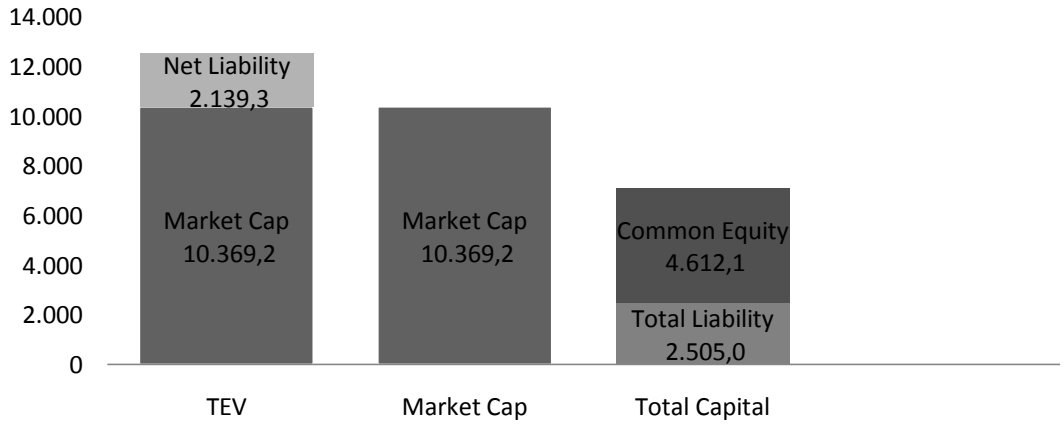
Figure 15: Capitalization at 22.04.2013 (in Millions of U.S. Dollars, except per share items)

	Apr-22-2013
Share Price	$ 64.64
Shares Outstanding	160.4
Market Capitalization	**10,369.2**
- Cash & Short Term Investments	365.7
+ Total Debt	2,505.0
+ Pref. Equity	-
+ Total Minority Interest	-
= Total Enterprise Value (TEV)	**12,508.5**
Book Value of Common Equity	4,612.1
+ Pref. Equity	-
+ Total Minority Interest	-
+ Total Debt	2,505.0
= Total Capital	**7,117.1**

Source: Bloomberg (Apr-22-2013) and Beam Annual Report, 2012

Both figures 15 and 16 present a summary of Beam's capitalization resorting to two fundamental metrics in business valuation - Enterprise Value and Market Cap – and, to Total Capital according to accounting numbers. Just like Pernod Ricard the market is valuing Beam, and its equity, higher than accounting is.

Figure 16: Capitalization at 22.04.2013 (in Millions of U.S. Dollars)



Source: Bloomberg (Apr-22-2013) and Beam Annual Report, 2012

Valuation Multiples

Valuation by multiples is particularly useful for comparing market's opinion between companies and industries. Given this, when comparing Beam with Pernod Ricard using such metrics, it is possible to observe that at the end of 2012 both companies have similar ratios, which is perfectly common between two companies operating in the same industry and at close level of competition.

Figure 17: Valuation Multiples based on capitalization at 22.04.2013

	Beam Inc.		Pernod Ricard
For the Fiscal Period Ending	12 Months Dec-31-2011	12 Months Dec-31-2012	12 Months Dec-31-2012
TEV/Total Revenue	5.4x	5.1x	4.1x
TEV/EBITDA	16.2x	16.7x	15.0x
TEV/EBIT	21.8x	19.6x	16.2x
P/Diluted EPS	76.5x	26.1x	21.3x
P/BV	2.5x	2.2x	2.2x

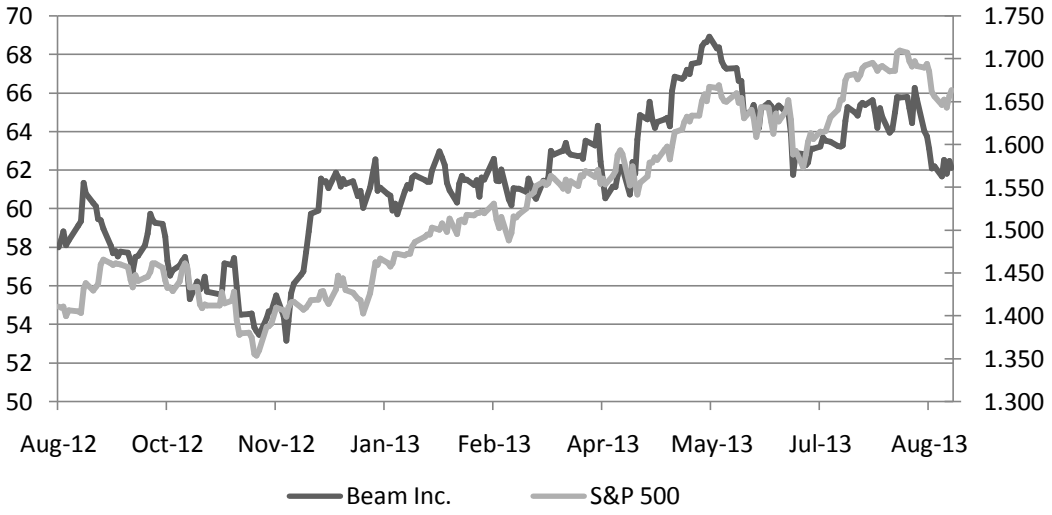
Source: Bloomberg (Apr-22-2013) and Beam Annual Report, 2012

It is however noticeable that Beam has a slightly higher price in the market when compared to its accounting items than Pernod Ricard (almost all of the multiples are at least 1x higher in Beam than in Pernod). This can indicate that the market sees Beam with a higher potential to grow and therefore prices it higher in the current moment. Regarding the deal being proposed in this paper, the fact that the market sees Beam with potential to grow can be interpreted as a good signal for the merger, however it also means that the company may not trade at a discount in the stock market, which is usually a very important pre-determinant fact for this type of deal to ultimately go forward.

Stock Performance

Beam's share performance in the market has been somewhat volatile (with very frequent oscillations of value, although not very wide changes). The 52 week (between August 2012 and August 2013) high was $ 69.78 while the 52 week low was $ 52.69, as depicted in figure 18 below.

Figure 18: Beam Inc. - NYSE:BEAM - Share Pricing



Share Price Performance (%)	3 month	6 month	12 month
Absolute	(2.0)	6.8	8.5
Rel. to S&P 500	(5.7)	(4.2)	(10.0)

Source: Bloomberg (Aug-26-2013)

Beam's one year performance in the market has yield shareholders with a 8.5% capital gain, however, the stock has underperformed the market (S&P 500 used as a proxy) by as much as 10%. It should be taken into account that the S&P 500 is currently going through an incredible bull market with some sectors yielding uncommon returns, nonetheless, questions regarding Beam's direction in the market could be a good reason for a potential M&A deal given the fact that the spirits industry is consolidating, with more than 40 deals in 14 years with an EBITDA multiple range of 5x to 23x (Beam currently presents an EBITDA multiple of 16.7x).

Conclusion

This section has identified the key characteristics and motors of the spirits industry: history of consolidation through M&A deals (over 40 in 14 years); market dominated by the big players; vodka and whiskey account for a bit more than 50% of the spirits produced and consumed in the US market; flavored spirits, premium products, expanded consumer access, especially in emerging markets, and finally the world fascination for American whiskey (bourbon), have been the engines of this industry that worldwide grew by an average of 2.5% (year on year) between 2006 and 2010, and is expected to grow at an yearly rate of 3% until 2015.

Both Pernod and Beam are key industry players in the spirits industry and have been the reflex of how the industry have evolved by attaining consistent growth in sales benefiting from their premium portfolios and increased access to new markets (in particular, Asia). Financially, both companies show strong key indicators and a slightly underperformance in the market.

4. Valuations

The following section is dedicated to a crucial step in the study of the proposed deal between Beam Inc. (US) and Pernod Ricard S.A. (French): the standalone valuations of both companies. This step is required as a mean to value the deal, the merged companies with synergies, and to compare the value eventually created for shareholders after the deal with the value of both companies before the deal has occurred.

The methodology followed to value each of the companies separately relies heavily on what was identified in the literature review chapter to be the key valuation approaches considered nowadays by the finance academics, however, this paper also relies, to a large extent, on real market information such as real equity research analysts expectations and opinions, always in a critical way. Comparisons between market players' expectations and the expectations drawn from this paper research will be offered, and analyzed in a critical manner as for a clearer indication on how the separate values of both companies were obtained. Nevertheless, it should be noted that the purpose of this paper is not to impersonate an equity research note; therefore this section will not present an extremely detailed description of all the considerations used to value both companies, it will on the other hand highlight the major value drivers and financial techniques influencing the sole value of each company. The detailed descriptions will be saved for the next chapter, where the M&A transaction will be valued and synergies will be measured.

4.1 BEAM Valuation

4.1.1 Key considerations and Value Drivers

Regarding BEAM's valuation it should be noted that the considerations included in the valuation model used are based on the company's public information, strategic objectives, market data and the way the firm has evolved over the past years as well as the industry it operates. For that, historical data was used from the FY2010 onwards (information only available from that date) and the financial statements were worked towards a reorganization that allows for a more robust assessment of operating performance and value. This happens because traditional accounting statements are not organized in a way that clearly separates items that can be from operating, non-operating and financing sources, which in turn can lead to common traps of double-counting, omitting cash flows, or hiding leverage.

In face of what was presented in the literature review section, BEAM is valued according to a discounted cash flow analysis being the WACC, on a first approach, the discount rate used to derive the present value of the forecasted stream of future cash-flows. With this in mind, and recalling that the mainstream DCF model applies to value a business as a whole (through the FCFF) the first key consideration lye on how to decide to compute the FCFF, which is nothing more than the cash flow available to the company's suppliers of capital after all operating expenses (including taxes) have been paid and necessary investments in working capital and fixed capital have been met. There are four possible ways to arrive at the FCFF, by starting with one of four different financial statement items (net income, EBIT, EBITDA, or cash flow from operations) and then making the appropriate adjustments. The FCFF used in the valuation of BEAM is calculated from earnings before interest and taxes (EBIT):

FCFF = EBIT (1-T) – CAPEX + Depreciation - ΔNWC +/- other noncash charge

Consequently, there are two commonly ways used to forecast future FCFF: either to calculate the FCFF in the most recent year, and project directly how the FCFF would grow, or, using a more realistic and flexible method, by forecasting the underlying components of free cash flow and calculate each year separately, assuming that each component of FCFF is growing at a different rate over some short-term horizon, resorting to the already mentioned explicit period. The model used to value BEAM resorts to the second alternative as to more effectively incorporate the value drivers identified in the companies and industry analysis presented in this dissertation.

Based on the method chosen to forecast the FCFF for BEAM, the model starts with top line organic sales assumptions for the future, tying the sales forecasts to future costs of Revenue and SG&A, capital expenditures, depreciation expenses, and changes in working capital, thus forecasting all the components of FCFF. Moreover, top line forecasts are made according to its geographical allocation (revenues are forecasted separately for North America, EMEA and APSA), and then consolidated as total revenues, influencing from then on the forecasts of more bottom line items.

As a model developed by an outside analyst with limited access to information, the forecast of revenues had to rely on verifiable variables and, to try to be as reliable as possible, it had to be kept simple and based on historical information, knowledge about the industry and the key value drivers already identified, instead of resorting to more complex and detailed methods that try to forecast a multitude of variables in which one faces a higher risk of not being accurate. One more general consideration regarding the way the model was built refers to the

explicit period of analysis chosen: the explicit period of the model is 5 years, which is in line with the explicit period usually used (5 - 15 years as mentioned in the literature review). Even though it is more common to use a 10 year period (Jennergren, 2008), a longer time frame is also more susceptible to the subjectivities of its assumptions, and besides, as pointed out in the literature review the fact that an explicit period is usually between 5 a 15 years contributes for the Terminal Value to generally represent well over 75% of the market value estimate (Young et al. 1999).

Revenues

Beam's revenues information allows for an analysis segmented by region: North America, Eur/MidEast/Africa (EMEA) and Asia Pac/South America (APSA). Approximately 59% of the consolidated net sales were generated in North America (based on country of destination) in the year ended December 31, 2012, in contrast with 56% in 2011 and 55% in 2010 (this yields a 6% increase in the percentage of net sales being generated in North America from 2010 to 2012). On the other hand, this increase in the proportion of sales in the North America region is counterbalanced with the decrease in percentage of sales being generated in the EMEA region, representing 20.8% of total sales in 2012 (decreased 9% in the three year period) and in the APSA region (represents 20.4% in 2012 and has decreased 6% in the same period).

Figure 19: Beam's total Revenues and proportions by regions

Revenues						
$ in millions, year end December	FY10	t. sales %	FY11	t. sales %	FY12	t. sales %
NorthAmerica	1,162	*55.5%*	1,272	*56.1%*	1,451	*58.8%*
Eur/MidEast/Africa (EMEA)	478	*22.8%*	506	*22.3%*	513	*20.8%*
Asia Pac/South America (APSA)	455	*21.7%*	487	*21.5%*	503	*20.4%*
Revenues	***2,095***	*100.0%*	***2,265***	*100.0%*	***2,466***	*100.0%*

Being the motto of this valuation "keep it simple", the way to forecast total future sales relied upon two separated and fairly straightforward forecasts: (a) the evolution of the percentage of total sales in each region; and (b) the growth of sales in North America, consequently yielding for the other two regions, different rates of sales growth depending on the evolution of the percentage of total sales computed in first place.

Regarding the first forecast on the evolution of the percentage of total sales for each region, the main value drivers identified in the previous section should be taken into account for this task. As such, the trends of expanded consumer access, in particular towards emerging markets like Asia, premiumization and demand for flavored products lead to the assumption that the APSA region and the North America region (through the leading position acquired by

Beam in the US and through the premiumization and demand for flavored products to be especially significant in mature markets like the US) will likely cannibalize a share of total percentage of sales to the EMEA region. This assumption relies also on the fact that Beam is essentially an American company, with its presence and potential to grow more concentrated at its home country and that it will continue like that. A further important factor for this assumption is that an additional value driver identified in the previous chapter, particularly important for Beam, resides mostly in the Australasian part of the world (the value driver is the world fascination for American whiskey –bourbon). Given this, figure 20 sum up the evolution of the percentage of sales by region:

Figure 20: Beam's percentage of total Revenues by region

Revenues						
% of total, year end December	**FY12**	FY13E	FY14E	FY15E	FY16E	FY17E
NorthAmerica	***58.8%***	*60.0%*	*60.5%*	*61.0%*	*61.5%*	*62.0%*
Eur/MidEast/Africa (EMEA)	***20.8%***	*20.0%*	*19.3%*	*18.5%*	*17.8%*	*17.0%*
Asia Pac/South America (APSA)	***20.4%***	*20.0%*	*20.3%*	*20.5%*	*20.8%*	*21.0%*
Revenues	***100.0%***	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*

According to the model assumptions, the North America region will increase its dominance of sales by 5% between 2012 and 2017 (vs. 6% between 2010 and 2012), the EMEA region will decline its weight in total sales by 18% (vs. -9% between 2010 and 2012), and the APSA region will increase its sales percentage by 3% (vs. -6% between 2010 and 2012).

Regarding the second separate forecast (growth of sales in North America) the model takes into account historical information from Beam's revenues, from the revenue in supplier gross value and premium spirits in the US (which presented a CAGR of 1%, and 11% respectively for the years between 2003 and 2012) and historical and projected rates of growth in the global spirits industry. The projected growth for the North America region, as well as for the other two regions, is displayed in figure 21 below.

Figure 21: Beam's revenues growth

Revenues (YOY % change)								
$ in millions, year end December	FY10	FY11	FY12	FY13E	FY14E	FY15E	FY16E	FY17E
NorthAmerica	*n.a.*	*9.5%*	*14.1%*	*9.0%*	*7.5%*	*7.0%*	*6.5%*	*6.0%*
Eur/MidEast/Africa (EMEA)	*n.a.*	*5.9%*	*1.3%*	*2.8%*	*2.6%*	*2.0%*	*1.4%*	*0.7%*
Asia Pac/South America (APSA)	*n.a.*	*7.1%*	*3.1%*	*4.9%*	*7.9%*	*7.4%*	*6.9%*	*6.4%*
Revenues	*n.a.*	*8.1%*	*8.9%*	*6.9%*	*6.6%*	*6.1%*	*5.6%*	*5.1%*

Beam highlighted that they expect the spirits global category to grow approximately3% next year, but expects BEAM to outperform the category on the top line. Trends are encouraging in

the US, with the category still growing in the 3-4% range, primarily due to strengthening price/mix. The forecasts obtained are consistent with the company's expectations. The growth rates yield the following forecasted revenues depicted in figure 22.

Figure 22: Beam's revenues

Revenues							CAGR	
$ in millions, year end December	**FY12**	FY13E	FY14E	FY15E	FY16E	FY17E	10/12	13E/17E
NorthAmerica	**1,451**	1,581	1,700	1,819	1,937	2,053	*11.7%*	*6.7%*
Eur/MidEast/Africa (EMEA)	**513**	527	541	552	559	563	*3.6%*	*1.7%*
Asia Pac/South America (APSA)	**503**	527	569	611	654	695	*5.1%*	*7.2%*
Revenues	***2,466***	***2,635***	***2,809***	***2,982***	***3,149***	***3,312***	***8.5%***	***5.9%***

The model expects total revenues to growth at a CAGR of 5.9% between 2013 and 2017 vs. a CAGR of 8.5% verified in the years comprising 2010 and 2012. For comparison purposes, the market consensus for Beam total revenues in 2016 is $ 3,065M (Bloomberg – 9th Aug. 2013) vs. $ 3,149M forecasted, thus, the model's top line forecasts presented are slightly optimistic when compared to market expectations, which, again, meets also the company's expectations.

Expenses, CAPEX, NWC and margins

After forecasting revenues, the model goes on forecasting bottom line items recurring to their dependence on sales. Costs of revenues, as well as Selling, General and Administrative expenses (SG&A), are expected to rise below sales (based on company's expectations), both at different rates, increasing in that way the operating margin over time, as depicted in figure 23.

Figure 23: Beam's operating margins

OperatingMargin								
	FY10	FY11	FY12	FY13E	FY14E	FY15E	FY16E	FY17E
OperatingMargin	*23.4%*	*22.9%*	*24.7%*	*24.5%*	*26.0%*	*27.5%*	*29.0%*	*30.5%*

The tax rate was assumed to remain constant and consistent with the tax rate used to compute the cost of capital (20.7% - the effective tax rate verified in fiscal year of 2012). Both Capital expenditures (CAPEX) and Depreciation are forecasted based on their historical values and weight relative to sales, and then computed for the future at the same decreasing rate given both items' close link and since there is no foreseeable event indicating an opposite course for any of these items.

In order to forecast Net Working Capital (NWC) it was projected, based on historical values, a series of metrics such as the number of days sales outstanding, days inventory held, the value of prepaid and other current assets as a % of sales (all these for forecasting Total Current Assets), the number of days payable outstanding, the value of short-term borrowings as a % of

sales and the value of other current liabilities as a % of sales (now these, to forecast Total Current Liabilities). These metrics make sense since NWC is a measure of operating liquidity and should be directly linked to the company's level of activity.

Cost of Capital

Based on the knowledge described in the literature review chapter about how academics and practitioners usually compute the weighted average of the after-tax costs of the different sources of capital, commonly referred to as WACC, Beam's cost of capital was computed.

Figure 24: Beam's WACC calculation

Beam's WACC		
Risk-Free Rate (R_F)	2.6%	*(Bloomberg - 10 Year US Treasury Bonds, as of 5th August 2013)*
Expected Market Return (R_M)	9.9%	*(Bloomberg R_M - S&P 500 Index as proxy, as of 5th August 2013)*
Market Risk Premium	7.3%	*(R_M- R_F)*
Raw Beta	0.80	*(Computed using monthly data for the past 3 years - August 2013)*
Equity Risk Premium	5.8%	*(Market Risk Premium * Raw Beta)*
Cost of Equity	**8.5%**	*(R_F + EquityRisk Premium)*
InterestCoverage Ratio	5.59	*(EBIT / InterestExpense)*
Rating (Damodaran)	A+	*(Damodaran online data – Appendix 7)*
CompanyBorrowing Premium (Spread)	1.4%	*(Damodaran online data, and the S&P rating BBB-)*
Tax rate	20.7%	*(Beam Inc. Financial Statements - Effective tax rate in 2012)*
After-Tax Cost of debt	**3.2%**	*(R_F + Spread) * (1-Tax Rate)*
EnterpriseValue (EV)	11,919.81	*(FY12, in Millions of USD)*
Debt/EV	21.0%	*(D / EV)*
WACC	**7.4%**	*(D / EV) * After-Tax Cost of Debt + (1 - D / EV) * Cost of Equity*

Regarding the cost of debt, and as pointed out in the literature review, since a company like Beam has all sorts of debt obligations thus making it difficult to get a precise rate of its cost, academics suggest the use of a spread over the risk-free rate that reflects the default risk of the company. For this, it was used an average spread yielded between two ratings obtained from two different sources: (1) the S&P rating agency which rates Beam as BBB- (Bloomberg); and (2) the Damodaran online information which yields a credit rating according to a company's coverage ratio and geographical location. Figure 24 sums up the results (after-tax cost of debt = 3.2%). On the same line of thought, the cost of equity was computed resorting to the model firstly proposed by Sharpe (1964), Lintner (1965), Mossin (1966) and Treynor (1965), the CAPM. The real market data used, its sources, as well as the methodology applied are described in figure 24, altogether yielding a cost of equity of 8.5%.

Concerning the capital structure, Beam has maintained a stable level of debt in relation to its capital. As of year end 2012, the ratio of the market value of Debt in relation to its total enterprise value was 21% and it is not expected to significantly change in the near future thus allowing for the assumption of this ratio for the computation of WACC. For these reasons,

given the circumstances in which Beam's capital structure is surrounded, and given what was presented in the literature review concerning the APV approach vs. the WACC approach, it was chosen to just present the WACC approach given the lack of value that adding the APV approach would bring to this paper.

The rate at which the WACC, under the assumptions just mentioned and described in figure 24, will discount the projected free cash-flows is 7.4%, and it is assumed a long term sustainable growth rate of 3%, which is a conservative estimate given the average expectations of IMF's forecasted world economy real growth for 2013-2018 (4.1%) and the forecasted global spirits growth by volume for the 1st half of the 2010's of 2.5%/3%.

In face of what was described above regarding the methodology used and the assumptions undertaken, Beam's total enterprise value is valued at $ 14,413M, which implies an equity value of $ 12,274M, corresponding to approximately $ 76.7 a share (appendix 8). The target price of Beam's by market analysts is $ 69.85 (Bloomberg – consensus mean as 9th Aug. 2013).

Relative valuation

The peer group selected to value Beam based on its peer's financial indicators had to respect some restrictions in order to provide an accurate comparison. Hence, the companies chosen had to operate exclusively within the alcoholic beverage industry, without exception, and should have a market capitalization within the range of around $ 10 Billion, up or down from Beam's market capitalization, however exceptions had to be made to incorporate Beam's close competitors such as Diageo and SAB Miller. Figure 25 demonstrates the multiples analysis.

Figure 25: Peer group and relative valuation

MultiplesValuation				
Company	**Market Cap.**	**EV/Sales**	**EV/EBITDA**	**EV/EBIT**
Brown-Forman Corporation (NYSE:BF.B)	14,321.0	5.3	15.9	16.8
WuliangyeYibin Co., Ltd. (SZSE:000858)	11,578.9	6.1	16.6	19.7
Constellation Brands Inc. (NYSE:STZ)	10,229.8	5.3	16.1	19.8
Pernod-Ricard SA (ENXTPA:RI)	22,954.2	3.7	13.3	14.4
SABMillerplc (LSE:SAB)	58,276.6	5.3	13.7	17.1
Molson Coors Brewing Company (NYSE:TAP)	8,949.8	3.3	10.1	12.9
LuzhouLaojiao Co., Ltd. (SZSE:000568)	4,955.1	7.0	15.6	17.8
United SpiritsLimited (BSE:532432)	5,207.9	4.6	27.5	19.3
RémyCointreau SA (ENXTPA:RCO)	3,890.6	3.5	16.9	18.1
Diageo plc (LSE:DGE)	58,528.8	5.2	14.6	15.9
Average	**19,889.3**	**4.9**	**16.0**	**17.2**
Beam, Inc. (NYSE:BEAM)	12,304.7	5.0	16.5	19.3
CompanyName		***Total Revenue***	***EBITDA***	***EBIT***
Beam, Inc. (NYSE:BEAM)		2,465.9	738.1	627.6
ImpliedEnterpriseValue		12,159.4	11,832.5	10,784.7

+ Total Cash & ST Investments	365.7	365.7	365.7
- Total Debt	2,505.0	2,505.0	2,505.0
ImpliedEquityValue	10,020.1	9,693.2	8,645.4
Shares Outstanding	160	160	160
Implied Price per Share	62.6	60.5	54.0

The information presented in figure 25 was based on the latest annual information from the companies. Based on the average of the peer group financial ratios (EV/Sales, EV/EBITDA and EV/EBIT), the value implied for Beam ranges between $ 54 and $ 62.6 which represents a discount of around $ 15- $20 to the WACC based valuation. The implicit value of Beam by this peer group analysis represents also that Beam is trading at a premium in the market with most of the past six months being traded at a price above $ 65.

Beam's premium relative to its relative valuation can indicate that the market is optimistic about the future of Beam which agrees with the WACC based valuation in which Beam's premium is warranted due its accelerating growth, exposure to brown spirits, favorable positions in key international markets and the fact that Beam is one of the few non-family influenced spirits pure-plays and has a solid presence in bourbon, which is a growing category.

4.1.2 Results and final considerations

According to the WACC approach Beam's share price has the potential to be worth approximately $ 76.7, while according to Beam's peer group analysis a value of no more than $ 62.6 should correctly price Beam's value per share. In relation to the WACC approach valuation presented in this paper, Beam's premium is reasonable given a series of factors that had to be incorporated in the valuation in the form of assumptions and expectations (it was mentioned already some of the factors such as Beam's great position in key markets and highly demanded American whisky – bourbon).

However, there are risks that may change the price estimated such as a US category slowdown, especially in Bourbon or Tequila, trade down or more aggressive promotions by peers, a consumption shift into other alcoholic beverage categories, macro/economic uncertainty given exposure to Europe and emerging markets. For that reason, it is presented a sensitivity analysis for a better comprehension of how sensitive the value obtained can be to certain variables:

Figure 26: Sensitivity analysis I

Assumptions		Terminal Growth Rate		
		2.5%	***3.0%***	*3.5%*
WACC	*6.9%*	77.5	87.2	99.8
	7.4%	69.0	**76.7**	86.3
	7.9%	61.3	67.4	74.9

Figure 26 illustrates how Beam's share price can diverge when different assumptions regarding the cost of capital and the terminal growth rate are applied. Using a range of 50 basis points up or down in both variables, the share price can be valued from $ 61.3 to as much as $ 99.8.

Figure 27: Sensitivity analysis II

Assumptions	NorthAmericasales growth		
	Underperform	***ForecastedScenario***	*Overperform*
	66.7	**76.7**	86.3

When accounting for possible growth rates in North America's sales (figure 27), the growth engine of Beam, the underperform case scenario (which supposes that this region is going to grow at a rate 6% inferior to that of the normal scenario) yields a value of $ 66.7 vs. a $ 86.3 value in the opposite case scenario (+6% than the normal scenario).

To conclude, according to the assumptions and the results presented, and taking into consideration that BEAM is a leading pure play spirits company, its key markets are the US, Australia, the EU and emerging markets representing 15 percent of sales, it is believed that Beam is in position to take advantage of growing consumer demand for spirits (particularly Bourbon) around the world. BEAM has taken action to raise productivity, streamline selling/distribution and increase support for marketing and new products. Therefore, the valuation presented tried to incorporate such facts. Further, the spirits industry is consolidating and BEAM could ultimately benefit from that.

4.2 Pernod Ricard Valuation

4.2.1 Key considerations and Value Drivers

Pernod Ricard's valuation closely followed the methodology used to value Beam and already described. Even though both companies have a lot in common and it has been useful to apply a similar approach regarding the way to forecast future indicators, Pernod has its specificities relative to Beam.

The main value drivers identified are in general similar to the ones identified for Beam, since they are common to the entire spirits industry. Emerging markets growth and premium spirits growth are the biggest engines for Pernod sales development, as well as for Beam, given their increased exposure to these meteoric markets and their more and more appreciated premium portfolios.

As noted, the valuation model for Pernod Ricard follows a very similar approach and methodology as the one used to value Beam. The model also starts with top line organic sales assumptions for the future, tying the sales forecasts to future costs of Revenue and SG&A, capital expenditures, depreciation expenses, and changes in working capital, thus forecasting all the components of FCFF. Similarly, top line forecasts are made according to its geographical allocation, which are however different from the allocation of Beam (Pernod revenues are forecasted separately for the Asia/Rest of world region, Americas, Europe excl. France and France), and then consolidated as total revenues, influencing from then on the forecasts of more bottom line items.

Revenues

Pernod Ricard sales landscape has been changing quite significantly over the past years. While in the financial year end of 2010, 32% of sales were generated in the Asia/Rest of the world (essentially Asia, because of China) region and 31% were generated in Europe (excl. France), in 2012, 39% of the sales were being generated in Asia in detriment of the sales generated in Europe which in 2012 represented less 5% of total sales than in 2010. Such changes represent a 20% increase on the weight of sales being generated in Asia, and a decrease of 15% in Europe excl. France (France also lost its weight on total sales by 11% and the Americas remained stable, with a small decrease of just 2%).

Figure 28: Pernod Ricard's total Revenues and proportions by regions

Revenues						
€ in millions, year end June	FY10	t. sales %	FY11	t. sales %	FY12	t. sales %
Asia/Rest of the world	2,273	32%	2,711	35%	3,165	39%
Americas	1,911	27%	2,068	27%	2,167	26%
Europeexcl. France	2,176	31%	2,114	28%	2,137	26%
France	721	10%	750	10%	746	9%
Revenues	***7,081***	*100%*	***7,643***	*100%*	***8,215***	*100%*

The method used to forecast total future sales was the same as in Beam's valuation thus relying on two different forecasts: (a) the evolution of the percentage of total sales in each region; and (b) the sales growth in the engine region, Asia, consequently yielding for the other regions, different rates of sales growth depending on the evolution of the percentage of total sales computed in first place.

Influencing the forecast on the evolution of the percentage of total sales for each region are the main trends that have been occurring over the past years as well as the drivers identified as shapers for the future growth in the different regions, such as the followings:

- Within big cap European beverages, Pernod Ricard is the most direct play on the rapid growth of international spirits in China, a strong play on broader emerging market growth as well as global premiumization trends;
- Growth of brown spirits in Asia, especially cognac and Scotch whisky;
- White liquor (vodka, run, gin) and wine remain underpenetrated in Asia;
- With more than 70% of brands premium or super-premium, premiumization provides mix and margin lift;

Factors like the ones just described lead to the assumption that the Asia/Rest of the World region will maintain its growth within the relative weight of its sales to total sales at the expense of the diminution of sales generated in Europe (excl. France). Thus, figure 29 sums up the evolution of the percentage of Pernod sales by region:

Figure 29: Pernod Ricard's percentage of total Revenues by region

Revenues						
% of total, year end June	**FY12**	FY13	FY14	FY15	FY16	FY17
Asia/Rest of the world	**39%**	42%	43%	44%	45%	46%
Americas	**26%**	26%	26%	26%	26%	26%
Europeexcl. France	**26%**	23%	23%	22%	21%	20%
France	**9%**	9%	9%	8%	8%	8%
Revenues	***100%***	*100%*	*100%*	*100%*	*100%*	*100%*

According to the model assumptions, the Asian region will increase its dominance of sales by 18% between 2012 and 2017 (vs. 20% between 2010 and 2012) while the Europe region (excl. France) will decline its weight in total sales by 22% (vs. -15% between 2010 and 2012).

Regarding the second separate forecast (growth of sales in Asia) the model takes into account historical information from Pernod Ricard's revenues, from the revenue in supplier gross value and premium spirits in the US (which presented a CAGR of 1%, and 11% respectively for the years between 2003 and 2012) and historical and projected rates of growth in the global spirits industry. The projected growth for the Asia region, as well as for the other three regions, is displayed in figure 30 below.

Figure 30: Pernod Ricard's revenues growth

Revenues (YOY % change)								
€ in millions, year end June	FY10	FY11	FY12	FY13E	FY14E	FY15E	FY16E	FY17E
Asia/Rest of the world	*12.3%*	*19.3%*	*16.7%*	*11.0%*	*9.5%*	*8.5%*	*7.5%*	*6.5%*
Americas	*-5.7%*	*8.2%*	*4.8%*	*3.0%*	*6.9%*	*6.0%*	*5.1%*	*4.2%*
Europeexcl. France	*-10.0%*	*-2.8%*	*1.1%*	*-7.9%*	*3.5%*	*2.5%*	*1.5%*	*0.4%*
France	*-1.9%*	*4.0%*	*-0.5%*	*0.1%*	*3.9%*	*2.9%*	*1.9%*	*0.9%*
Revenues	*-1.7%*	*7.9%*	*7.5%*	*3.0%*	*6.9%*	*6.0%*	*5.1%*	*4.2%*

Pernod Ricard's Asian growth engine is expected to slow down within the next years which corresponds to 2013 company's expectations, maintaining however its position of leading region, driving Pernod total sales.

Figure 31: Pernod Ricard's revenues

Revenues							**CAGR**	
€ in millions, year end June	**FY12**	FY13E	FY14E	FY15E	FY16E	FY17E	FY08/12	FY13E/17E
Asia/Rest of the world	3,165	3,513	3,847	4,174	4,487	4,779	12.1%	8.0%
Americas	2,167	2,232	2,386	2,529	2,658	2,769	6.3%	5.5%
Europe excl. France	2,137	1,968	2,037	2,087	2,117	2,127	-0.4%	2.0%
France	746	747	776	799	814	822	1.2%	2.4%
Revenues	***8,215***	***8,460***	***9,046***	***9,589***	***10,077***	***10,496***	***5.7%***	***5.5%***

Pernod management and most sell-side equity research analysts have stated their expectations of a new "normal" growth in Asia, based on the evolution of several of its products. Over the past 12 months, Pernod Ricard has stated that it expects cognac volumes to grow at mid-single-digit rates due to supply constraints. PR expects the new "normal" to be high-single digit to low-double-digit sales growth for some of its products like cognac and high-single-digit growth for scotch in the medium term, for instance.

As a result, and given the assumptions used, the model output a conservative growth of sales with a CAGR of 8% for sales in Asia between the explicit period (vs. a CAGR of 12.1% between 2008 and 2012). Altogether, revenues are expected to grow at a CAGR of 5.5% between 2013

and 2017 (vs. a 5.7% CAGR between 2008 and 2012). For comparison purposes, market consensus on Pernod Ricard total revenues in 2017 is € 10,423M (Bloomberg – 9th Aug. 2013) vs. € 10,496M forecasted, which represents a very small difference. On EBIT, market consensus is € 2,923M (Bloomberg – 9th Aug. 2013) vs. a forecasted EBIT of € 2,275M which represents a more conservative estimate of EBIT than the market.

Expenses, CAPEX, NWC and margins

As for Beam valuation, after forecasting revenues, the model goes on forecasting bottom line items recurring to their dependence on sales. Costs of revenues are expected to evolve according to sales, however, Selling, General and Administrative expenses (SG&A) are expected to rise slightly above sales reflecting the tendency of increasing expenses with marketing (based on company's expectations), thus decreasing the operating margin over time, as depicted in figure 32.

Figure 32: Pernod Ricard's operating margins

Operating Margin										
	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E	FY15E	FY16E	FY17E
Operating Margin	*23.1%*	*25.6%*	*25.4%*	*25.0%*	*25.7%*	*23.7%*	*23.2%*	*22.7%*	*22.2%*	*21.7%*

The tax rate was assumed to remain constant and consistent with the tax rate used to compute the cost of capital (23.5% - the effective tax rate verified in fiscal year of 2012). Both Capital expenditures (CAPEX) and Depreciation are forecasted exactly the same way as for Beam. Based on their historical values and weight relative to sales, and then computed for the future at the same decreasing rate given both items' close link and since there is no foreseeable event indicating an opposite course for any of these items.

In order to forecast Net Working Capital (NWC) it was projected, based on historical values, a series of metrics such as the number of days sales outstanding, days inventory held, the value of prepaid and other current assets as a % of sales (all these for forecasting Total Current Assets), the number of days payable outstanding, the value of short-term borrowings as a % of sales and the value of other current liabilities as a % of sales (now these, to forecast Total Current Liabilities). These metrics make sense since NWC is a measure of operating liquidity and should be directly linked to the company's level of activity.

Cost of Capital

Based on the knowledge described in the literature review chapter about how academics and practitioners usually compute the weighted average of the after-tax costs of the different

sources of capital, commonly referred to as WACC, Pernod Ricard's cost of capital was computed.

Figure 33: Pernod Ricard's WACC calculation

Pernod Ricard's WACC		
Risk-Free Rate (R_F)	1.7%	*(Bloomberg - 10 Year German Bunds, as of 6th August 2013)*
Expected Market Return (RM)	12.0%	*(Bloomberg R_M: CAC 40 Index as proxy, as of 6th August 2013)*
Market Risk Premium	10.3%	*(R_M- R_F)*
Raw Beta	0.65	*(Computed using monthly data for the past 3 years - August 2013)*
Equity Risk Premium	6.7%	*(Market Risk Premium * Raw Beta)*
Cost of Equity	**8.4%**	*(R_F + Equity Risk Premium)*
Interest Coverage Ratio	4.06	*(EBIT / Interest Expense)*
Rating (Damodaran)	A-	*(Damodaran online data – Appendix 7)*
Borrowing Premium (Spread)	1.7%	*(Damodaran online data, and the S&P rating BBB-)*
Tax rate	23.5%	*(Pernod Ricard Financial Statements - Effective tax rate in 2012)*
After-Tax Cost of debt	**2.6%**	*(R_F + Spread) * (1-Tax Rate)*
Enterprise Value (EV)	31,706.98	*(FY12, in Millions of EUR)*
Debt/EV	32.1%	*(D / EV)*
WACC	**6.5%**	*(D / EV) * After-Tax Cost of Debt + (1 - D / EV) * Cost of Equity*

Pernod Ricard's cost of capital is substantially lower than Beam's (Pernod = 6.5% vs. Beam = 7.4%). This difference is due mainly to a slightly lower cost of equity given the ability of Pernod to fund itself in the European market, and thus taking advantage of the historical low rates that are usually used as a proxy for the risk free. However, the main different resides on the after-tax cost of debt (2.6% in Pernod vs. 3.2% in Beam) due to differences on the tax rate and on the risk-free rate.

Concerning the capital structure, Pernod Ricard has been deleveraging its Balance Sheet ever since its debt level highly increased with the acquisition of V&S in 2008. As of year end 2012, the ratio of the market value of Debt in relation to its total enterprise value was 32% and even though it is been decreasing it is not expected to significantly decrease much further given it is already close to its historical and industry levels. As such, the model will consider this target debt to enterprise value of 32.1% and given the arguments presented and that there is no expectation of significant financial maneuvers that could be better captured recurring to an APV based approach, the only DCF methodology used will be the WACC based approach. The rate at which the WACC, under the assumptions just mentioned and described in figure 24, will discount the projected free cash-flows is 6.5%, and it is assumed a long term sustainable growth rate of 3%, which is a conservative estimate given the average expectations of IMF's forecasted world economy real growth for 2013-2018 (4.1%) and the forecasted global spirits growth by volume for the 1st half of the 2010's of 2.5%/3%.

In face of what was described above regarding the methodology used and the assumptions undertaken, Pernod Ricard's total enterprise value is valued at € 40,932M, which implies an equity value of € 31,375M, corresponding to approximately € 119.1 a share (appendix 9). The target price of Pernod Ricard's by market analysts is € 97.23 (Bloomberg – consensus mean as 9th Aug. 2013).

Relative valuation

The peer group selected to value Pernod Ricard based on its peer's financial indicators had to respect some restrictions in order to provide an accurate comparison. Hence, the companies chosen had to operate exclusively within the alcoholic beverage industry, without exception. Pernod Ricard main peers however can have very different values of market capitalizations given the very different markets in which they operate (for instance, United Spirits operates in India) thus the market capitalization was not an exclusive factor, although it was indicative. The main criteria used to choose the peer group was definitely the fact of whether the companies operate in the alcoholic beverage industry or not (in particular, spirits industry and/or big players in beer/wine products), which given the fact that this is such a concentrated market limits many of the possibilities. Figure 34 demonstrates the multiples analysis.

Figure 34: Peer group and relative valuation

Multiples Valuation				
Company	**Market Cap.**	**EV/Sales**	**EV/EBITDA**	**EV/EBIT**
Anheuser-Busch InBev SA/NV (ENXTBR:ABI)	117,386.8	4.1	13.8	16.2
Brown-Forman Corporation (NYSE:BF.B)	14,321.0	5.3	15.9	16.8
Diageo plc (LSE:DGE)	58,528.8	5.2	14.6	15.9
Heineken NV (ENXTAM:HEIA)	29,756.2	2.3	11.0	17.0
United Spirits Limited (BSE:532432)	5,207.9	4.6	27.5	19.3
Beam, Inc. (NYSE:BEAM)	12,304.7	5.0	16.5	19.3
Reckitt Benckiser Group plc (LSE:RB.)	37,546.6	3.5	13.6	14.5
RémyCointreau SA (ENXTPA:RCO)	3,890.6	3.5	16.9	18.1
SABMiller plc (LSE:SAB)	58,276.6	5.3	13.7	17.1
Constellation Brands Inc. (NYSE:STZ)	10,229.8	5.3	16.1	18.4
Average	**34,744.9**	**4.4**	**16.0**	**17.3**
Pernod-Ricard SA (ENXTPA:RI)	22,954.2	3.7	13.3	14.4
Company Name		***Total Revenue***	***EBITDA***	***EBIT***
Pernod-Ricard SA (ENXTPA:RI)		8,575.0	2,402.0	2,230.0
Implied Enterprise Value		37,790.0	38,335.9	38,496.5
+ Total Cash & ST Investments		620.0	620.0	620.0
- Total Debt		9,521.0	9,521.0	9,521.0
- Minority Interest		168.0	168.0	168.0
Implied Equity Value		28,721.0	29,266.9	29,427.5
Shares Outstanding		264	264	264
Implied Price per Share		109.0	111.1	111.7

The information presented in figure 34 was based on the latest annual information from the companies. Based on the average of the peer group financial ratios (EV/Sales, EV/EBITDA and EV/EBIT), the value implied for Pernod Ricard ranges between € 109 and € 111.7 which represents a discount of around € 8 - € 10 to the WACC based valuation. The implicit value of Pernod Ricard by this peer group analysis represents that Pernod is trading at a discount in the market with its 52 week high being only € 101.2, denoting some undervaluation and/or concerns by the market participants.

4.2.2 Results and Final Considerations

According to the WACC approach Pernod Ricard's share price has the potential to be worth approximately € 119.1, similarly with the peer group analysis which value Pernod in between € 109 and € 111. Pernod's valuation premium is due to its leading positions in the top3 regional markets of China, India and Travel Retail, premiumization, acceleration of growth in categories such as vodka, malt, champagne and wine, expansion to new territories through higher share as well as geographic expansion and effective marketing.

Nonetheless there are several factors able of impacting the future of Pernod value, some positive, some negative. On the upside, Pernod's value can benefit from a faster than expected recovery in demand in China and a more robust pricing in the U.S. On the other hand, a further deterioration in demand in some regions of western Europe, a further slowdown in emerging markets growth, any further pressure on cash flow and further EUR weakness can negatively impact Pernod's value. For that reason, it is presented a sensitivity analysis for a better comprehension of how sensitive the value obtained can be to certain variables:

Figure 35: Sensitivity analysis I

Assumptions		Terminal Growth Rate		
		2.5%	***3.0%***	*3.5%*
WACC	*6.0%*	123.2	145.9	177.7
	6.5%	102.7	**119.1**	140.8
	7.0%	89.3	102.0	118.4

Figure 35 illustrates how Beam's share price can diverge when different assumptions regarding the cost of capital and the terminal growth rate are applied. Using a range of 50 basis points up or down in both variables, the share price can be valued from € 89.3 to as much as € 177.7.

Figure 36: Sensitivity analysis I

Assumptions	Asia (& Rest of world)sales growth		
	Underperform	***Forecasted Scenario***	*Overperform*
	98.9	**119.1**	139.8

When accounting for possible growth rates in Asia's sales (figure 36), the growth engine of Pernod Ricard, the underperform case scenario (which supposes that this region is going to grow at a rate 6% inferior to that of the normal scenario) yields a value of € 98.9 vs. a € 139.8 value in the opposite case scenario (+6% than the normal scenario).

Both Beam and Pernod Ricard valuations were performed resorting to straightforward assumptions based on each company's public information, managements public expectations, real market data, equity research analysts' studies and industry insights. Beam's value under the WACC based approach is of $ 76.7 per share (vs. market consensus of $ 69.85), while its peer group analysis indicates a value slightly lower of around $ 60 per share. Pernod Ricard valuation under the WACC approach is more congruent with its multiples valuation with a value per share of € 119.1 and around € 111 for each respective valuation method (vs. market consensus of € 97.23).

The methods used only try to model how the current public information influences the value of these companies, and given that it resorts only to public information, accurate estimates had to remain simple and verifiable. To counteract such limitations, it was provided a complementary sensitivity analysis to better understand how these firms' values can change posed with different inputs.

5. The Merger

This chapter is devoted to the detailed study of how the proposed merger between Pernod Ricard and Beam could develop, be valued and create value. Previous chapters have defined synergies as the additional value produced by two combining firms that together create opportunities that would not otherwise been created. This section will enlighten what these opportunities can be for the two companies under analysis and what value could outcome from the proposed deal for the shareholders of both firms. However, the way the deal is structured both at a strategic and financial level will impact the ultimate value creation that can arise from such deal. For that reason, the structure and mechanics of the deal will be closely analyzed in order to understand how the value of this deal can be created and maximized given the knowledge about the stylized facts on M&A deals previously described in the literature review chapter.

5.1 The Merged Entity

As Damodaran (2005) argues, it is important to keep the value of the synergies apart from the value of control when valuing the synergies. According to the author, after valuing the firms involved in the merger independently, one should then value the combined firm with no synergies, and only then value the combined firm with synergies.

5.1.1 Consolidation and cross border issues

The purpose of valuing the merged entity without considering any synergies is to make sure that the new valuation model is based on the same structural assumptions considered when valuing the firms separately, thus inferring that both companies value when added together should yield the same value of the merged entities without considering the potential synergies.

However, this approach is not exactly suitable for the type of merger under study, which is a cross border merger with both firms' headquarters operating in different countries. What this implies is that both firms' costs of capital are substantially different, considering a WACC based approach, when it comes to the inputs and assumptions used. For this reason, and in this case, when computing a new cost of capital with assumptions that seem reasonable for the new entity, one is automatically computing a WACC that may deliver a different value for the combined firm than the sum of both separate firms, even if the rest of the valuation model is based on the same structural assumptions. So, in this case, the WACC that yields a value for

the merged entity equal to the sum of the separate values of both companies would be different in its essence from the WACC that can be computed with more reasonable assumptions which yields a slightly different value for the merged entity than the sum of both firms' separate values.

As just mentioned, the computation of a new WACC for the merged entity, all else remaining equal regarding the forecasts of all the other financial statements' items, can yield a different value for the new company when compared to the assumed value without synergies (sum of both standalone valuations). However, the computation of the new cost of capital resorts to simple and realistic assumptions and it follows the same technique used to compute the separate WACCs.

Figure 37: After consolidation cost of capital

After - Merger WACC		
Risk-Free Rate (R_F)	1.7%	*(Bloomberg - 10 Year German Gvt Bonds, as of 6th August 2013)*
Expected Market Return (RM)	12.0%	*(Bloomberg R_M: CAC 40 Index as proxy, as of 6th August 2013)*
Market Risk Premium	10.3%	*(R_M- R_F)*
Raw Beta	0.68	*(Weighted average by EV of both companies Betas)*
Equity Risk Premium	7.1%	*(Market Risk Premium * Raw Beta)*
Cost of Equity	**8.8%**	*(R_F + Equity Risk Premium)*
Interest Coverage Ratio	4.27	*(EBIT / Interest Expense)*
Rating (Damodaran)	A-	*(Damodaran online data)*
Borrowing Premium (Spread)	1.3%	*(Damodaran online data)*
Tax rate	23.5%	*(Pernod Ricard Effective tax rate in 2012)*
After-Tax Cost of debt	**2.3%**	*(R_F + Spread) * (1-Tax Rate)*
Enterprise Value (EV)	40,741.25	*(Bloomberg - as of FY12)*
Target Debt/EV	32.9%	*(D/EV)*
WACC	**6.6%**	*(D / EV) * After-Tax Cost of Debt + (1 - D / EV) * Cost of Equity*

Figure 37 describes step-by-step the sources and rationales behind the values used to compute the new WACC. Regarding the cost of equity, the only difference from the post-merger WACC to the acquiring firm (Pernod) WACC is the beta, since Beam's correlation with the market needs to be taken into account when computing the overall new company's correlation with the market. For that, it was computed the weighted average by enterprise value of both companies' betas, yielding a slightly higher beta than Pernod's beta, thus explaining the increased cost of equity after the two companies merge. The after-tax cost of debt however, slightly decreased given Beam's better financial flexibility which improves the overall rating of the total debt, thus lowering the spread paid when compare to Pernod alone. Overall, the new cost of capital is 6.6% (vs. Pernod Ricard's WACC of 6.5% and Beam's WACC of 7.4%).

Therefore, and given that the difference in the computed enterprise value between the combined firm (€ 51,919M) and the sum of both companies (€ 51,880M) is only € 38M (which

represents 0.07% of the total enterprise value of the combined firm), it will be assumed that the consolidated company's value is the one computed with the new WACC, thus the EV of the combined firm of € 51,919M will be the EV assumed for the rest of the analysis on the merger between both companies.

An additional matter regarding the specifics of a cross border deal has to do with the consolidation of the two companies, valued and forecasted at different exchange rates. In order for an accurate estimation of the consolidated items that constitute the merged entity, Beam's financial statements need to be converted into the acquirer's home currency, the euro. Frood & Kester (1995) provide an insightful study on cross border valuation, and according to the authors, one of the approaches that can be used in a situation like this involves the conversion of the items from the foreign currency to the home currency at the expected future exchange rates. The paper's authors claim that this method can be particularly useful if the foreign currency is sensitive to exchange rates. To choose a different approach would imply an assumption that the exchange rate would not fluctuate throughout the explicit period, which does not seem like a realistic assumption for the USD/EUR exchange rate when forecasting five years of financial statement items.

On an additional note, when consolidating revenues, the segmentation considered was the one used by Pernod Ricard: Asia/Rest of World, Americas, Europe excl. France and France. Thus, Beam's revenues in North America add to Pernod's revenues of Americas, the EMEA region revenues sum to the Europe excl. France revenues, and the APSA region add to Pernod's revenues of Asia/Rest of World.

Thus, Beam's financial statements as well as the items forecasted were converted from US Dollars to Euros, using final year historical rates for past years' information and the forward exchange rates for the explicit period forecasts:

Figure 38: Forecasted exchange rates

Forward exchange rates USD/EUR as of 1st Sept. 2013 (Bloomberg)								
	FY10	FY11	FY12	FY13E	FY14E	FY15E	FY16E	FY17E
$/€	*1.3362*	*1.2939*	*1.3194*	*1.3196*	*1.3219*	*1.3296*	*1.3432*	*1.3600*

The entire valuation of Beam was then computed in Euros yielding an enterprise value of € 10,948M.

All considered, it will be recognized the value of the merged entity without synergies as the value of the consolidated company discounted at the new WACC (EV = € 51,919M) in detriment of the sum of both Beam and Pernod Ricard standalone valuations previously

computed (in which Beam EV in € = 10,948M + Pernod Ricard EV in € = 40,932M = Total EV = € 51,880M).

5.1.2 Synergies analysis

An agreement to combine both Beam and Pernod Ricard has the potential to create innumerous valuable opportunities that do not exist with these companies operating separately. Such opportunities however need to be cautiously assessed as it was demonstrated in the literature review how "foggy" this assessment can be. The following sub-section will closely analyze the different types of synergies that can be created from different sources such as operating and financial synergies.

Operating synergies

Operating synergies, as the name suggests, refer to those opportunities that can arise at an operational level with the potential to increase the operating income and/or its growth. As such, possible operational synergies can arise from generally two operating sources: operating revenues and, operating costs. It is widely regarded that cost synergies are usually more prone to be realistically estimated as they are concerned with internal issues and less dependent on the market's and competitors' response, as it is the case with synergies originated at the revenue side.

Besides synergies at the top line items, there are also potential opportunities that can be generated at the working capital and capital expenditures level which can be considered as synergies or directly influence the creation of synergies at operating levels.

Revenue synergies

As just mentioned, identifying and valuing revenue synergies is a task subject to more bias and subjectivity than performing it on cost synergies given the revenue dependency on external factors difficult to predict in a reliable way. With this in mind, Sirower & Sahni (2006) argue that a 100 day period past the consolidation should pass in order for the deferred revenue synergies that can outcome from the merger can be noticed.

By taking a conservative approach when trying to identify potential synergies one can recognize however that a merger between Beam and Pernod Ricard would possibly create opportunities in its top line items through the reduced competition and higher market shares expected after the consolidation process. For instance, within the U.S. market a merger between Beam and Pernod would give place to a 19% market share for the new company

(getting close to Diageo's market share of 26%) instead of the 10% market share for Beam and 8% share for Pernod while operating separately (appendix 4 and 5).

A KPMG study which surveyed 101 CEO's and other top executives in the food and beverage industry in 2011 revealed important findings regarding top management expectations and beliefs on the future of their businesses. Amid various curious results, one of them pops out as noteworthy for the study of Beam and Pernod Ricard merger synergies' analysis: 72% of the surveyed managers recognized their company's databases and information on its customers as one of the core components of growth drive, as it allows companies to gain a competitive edge, adapt to changes in consumer behavior, and interface with customers. This can be a major opportunity for a joint between Beam and Pernod, as these companies would be able to merge their customer's databases therefore accessing new clients and better adapting to their consumer behaviors with a more complete portfolio of spirits' brands able to suit more preferences.

Moreover, Pernod Ricard acquired Vin & Sprit (V&S) in 2008, owner of the Absolut brand, in a merger similar in a variety of aspects, though with a slightly smaller dimension, to the one being studied in this paper. Some inferences can be made from such deal in order to understand how this merger can create value. The acquisition of V&S in 2008 was able to mainly prove that Pernod Ricard definitely had the clout, especially in terms of distribution, to move Absolut on to the next level. Total expected synergies derived from both cost reduction and integration of distribution margin estimated between €125m and €150m and the full extraction of synergies was expected over 2 to 4 years.

To conclude, revenue synergies can definitely be difficult to distinguish and value, however, this chapter showed how it is possible to create opportunities that otherwise would not be created at revenue levels. Taking this into consideration, and mainly based on the increase in market share of the new company as well as the potential to cross databases on customers information allowing for a better tailored approach, it should be concluded that there are possible synergies occurring from a merger between Beam and Pernod Ricard. Nonetheless, there is no appropriate method to quantify such synergies, for which assumptions will need to be made:

- Revenue synergies will only be effective after 2013
- The increase in revenues due to synergies will be computed based on the maximum year on year growth between Pernod Ricard revenues, by each segment (region), and the year on year growth of the consolidated company revenues also by each segment.

What this means is that the year on year growth rate of revenues by segment of the new company with synergies will be the maximum between the year on year growth rate of Pernod Ricard and the consolidated company without synergies, after 2013. Figure 39 illustrates how the new growth rates, reflecting synergies, were computed.

Figure 39: Forecasted YOY% change in revenues

Pernod Ricard YOY % change					
	FY13E	FY14E	FY15E	FY16E	FY17E
Asia/Rest of the world	*11.0%*	*9.5%*	*8.5%*	*7.5%*	*6.5%*
Americas	*3.0%*	*6.9%*	*6.0%*	*5.1%*	*4.2%*
Europe excl. France	*-7.9%*	*3.5%*	*2.5%*	*1.5%*	*0.4%*
France	*0.1%*	*3.9%*	*2.9%*	*1.9%*	*0.9%*

Consolidated Company without synergies YOY % change					
	FY13E	FY14E	FY15E	FY16E	FY17E
Asia/Rest of the world	*10.3%*	*9.3%*	*8.3%*	*7.3%*	*6.4%*
Americas	*5.0%*	*7.1%*	*6.1%*	*5.2%*	*4.3%*
Europe excl. France	*-6.3%*	*3.3%*	*2.3%*	*1.3%*	*0.3%*
France	*0.1%*	*3.9%*	*2.9%*	*1.9%*	*0.9%*

Consolidated Company with synergies YOY % change					
	FY13E	FY14E	FY15E	FY16E	FY17E
Asia/Rest of the world	*10.3%*	*9.5%*	*8.5%*	*7.5%*	*6.5%*
Americas	*5.0%*	*7.1%*	*6.1%*	*6.2%*	*5.3%*
Europe excl. France	*-6.3%*	*3.5%*	*2.5%*	*1.5%*	*0.4%*
France	*0.1%*	*3.9%*	*2.9%*	*1.9%*	*0.9%*

The growth rates pointed out in red in the third table are the rates that have changed from the "without synergies" scenario to the "synergies" scenario. The rationale of such assumptions is basically the joint of the best of both worlds, due to, as mentioned, the ability for the two companies to expand their market share and access each other customers' databases with potential useful information. Most importantly however is the ability for Pernod Ricard to take Beam brands (in particular its premium bourbon Jim Beam) to the next level in terms of distribution and consequently increase its position and growth rates in the markets where Beam is not so well positioned, like Europe and Asia. Thus, it seems reasonable to assume that the post-merger company would not grow at an inferior rate than would Pernod Ricard do by itself in any of the regions.

The two growth rates pointed out in green refer to the assumption, based on an increased market share by Pernod portfolio in the U.S. market after some years of consolidation due to the already mentioned expanded market share and resources to better tailor Beam's customers. Such assumptions yield that revenue synergies will be 80% due to the increased

ability of Pernod to distribute Beam's premium brands and 20% to an increased potential for both brands together to growth in the U.S. market.

Cost synergies

Cost synergies as opposed to revenue synergies are in theory easier to implement, identify and value. It is a reasonable argument since many of the costs are dependent mainly on internal issues that can be controlled. Synergies stemmed from cost reductions are the most common type of synergies, and as described above, the acquisition of V&S by Pernod had expected synergies deriving from both cost reduction and integration of distribution margin estimated between €125m and €150m on annual basis for 2 to 4 years. Approximately 40% of total synergies derived from "distribution" synergies (integration of downstream margin, reduction of logistics and production costs, optimization of A&P spend…) while 60% were mainly generated by "structure cost" synergies (procurement, overheads, commissions…).

As seen, a merger between Beam and Pernod Ricard should generate several opportunities to reduce costs at a consolidated basis, in particular since this is a horizontal merger. Lower production costs and higher bargaining power with the suppliers are able to reduce **costs of revenues**. Unfortunately, none of the companies disclose detailed information regarding their costs of revenues for which the entire line item will have to be addressed as a whole. Given this limitation, it is somewhat difficult to quantify exactly where the synergies may come from, if from logistics cost reductions and/or from distribution cost reductions. In order to try to compute the impact on cost reduction of a merger with Beam, the cost of revenues were decomposed by region. It will be assumed the same distribution than on the V&S deal, with 40% of total synergies on cost of revenues coming from distribution synergies and 60% from all the other structure costs. Furthermore, Pernod Ricard's costs of revenues in the Americas region in the past three years has been accounting for around 25% of the total costs of revenues. It is expected that the main cost reduction opportunities that can arise from a merger between Pernod Ricard and Beam are due to the increased access and distribution network that Beam can offer to Pernod, similarly to what happen with the V&S acquisition in 2008, which allowed Pernod to benefit from V&S penetration in the US market and its distribution agreements. Based on past similar deals (appendix 6), like the one between Pernod and V&S, it should be expected a reduction of 2% on the U.S. costs of revenues (thus 0.5% on total costs of revenues, assuming that 25% of the total cost of revenues will continue to be originated essentially in the Americas region).

No enterprise cost reduction is complete without some consideration of **selling, general and administrative** (SG&A) expenses since SG&A touches every part of a company. It is common in a merger to benefit from some opportunities that would not otherwise been possible without the combination of both firms such as: (a) reassigning staff, (b) lowering indirect expenses, such as procurement and travel, companywide, (c) creating a flexible cost structure. However, based on Pernod Ricard past approaches regarding deals like the one being studied, it should not be expected a great reduction regarding costs with staff as Pernod organizational structure should not be significantly affected by this deal. Nonetheless, marketing expenses, for instance, are one of the main investments undertaken by Pernod Ricard and it is even expected to increase at a rate higher than sales in the foreseen years. As such, with the alliance with Beam for which SG&A is expected to increase at a rate lower than sales, it can be inferred that both effects neutralize each other, thus yielding a new expectation that the combined firm will manage its SG&A in a way that allows to capture both firms' expectations. Since Pernod Ricard's SG&A are supposed to increase above sales due to its high costs in marketing, and considering that Beam's SG&A are supposed to increase below sales, it can be assumed that both firms together will manage their marketing expenses in a way that when together SG&A expenses can increase at the same level than sales.

Capital expenditure synergies are not expected to be relevant given the industry and type of business in which these companies operate which do not requires extensive investment in fixed assets. Also, historical deals in this industry such as the Pernod Ricard and Vin & Sprit acquisition, the Beam acquisition of Cooley Distillery, Diageo's acquisition of Mey Içki have all proven that synergies in this industry are more relevant and probable when outcoming from distribution cost savings and SG&A expenses' reductions.

Financial synergies

Financial synergies, as opposed to the operating synergies, refer to the opportunities that can arise due to the different financial strengths in a consolidation process. Financial synergies include tax benefits, diversification, higher debt capacity and uses for excess cash (higher expected cash flows and/or lower discount rates).

Tax benefits do not seem like a potential opportunity for these companies to look for since both of them have operational gains thus stopping any future tax deductions that could occur from this merger (this is often a cited rationale by managers to engage in a M&A deal). It is also not likely that both companies together can have any special opportunity in tax benefits from an increasing depreciation which could reduce tax payments, as well as an increasing

debt capacity, since both companies' management have stressed their intention in remaining financial flexibility, in particular Pernod Ricard which has been incurring in great efforts to deleverage its balance sheet after financing Vin & Sprit acquisition solely with debt in 2008.

Integration and Restructuring Costs

M&A deals besides providing with new opportunities, also come with a cost due to the necessity for the integration of both companies as well as all restructuring costs that may arise for the synergies to play effect. These costs need to be deducted to the synergies value in order for a reliable analysis on the value of a merger or acquisition.

M&A costs start at the very first step of the deal with all the legal costs (lawyers and taxes in some cases), consultancy fees for due diligences and investment banks payments to assess the deal. After the initial integration costs, in order to better exploit synergies many changes may have to be undertaken at a structure level which of course comes at a cost.

In the case of Beam merger into Pernod Ricard, because it is a horizontal merger, considering the synergies identified in this analysis and since there won't be the need for building a new company (from the strategic point of view of the deal, which will be discussed further on in this paper, Beam will integrate Pernod Ricard organizational structure), some of the mentioned costs won't have much weight on this deal. One of the biggest costs that may arise in a Pernod Beam merger will have to do with its distribution contract agreements.

Even though, as an outside analyst, there is not the possibility to have inside information regarding both companies distribution agreements, it may be reasonable to assume that there may be some distribution contracts that are currently in use, to end, in order for new agreements to be arranged. This assumption has also an historical basis, since many M&A deal within the spirits industry have been mentioned to have expected penalty fees to exit some distribution deals. Most notably, one of the successes of Pernod Ricard deal with V&S was the lower than expected penalty fees to exit some of the V&S distribution deals, besides higher than expected synergies. At the time of the deal V&S had a distribution agreement with Maxxium for most major markets outside of the US, for which Pernod Ricard paid to Maxxium a $ 86M fee to anticipate the end of the agreement with V&S in order for Pernod to take over the distribution of Absolut in most markets outside the U.S. immediately and with no associated costs. This enabled Pernod Ricard to implement cost synergies sooner than originally expected and thereby leverage the portfolio synergies in these markets through an accelerated integration of Absolut within Pernod Ricard.

According to Pernod Ricard information the penalty paid to Maxxium represented about 60% of the total costs of the merger, and assuming that the costs between Pernod Ricard and Beam could be around 20% higher (to reflect the bigger size of Beam deal, also around 20%), it will be assumed that the integration and restructuring costs should be around € 130M ($ 86M in EUR should be in 2012 about € 65M, which after computing the total proportion and increase of 20%, yields a value in EUR of 130M) and should be 100% allocated in year 2013 to SG&A expenses.

5.1.3 Synergies valuation

The synergies analysis just provided analyzed how opportunities could be created from a merger between Beam and Pernod Ricard and how these could be quantified based on historical, public, and common sense information. The next analysis studies how the identified synergies can be incorporated in the valuation model of the consolidated companies, and what is the new value of the combined firms with synergies, and from the differential one can infer the value synergies can attain.

It will be offered an analysis on how these synergies are created by incorporating within the valuation model the assumed synergies one by one, and assessing each independent contribution to the overall new value of the company.

Overall, the total value of the consolidation of Beam within Pernod Ricard amounts to € 51,919M without synergies (appendix 10), as already stated, and to € 55,275M with all the estimated synergies considered and without restructuring costs (appendix 11). With restructuring costs the value lowers to € 55,176M, thus valuing net synergies at a total value of € 3,257M. Figure 40 illustrates how synergies are allocated to each of its sources and what is the impact on the EV of the consolidated company.

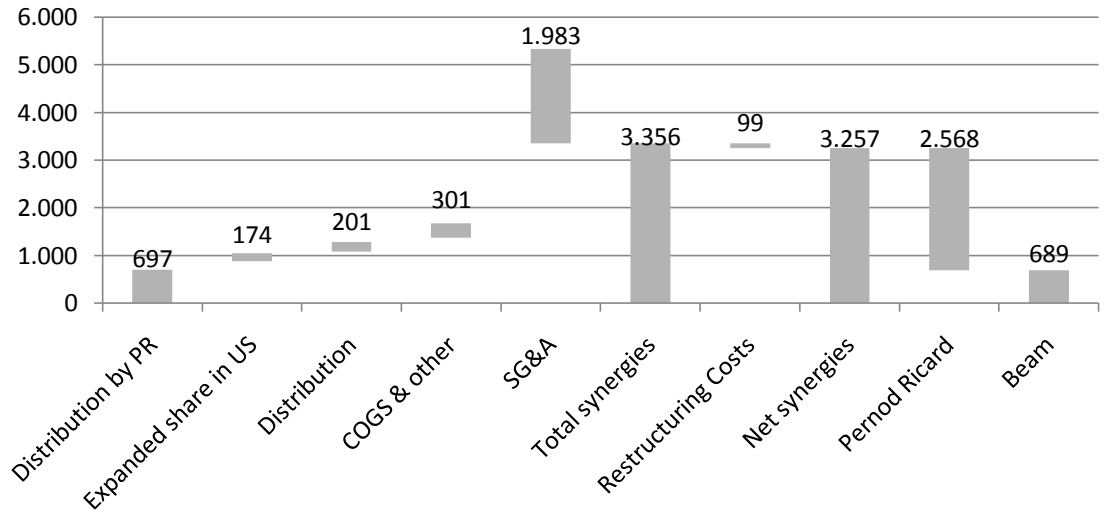
Figure 40: Synergies estimates

Synergies Value			
€ in millions	**Value of Synergy**	**EV with Synergy**	**% total synergies**
Revenue Synergies	**872**	**52,790**	***26%***
Distribution by Pernod Ricard	697	52,616	*21%*
Expanded market share in US	174	52,093	*5%*
Cost Synergies	**2,485**	**54,403**	**74%**
Distribution	201	52,119	*6%*
COGS & other	301	52,220	*9%*
SG&A	1,983	53,902	*59%*
Total Synergies	**3,356**	**55,275**	***100%***
Distribution Restructuring Costs	99		
Total Net Synergies	**3,257**	**55,176**	

Coherently with the literature on M&A, it is expected that almost three quarters of the synergies are due to cost savings, while only one quarter from revenues. Even though it was not possible to further segment the SG&A expenses line item, whose expected synergies represent 59% of the total synergies, it should be noted that most of these savings should outcome from an higher efficiency at internal operations and particularly from a reduction in marketing and publicity expenses since such expenses represent one of the biggest investments these companies undertake so the potential savings are accordingly higher.

Distribution however is the secret for a great M&A deal within the spirits industry. Notice in figure 40 how distribution shows up three times both in revenue synergies and cost synergies and as well as a restructuring cost. In fact, distribution plays a crucial role for companies like Beam and Pernod who produce and sell wholesale since it directly affects all of its business components. As such, in an M&A deal between companies in the spirits industry one should understand that new distribution agreements can lead to the creation of synergies due to higher revenues allowed by new distribution of its products in new markets, lower costs of distribution due to higher bargaining power next to the distributors and economies of scale, and finally costs of breaking up with existing distribution agreements. Figure 41 illustrates the components of synergies as well as is distribution according to its source as well as the separate entity gainer of such synergies.

Figure 41: Synergies distribution



It is assumed that each company's individual contribution to each synergy determines how synergies will be split between the two companies in order to reflect the unique strengths that each of the companies brings to the merger. Synergies of a general nature are divided according to the weight of each company's enterprise value on the merged enterprise value.

As such, revenue synergies that may be created by the better distribution of Pernod Ricard's network for Beam's products will be allocated to Pernod, while the "Expanded share in US" synergies are allocated to Beam. Altogether, Beam's allocated synergies represent 21% of the value of net synergies, while Pernod is awarded with 79% of the total net synergies.

5.2 Aspects of the deal

The following, and final, section of this dissertation will focus on the strategic and structural part of the deal. After proposing a merger between Pernod Ricard and Beam, and been conducting its entire analysis oriented to the final goal of merging both companies, this is now the time to closely study the ultimate step of the deal.

Resorting to the distinctions already presented in the literature review section, the deal between Pernod and Beam will be classified attending to its characteristics, its singularities to shareholders, its process of acquisition, in short words: the deal's "modus operandis" will be reviewed.

5.2.1 Deal's rationale

As the spirits industry continues to consolidate, with more than 40 deals taking place in the past 14 years, the spirits industry has a constantly changing landscape. The major players today have to focus as much as in organic growth as in inorganic growth, and to miss an opportunity can have them left behind.

Throughout the analysis and valuation of Pernod Ricard it was stated how Pernod expects a new "normal" growth in its key market (Asia) at high-single digit to low-double digit growth rates. Beam on the other hand, is a much more flexible company and its accelerating growth, exposure to brown spirits, favorable positions in key international markets and the fact that Beam is one of the few non-family influenced spirits pure-plays and has a solid presence in bourbon, which is a growing category, have ringed some bells on the market with rumors starting to arise on whether Beam could be acquired by one of the bigger players out in the market.

This paper identifies only two probable candidates to acquire Beam at the present date (mid 2013): Pernod Ricard and Diageo. These are the only two players with enough history, size and market position to both have a chance of acquiring Beam as to create value from such an operation. Diageo however has other major deals on hands (acquiring a large position in United Spirits and long run negotiations to purchase Jose Cuervo Tequila). Meanwhile, Pernod has more incentives than Diageo to acquire Beam as bourbon sales outpace vodka in the U.S.,

which is Pernod's biggest source of income in the U.S. (Absolut brand). Diageo remains the leader of the U.S. spirits market, a position it will continue to enjoy until another player gains sufficient scale to compete on equal terms. Beam could potentially be the vehicle through which Pernod can achieve this.

5.2.2 Characteristics of the merger

Type of Deal

According to the types of deals studied in the literature review chapter, it will be considered that the more reasonable scenario for a deal between Pernod Ricard and Beam would contemplate a board of directors' agreement to merge and then seek stockholder approval for the combination. This is considered the typical merger scenario which requires at least 50% of the shareholders of the target and bidding firm to agree and leads to the full integration of the target firm within the acquiring firm. A tender offer scenario where Pernod would announce its intention to buy Beam's outstanding stock at a specific price, thus bypassing the management and board of directors could also be possible, although not likely, since from a practical standpoint the outcome of the tender offer would end up being the same as the merger, if the acquiring firm would succeed in gaining control of the target firm, but would turn out to be much more expensive. Thus, if Pernod and Beam boards' of directors could not agree on a merger, Pernod probably would not consider a tender offer at the present time, but wait on a changing of conditions.

Fair price and premium offered

Assuming a merger scenario, the acquisition price is the price that will be paid by the acquiring firm for each of the target firm's shares after eventual stockholder approval. As mentioned, Beam is one of the only non family influence spirits players, for which stockholder approval should not be overly difficult under a normal scenario in which the price seems reasonable.

With that in mind, over the last year, the target firm's (Beam) average market capitalization was, in Euros, € 7,455M. However, the theoretical value computed in the valuation chapter concluded that Beam's equity can worth € 8,809M, which represents an 18% upside potential in relation to its last year's average. Adding the premium for the synergies that should be imputed to Beam (€ 689M) and the effective offering price should be close to € 9,498M, which yields a € 59.33 per share (which according to the 2013 average USD/EUR yields something like $ 78.29 per share). The difference between the acquisition price and the market price prior to the acquisition is called the acquisition premium which, at an assumed announcement date at the 1st of August of 2013 (market price = $ 65.58/share), is around 19%.

Financing

The financing of the deal has to be carefully analyzed given its influence on the outcome of the deal. Beam's market values (52 week average $ 61.1/share) are underpriced relative to the WACC approach valuation circa 10% ($ 76.7), underpriced compared to analysts' consensus (around $ 69.9), and only in line with its peer group valuation. If the DCF valuation presented in this paper as well as the analysts' valuations are correctly valuing Beam, then this should be a good timing for Pernod Ricard to make a move on Beam, as the company is trading at a discount.

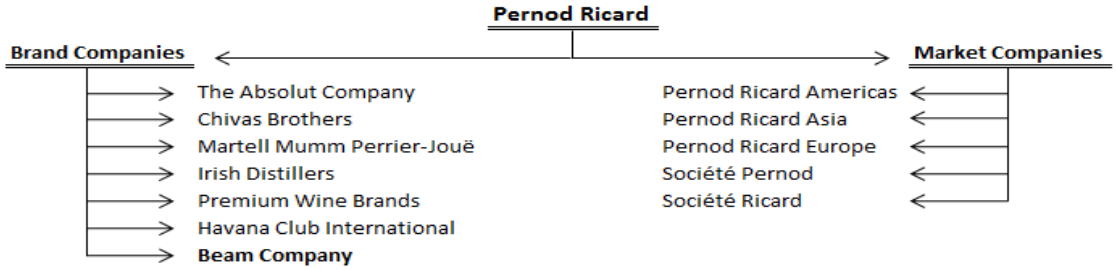
On the other hand, Pernod Ricard also seems to be trading at a discount. According to the DCF valuation, Pernod's shares are worth € 119.1 each. Similarly, the peer group valuation carried also indicates a fair value of around € 111, while analysts' forecast a more conservative share value of € 97.2. Nonetheless, the highest value in the past 52 weeks was only € 101.2, and the lowest was € 82.31. The fact that also Pernod Ricard may be trading at a discount to its fair value indicates that this is probably a bad timing to issue equity, which would cause Pernod to avoid financing such deal with stock. Also, stylized facts on M&A, according to Sirower & Sahni (2006) have proved that cash deals outperform stock deals. However the main reason should be tied to the fact that the Ricard family, stockholders of Pernod Ricard, desire to maintain its influence over the group which will most likely lead to debt being favored over equity.

All of the conditions seem to favor a debt financed acquisition; nonetheless, the impact on capital structure needs to be taken into account. Pernod Ricard took on a lot of leverage to finance its 2008 V&S acquisition and has been deleveraging its Balance Sheet ever since. However, as already presented, the consolidated Debt to Capitalization ratio is around 32%. According to Damodaran online data, a ratio of Debt to Capitalization for a BBB company in the US can go until around 50%. This allows for an inference, since the consolidated company holds in 2012 around € 12Bn of debt and maintains a 32% debt to capitalization ratio (A-rating), then it could go on to around € 20Bn before putting its A- rating at risk. This should yield something like € 8Bn that can be raised additionally by Pernod Ricard before the merged company suffers any downgrade by agency ratings. It should be taken into account that Pernod Ricard holds close to € 800M of cash & cash equivalents in 2012. Since a merger between Pernod and Beam would not require that Pernod had to acquire the entire shareholder structure, it can be stated that Pernod can have sufficient resources in cash through its reserves and debt issuances that can finance the deal without resorting to stock deals.

5.2.3 Final considerations

Considering Pernod Ricard's current organizational structure, Beam could be integrated within its Brand Companies (just like V&S was), as it is illustrated in figure 41.

Figure 42: New organizational structure



Pernod Ricard's decentralized organizational structure is a main advantage for this deal. Nonetheless, some considerations regarding the proposed deal should be made.

Even though it is out of the scope of this paper to analyze it on detail, it is the author's belief that this deal can have further room for improvements with the spin-off of some of Beam's brands. A merger between Pernod and Beam could ultimately lead Pernod to be the number one premium spirits producer ahead of Diageo whose brands are not exclusively focused on premium. Pernod strategy however has been more and more focused on the premium brands, and an acquisition of Beam would allow Pernod to explore both premium and value category products of Beam, or it could sell the value category brands and reinvest it on the rest of its premium portfolio. Thus, Pernod should focus on Beam's two sections: Power Brands and Rising Stars. These two divisions produce and market brands like Jim Beam, Maker's Mark, Courvoisier and Skinnygirl. This opinion reflects the personal opinion of the author based on the state of the industry and prospects for both companies. The acquisition of solely these two brands is not suggested as it would be very unlikely Beam's shareholders would approve such an operation at a price that would create value for Pernod. Also, one of the factors that probably make Beam so attractive to be acquired is probably the existence of these value brands.

On a final note, even though the merger between Pernod and Beam is being proposed as happening in August 2013, it should be noted that there may be some better moments to go ahead with this deal. This suggestion is mostly due to the fact that Pernod can be constrained by its Balance Sheet and shareholding structure to do the deal in the next year. Although there is room for Pernod to finance this acquisition through debt and maintain a somewhat stable rating outlook, the company would lose some of its flexibility which can be of utmost importance in the spirits industry.

6. Conclusion

The spirits industry is one of those industries who seem to insist on consolidation. Over the years this industry landscape has been constantly changing and is now ruled by some major players. The major players however are very distinct one from another, and the leader today may not be the leader tomorrow. This industry is constantly changing and demographics, technology and emerging markets development mold the demand for alcoholic beverages.

Pernod Ricard has been following a strategy of organic growth combined with M&A deals to boost its growth. At the same time, Beam has returning higher than expected growth ever since it was separated from Fortune Brands in 2011. Beam seemed like an immediate takeover target, however the American company's progress has been extraordinary and is now getting to a value when it becomes almost unreachable for most of its potential bidders.

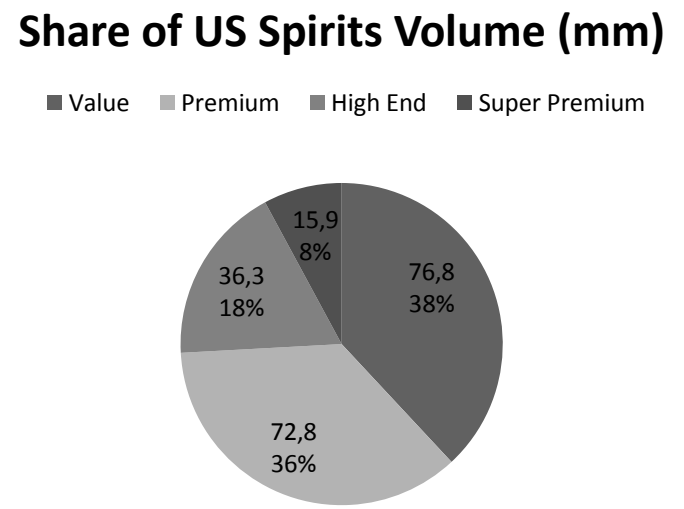
As such, the possible merger between Pernod Ricard and Beam seems to be getting near to its most advantageous timing (although it may be possible to happen in the near future under better conditions). At this time (August 2013) Pernod Ricard could attempt to merger with Beam, and according to the valuations presented, offer a conservative premium of 19% ($ 78/share) to its last year's average price ($ 61/share) that reflected Beam's fair value with potential synergies, in a deal financed with debt. Pernod Ricard could definitely take Beam on to the next level due to its distribution supremacy in key growing markets, and Beam could take huge advantageous from its super growing demand by bourbon to reach new markets and consolidated a position for its brands.

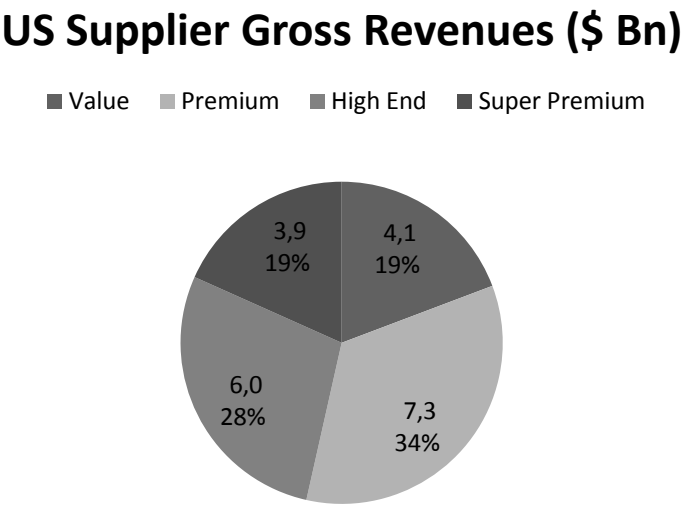
Revenue synergies are estimated to make up 26% of total synergies while cost synergies the rest. As it was seen, changes and opportunities in distribution are the most important for a successful M&A between companies like Pernod and Beam. Whether it is by the opportunities to enhance sales of certain brands with new distribution agreements on new markets, or by the costs the same exact new deals can save, or even by the costs the breakup of existent agreements can create, distribution is the center of the possible value of synergies in a deal like this one, thus needing to be well managed.

Mergers, and acquisitions, of firms have always been a natural strategy used by businesses with the intent to grow, prosper and deliver value for its investors and customers.

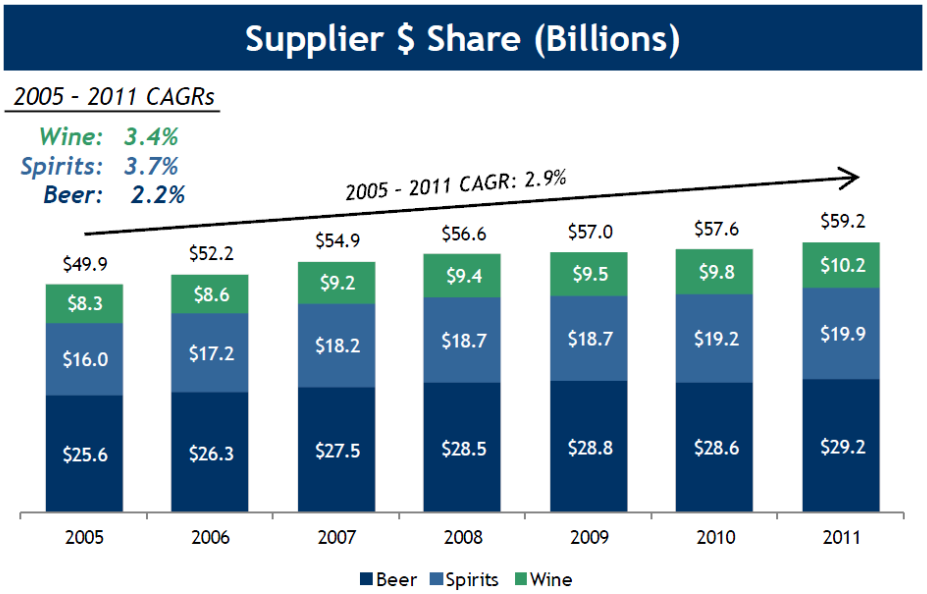
7. Appendixes

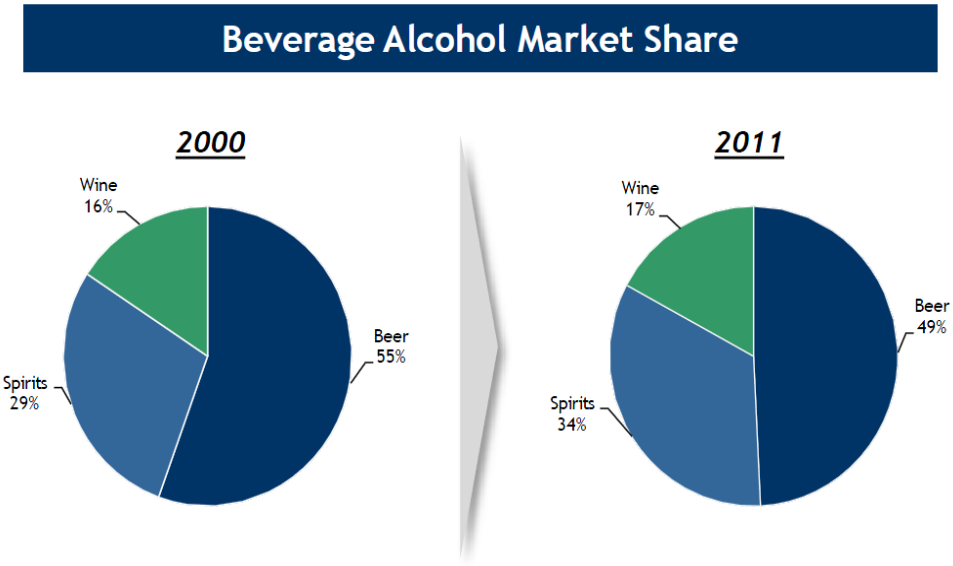
Appendix 1: Distribution by Volume and Gross Revenue of the four categories of spirits

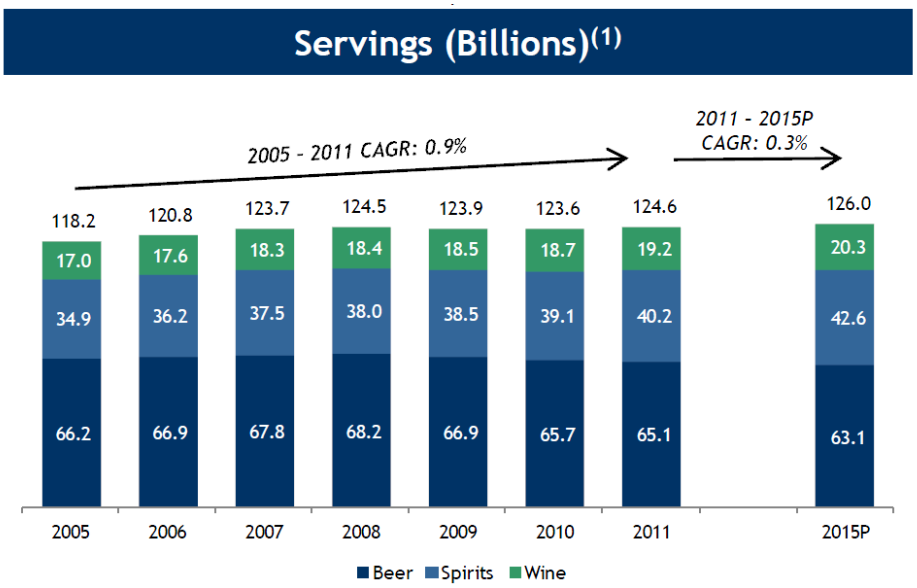


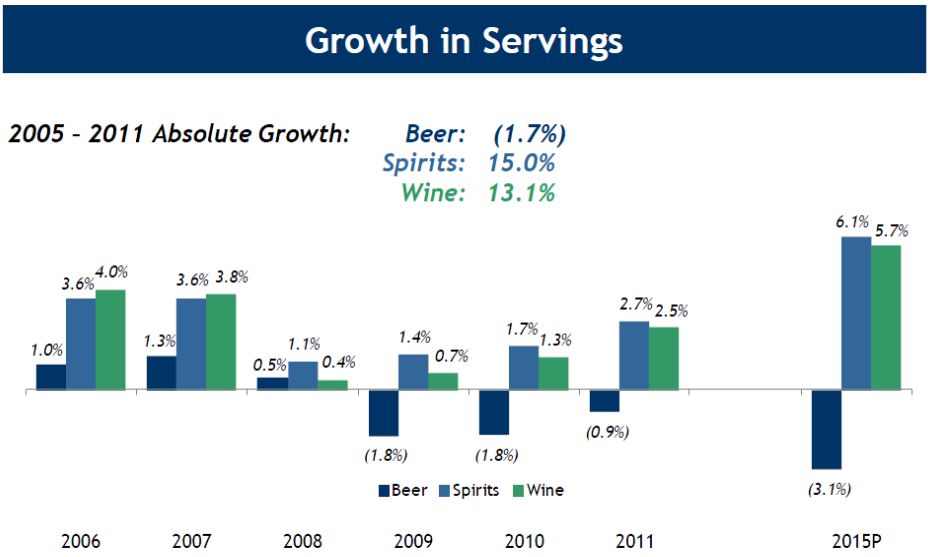


Appendix 2: Spirits evolution within the US market in four pictures

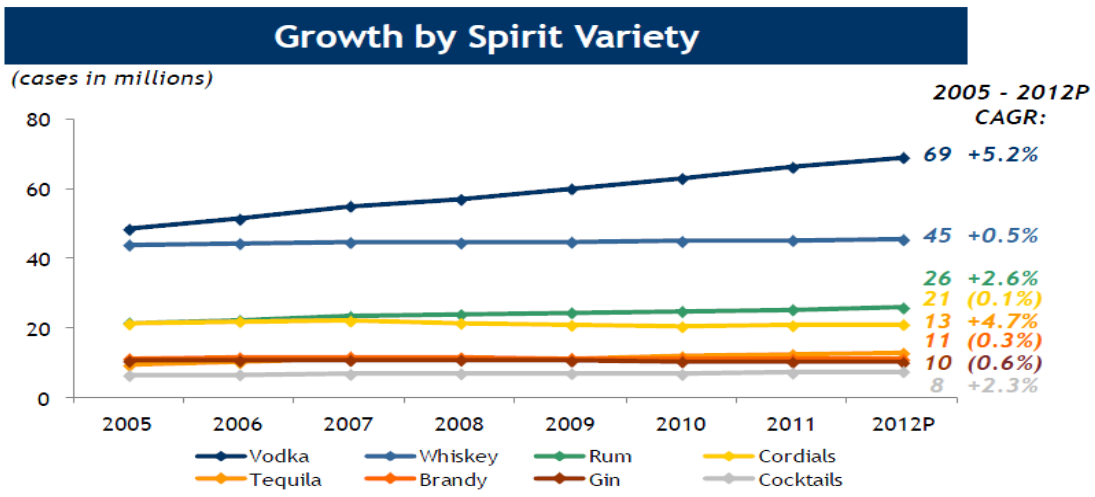




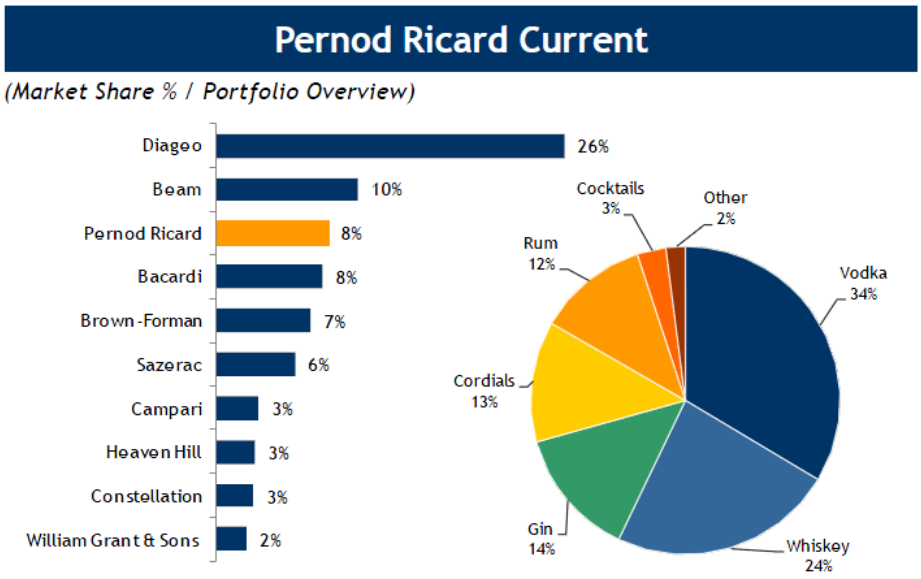




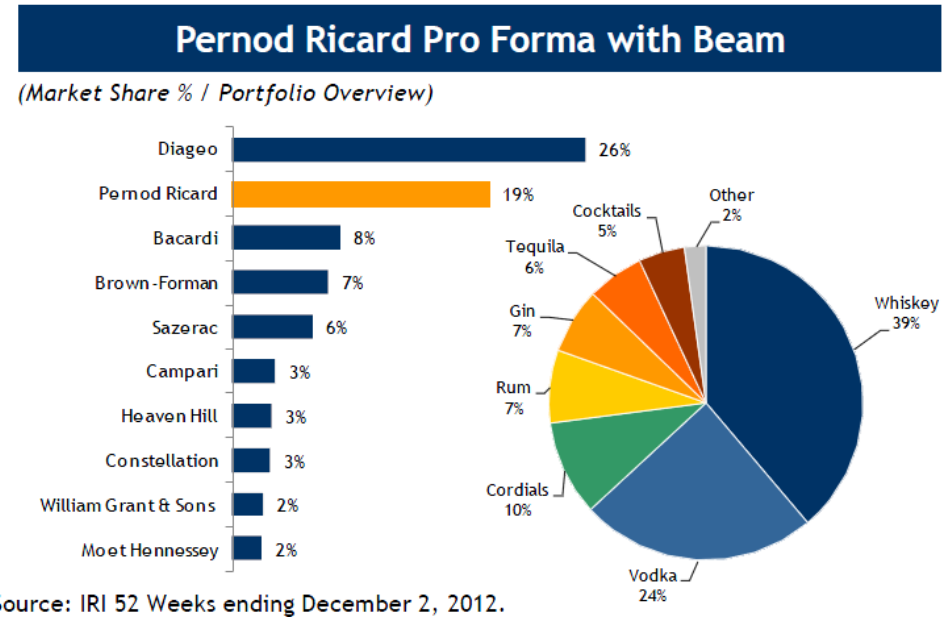
Appendix 3: Growth by Spirit Variety



Appendix 4: Pernod Ricard Market Share in the US



Appendix 5: Pernod Ricard Pro Forma with Beam Market Share in the US



Source: IRI 52 Weeks ending December 2, 2012.

Appendix 6: Spirits Industry M&A deals between 2010 and 2011

Spirits Industry M&A Deals by Quarter (2010 – 2011)							
Quarter	# of Deals	Total Value	Mean	Median	MIN	MAX	Notable Transactions
Q1 2010	41	584	38.9	4.2	0.1	300	Bemberg Invesora S.A. acquires Grupo Peñaflor S.A. from DLJ Merchant Banking Partners
Q2 2010	34	844	49.6	2.9	.04	399	William Grant & Sons acquires Spirits and Liquors Division of C&C Group (nka:William Grant & Sons Irish Brands Ltd.)
Q3 2010	31	515	42.9	29.3	0.68	169	Gruppo Campari acquires Carolans, Frangelico and Irish Mist Brands from William Grand & Sons Irish Brands Ltd.
Q4 2010	40	479	31.9	13.2	0.33	231	CHAMP Private Equity acquires of 80.1% stake in both Vincor UK and CBI Australia from Constellation Brands
Q1 2011	49	2,780	174	19.3	2.25	2,076	Diageo plc acquires Mey Içki A.S. from Actera Group, TPG Capital and Mey Icki Management
Q2 2011	51	1,146	88.2	40	0.79	555	Europeenne de Participations Industrielles SAS acquires Piper Heidsieck C.C. from Remy Cointreau
Q3 2011	35	1,718	101	7	0.17	1,259	Asahi Holdings (Australia) Pty Ltd. acquires Flavoured Beverages from Pacific Equity and Unitas Capital Pte. Ltd.
Q4 2011	51	251	13.2	2.1	0.18	95	Beam Inc. acquires Cooley Distillery PLC from Cooley's existing shareholders and Cooley Management

Source: Winchester Research

Appendix 7: S&P ratings according to Damodaran on-line data

For large non-financial service companies with market cap > $ 5 billion

(source: Damodaran January 2013)

If interest coverage ratio is

>	≤ to	Rating is	Spread is
8.5	100000	AAA	0.40%
6.5	8.499999	AA	0.70%
5.5	6.499999	A+	0.85%
4.25	5.499999	A	1.00%
3	4.249999	A-	1.30%
2.5	2.999999	BBB	2.00%
2.25	2.49999	BB+	3.00%
2	2.2499999	BB	4.00%
1.75	1.999999	B+	5.50%
1.5	1.749999	B	6.50%
1.25	1.499999	B-	7.25%
0.8	1.249999	CCC	8.75%
0.65	0.799999	CC	9.50%
0.2	0.649999	C	10.50%
-100000	0.199999	D	12.00%

Appendix 8: Beam's Valuation

Income Statement						
$ in millions, year end December	FY10	Δ %	FY11	Δ %	FY12	Δ %
North America	*1,162*	*n.a.*	*1,272*	*9.5%*	*1,451*	*14.1%*
Eur/MidEast/Africa (EMEA)	*478*	*n.a.*	*506*	*5.9%*	*513*	*1.3%*
Asia Pac/South America (APSA)	*455*	*n.a.*	*487*	*7.1%*	*503*	*3.1%*
Revenues	***2,095***	***n.a.***	***2,265***	***8.1%***	***2,466***	***8.9%***
- Cost of Revenue	865	*n.a.*	988	*14.2%*	1,028	*4.0%*
Gross Profit	***1,230***	***n.a.***	***1,323***	***7.6%***	***1,438***	***8.7%***
- Selling, General & Admin Expense	740	*n.a.*	805	*8.8%*	829	*3.0%*
EBIT (Operating Income)	***490***	***n.a.***	***518***	***5.8%***	***610***	***17.6%***
CAPEX	-223	*n.a.*	-219	*-2.0%*	-137	*-37.5%*
Depreciation	245	*n.a.*	199	*-18.6%*	111	*-44.6%*
Net Working Capital	2,236	*n.a.*	1,676	*-25.1%*	1,655	*-1.2%*
Δ NWC	n.a		-560		-21	

Income Statement	**Projections**					**CAGR**	
$ in millions, year end December	FY13E	FY14E	FY15E	FY16E	FY17E	FY10/12	FY13E/17E
North America	*1,581*	*1,700*	*1,819*	*1,937*	*2,053*	*11.7%*	*6.7%*
Eur/MidEast/Africa (EMEA)	*527*	*541*	*552*	*559*	*563*	*3.6%*	*1.7%*
Asia Pac/South America (APSA)	*527*	*569*	*611*	*654*	*695*	*5.1%*	*7.2%*
Revenues	***2,635***	***2,809***	***2,982***	***3,149***	***3,312***	***8.5%***	***5.9%***
- Cost of Revenue	*1,098*	*1,157*	*1,213*	*1,265*	*1,314*	9.0%	4.6%
Gross Profit	***1,537***	***1,653***	***1,769***	***1,884***	***1,998***	***8.1%***	***6.8%***
- Selling, General & Admin Expense	*891*	*922*	*949*	*971*	*988*	5.8%	2.6%
EBIT (Operating Income)	***646***	***731***	***820***	***914***	***1,010***	***11.5%***	***11.8%***
CAPEX	*-146*	*-127*	*-105*	*-80*	*-51*	-21.8%	-23.2%
Depreciation	*118*	*98*	*74*	*47*	*16*	-32.9%	-39.4%
Net Working Capital	*1,567*	*1,650*	*1,728*	*1,802*	*1,870*	-14.0%	4.5%
Δ NWC	-88	83	79	74	68	0.0%	0.0%

Discounted Cash Flow	**Explicit Period**				
FCFF	**572**	**467**	**540**	**618**	**698**
PV FCFF	**533**	**405**	**436**	**465**	**489**
Terminal Value					**16,440**
PV Terminal Value					**11,518**
Total Enterprise Value					***14,413***
Less: Total Debt					2,505
Plus: Cash					366
Implied Equity Value					***12,274***
Shares Outstanding					160
Implied Share Price					***76.7***

Appendix 9: Pernod Ricard's Valuation

Income Statement						
€ in millions, year end June	FY10	Δ %	FY11	Δ %	FY12	Δ %
Revenues	***7,081***	***-1.7%***	***7,643***	***7.9%***	***8,215***	***7.5%***
- Cost of Revenue	2,863	-4.4%	3,033	5.9%	3,169	4.5%
Gross Profit	**4,218**	**0.2%**	**4,610**	**9.3%**	**5,046**	**9.5%**
- Selling, General & Admin Expense	2,422	2.5%	2,701	11.5%	2,933	8.6%
EBIT (Operating Income)	***1,796***	***-2.7%***	***1,909***	***6.3%***	***2,113***	***10.7%***
CAPEX	-184	-23.7%	-223	21.2%	-271	21.5%
Depreciation	267	-21.7%	202	-24.3%	182	-9.9%
Net Working Capital	1,942	-27.3%	3,113	60.3%	2,814	-9.6%
Δ NWC	-730	-367.4%	1,171	-260.4%	-299	-125.5%

Income Statement	**Projections**					**CAGR**	
€ in millions, year end June	FY13E	FY14E	FY15E	FY16E	FY17E	FY08/12	FY13E/17E
Revenues	***8,460***	***9,046***	***9,589***	***10,077***	***10,496***	***5.7%***	***5.5%***
- Cost of Revenue	3,437	3,675	3,895	4,094	4,264	2.9%	5.5%
Gross Profit	**5,023**	**5,371**	**5,694**	**5,983**	**6,232**	**7.6%**	**5.5%**
- Selling, General & Admin Expense	3,020	3,275	3,520	3,749	3,957	6.9%	7.0%
EBIT (Operating Income)	***2,003***	***2,096***	***2,174***	***2,234***	***2,275***	***8.6%***	***3.2%***
CAPEX	-276	-295	-313	-329	-342	-0.2%	5.5%
Depreciation	269	288	305	321	334	1.9%	5.5%
Net Working Capital	2,975	3,181	3,372	3,543	3,691	4.1%	5.5%
Δ NWC	161	206	191	171	147	0.0%	-2.1%

Discounted Cash Flow	**Explicit Period**				
FCFF	**1,365**	**1,391**	**1,465**	**1,530**	**1,585**
PV FCFF	**1,281**	**1,225**	**1,211**	**1,188**	**1,155**
Terminal Value					**46,116**
PV Terminal Value					**33,596**
Total Enterprise Value					***40,932***
Less: Total Debt					10,176
Plus: Cash					787
Less: Minority Interest					168
Implied Equity Value					***31,375***
Shares Outstanding					264
Implied Share Price					***119.1***

Appendix 10: After-Merger Valuation without synergies

Income Statement						
€ in millions, year end June	FY10	Δ %	FY11	Δ %	FY12	Δ %
Revenues	***8,649***	***0.0%***	***9,393***	***8.6%***	***10,084***	***7.4%***
- Cost of Revenue	3,510	0.0%	3,796	8.1%	3,948	4.0%
Gross Profit	**5,138**	**0.0%**	**5,597**	**8.9%**	**6,136**	**9.6%**
- Selling, General & Admin Expense	2,976	0.0%	3,323	11.7%	3,561	7.2%
EBIT (Operating Income)	***2,163***	***0.0%***	***2,274***	***5.1%***	***2,575***	***13.2%***
CAPEX	-351	0.0%	-392	11.7%	-374	-4.4%
Depreciation	450	0.0%	356	-20.9%	266	-25.4%
Net Working Capital	1,942	0.0%	3,113	60.3%	2,814	-9.6%
Δ NWC	n.a.	n.a.	793	0.0%	-340	-142.9%

Income Statement	**Projections**					**CAGR**	
€ in millions, year end June	FY13E	FY14E	FY15E	FY16E	FY17E	FY10/12	FY13E/17E
Revenues	***10,457***	***11,171***	***11,832***	***12,422***	***12,931***	***3.9%***	***5.5%***
- Cost of Revenue	4,269	4,550	4,807	5,035	5,230	3.0%	5.2%
Gross Profit	**6,188**	**6,621**	**7,024**	**7,386**	**7,701**	**4.5%**	**5.6%**
- Selling, General & Admin Expense	3,696	3,972	4,233	4,472	4,684	4.6%	6.1%
EBIT (Operating Income)	***2,492***	***2,649***	***2,791***	***2,915***	***3,018***	***4.5%***	***4.9%***
CAPEX	-386	-391	-392	-388	-380	1.6%	-0.4%
Depreciation	359	362	361	356	346	-12.4%	-0.9%
Net Working Capital	2,949	3,153	3,342	3,512	3,659	9.7%	5.5%
Δ NWC	94	266	243	213	181	0.0%	17.7%

Discounted Cash Flow	**Explicit Period**				
FCFF	**1,695**	**1,657**	**1,806**	**1,949**	**2,083**
PV FCFF	**1,590**	**1,457**	**1,489**	**1,507**	**1,510**
Terminal Value					**58,928**
PV Terminal Value					**42,729**
Total Enterprise Value					***51,919***
Less: Total Debt					10,176
Plus: Cash					787
Implied Equity Value					***42,530***

Appendix 11: After-Merger Valuation with synergies

Income Statement	Projections					CAGR	
€ in millions, year end June	FY13E	FY14E	FY15E	FY16E	FY17E	FY10/12	FY13E/17E
Revenues	***10,457***	***11,182***	***11,855***	***12,459***	***12,981***	***3.9%***	***5.6%***
- Cost of Revenue	4,247	4,527	4,783	5,010	5,204	3.0%	5.2%
Gross Profit	**6,209**	**6,655**	**7,072**	**7,449**	**7,777**	**4.5%**	**5.8%**
- Selling, General & Admin Expense	3,826	3,948	4,182	4,390	4,570	4.6%	4.5%
EBIT (Operating Income)	***2,384***	***2,707***	***2,890***	***3,058***	***3,207***	***4.5%***	***7.7%***
CAPEX	-386	-391	-392	-388	-380	1.6%	-0.4%
Depreciation	359	362	361	356	346	-12.4%	-0.9%
Net Working Capital	2,949	3,153	3,342	3,512	3,659	9.7%	5.5%
Δ NWC	94	266	243	213	181	0.0%	17.7%

Discounted Cash Flow	Explicit Period				
FCFF	**1,612**	**1,701**	**1,881**	**2,059**	**2,227**
PV FCFF	**1,512**	**1,496**	**1,551**	**1,592**	**1,615**
Terminal Value					**63,018**
PV Terminal Value					**45,694**
Total Enterprise Value					***55,176***
Less: Total Debt					10,176
Plus: Cash					787
Implied Equity Value					***45,787***

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