Meet The Presidents – Asia Pacific

DIAGEO

Nick Blazquez

President, Diageo Africa and Asia Pacific

Welcome everyone and thank you for joining us. As part of our regular series of President Calls, today Sam Fischer is here to talk about the Asia Pacific business that he is responsible for. As we said in the invitation Sam is not accountable for India, so we will not be discussing India in this call.

Following the introduction we will open up the line for questions.

As you saw the details of our first half performance less than a month ago we will not focus on that in our opening remarks today, although I am sure that you will have questions for us on F15 performance when we get to the questions and answer session.

As this is the first time Sam has had an opportunity to talk to you about the markets that he is responsible for, we are going to focus for the next 20 minutes or so on the future for the industry and for Diageo as the leading international spirits company in these markets. Sam will outline how we plan to accelerate our performance through building on our current position and broadening our participation.

So let's get started. Over to you, Sam.

Sam Fischer

President, Diageo Greater China and Asia

Thanks, Nick, and good morning or good afternoon to everyone and importantly, Gong Xi Fa Cai or Happy Lunar New Year to you all on the phone as we call in from Singapore.

As Nick has said this is the first time I have spoken with many of you so first let me introduce myself. I have worked in consumer goods for over 20 years across a number of international markets, largely in Asia. I joined Diageo in 2006 and have held General Manager positions within the region, including from July 2009 as the Managing Director for Southeast Asia until July 2013, where I became MD of Greater China. In September 2014, my responsibilities were broadened to include South East Asia, North Asia and Australasia and at that time I joined Diageo's Executive Committee.

It is these markets that I want to talk about today, in particular Diageo's participation in these attractive countries, the cornerstones we have laid and where I see us expanding further as we look ahead.

Asia Pacific is home to some of the fastest growing economies in the world, with favourable demographic trends. It has the largest pool of LDA consumers, most of which reside in emerging Asia Pacific markets. The already large and still fast growing emerging middle class population in Asia Pacific is becoming increasingly urbanised, resulting in growth in disposal incomes and this trend, along with the social media explosion we are seeing in the region, is leading to increased awareness of international brands.

In key markets such as Southeast Asia and China, the number of affluent consumers in the region is also expected to grow, expanding the already large pool of high net worth individuals in Asia Pacific. As a result of these growth trends, in the next three years, approximately 45% of total volume growth in TBA across the world is expected to come from Asia Pacific, excluding India. And with super and ultra-premium brands expected to grow even faster and inflation led price increases across brands, value growth is expected to be even greater.

International spirits has been our primary focus to date and we have built a significant market leading position. In international style spirits, standard priced and above we have almost 19% share across China, Southeast Asia, North Asia and Australia and our performance has been led by strength in scotch. Across these same markets we have gained significant value share in this category from 2008 to 2013 to extend our lead from 2 points to 13 points above the second largest competitor according to IWSR data.

The growth we have achieved through the focus we have had in our luxury spirits has been an important driver of our performance. Around 25% of our net sales for the region are from super premium and above variants compared with just over 15% three years ago. This is a very profitable portfolio with gross margin almost 10 percentage points above the average for Asia Pacific. We also continue to expand the entire international spirits portfolio through the premium core brands such as Johnnie Walker Black and Red Label, Guinness, Baileys and Smirnoff.

However, we still see significant opportunity for us to expand our participation in Asia and drive for a bigger proportion of the total beverage alcohol market. TBA in Asia Pacific is largely led by beer with local spirits and wine also holding a significant share. The shape of TBA in each country varies, yet overall, our current participation in TBA is narrow, therefore, breaking into new occasions, categories and price points will be critical for us to drive scale and capture growth.

At a market and country level we have built good foundations. These markets are at very different stages of development and have different routes to consumer and our approach to capture growth in each country is fit for purpose, leveraging our brands, our strength in innovation and our partnerships. In a number of countries we have our own in market company. This is where we have Diageo marketing teams, building and innovating on our brands and sales teams on the ground. Across almost all of these markets we currently have route to consumer programmes in place to strengthen our influence. We have extended our position in the region through our equity investments, including more recently, Shuijingfang in China and Halico in Vietnam and through distributor partnerships, many of which I will refer to later. And we have manufacturing capabilities across many markets including Australia and Korea, as well as third party facilities in Indonesia and Halico’s operations in Vietnam.

With these foundations in place, we are in a strong position to broaden our participation in TBA, in particular gaining share from beer and existing local spirits brands, something which Diageo has a strong track record of doing in many parts of the world.

Now I am going to share some examples of how we are broadening our participation to capture the industry growth I have just described.

And I am going to start in China, which although a small proportion of our business today is I know of great interest to many of you on the call and to Diageo as we look to the future. The challenges faced by the industry as a result of the government's anti-extravagance measures have been well covered and our performance in both baijiu and scotch has been impacted by the consequences of these measures. While I don't expect to see baijiu and scotch rebound quickly, I do remain confident about China in the medium to long-term. GDP is expected to grow at 6 to 7% CAGR in the next five years and the number of mass affluent consumers is expected to more than double by 2020.

Over the last few years, we have accelerated the luxury credentials of scotch in China, led by the Johnnie Walker Houses and marketing investment behind Johnnie Walker Blue Label. Currently, we have three Johnnie Walker houses across China selling exclusive Johnnie Walker blends and limited editions and holding mentoring dinners for key customers. To support the growing demand in China for customised offerings and small batch limited editions we have invested behind a luxury finishing centre in Shanghai where we have the specialised capabilities to assemble complex, luxury packaging and this includes personalised engraving. As a result of our investment and focus, our super-premium plus scotch brands have grown more than 30% CAGR from Fiscal 2011 to Fiscal 2014.

This is a great base for us but to capture the growth of mass affluent consumers I just referred to, we need to broaden our offering. Our route to consumer has helped us define clear pockets of opportunity. Over 85% of alcohol in China is consumed in meal occasions. Much of the meal occasion consumption is with products sold in the off-trade and this channel is significantly more profitable than other on-trade channels in China. Let me share some examples of how we have started to drive penetration in the meal occasion.

We have recently hosted mentored dinners in partnership with off-trade liquor store owners. They invite their important VIP customers for a beautiful Chinese meal and we provide either a baijiu or scotch immersion, sharing our brand stories and liquid credentials in a way that demonstrates the compatibility of our brands with food. We have also created a significant sales opportunity in these occasions with sales of up to 400 cases in any one dinner with around 20 to 30 participants. These events have been highly successful. The liquor store owners love it because it creates a wonderful experience for their customers and it gives us a fantastic opportunity to insert our brands into the meal occasion.

We have also started making progress in extending into the meal occasion through media influencers. Our work with Haig Club is an example of this where we recently ran a food pairing and mentoring event in Guangzhou with 18 columnist and food critics.

As we look to increase scale, through our route to consumer in China we identified the opportunity to drive synergy from our baijiu business and international spirits business, Diageo China Limited.

We now have a sales service agreement between DCL which is selling brands like Haig Club, Smirnoff and Baileys and our baijiu business. This empowers our sales teams to provide a broader offering to consumers at scale in our focus channels and geographies.

Moving next to the Philippines. The Philippines is the fifth largest economy in Southeast Asia and GDP growth over the next five years is expected to be around 6%. Excluding India, it is the seventh largest TBA market in Asia Pacific in volume terms, with beer and local spirits accounting for almost two-thirds of this. We have seen considerable tax reform that has allowed international spirits brands to compete on a far more competitive basis with local brands than was previously the case.

Through our Diageo Philippines entity, we expanded our current Johnnie Walker Red Label distribution into 3,700 outlets, a 43% increase versus last year and, as a result, we have seen Red Label sales more than double in the past six months. Currently there is no whisky category in the below $10 price point and whisky is seen as premium and aspirational by consumers in the Philippines, traditionally a more brown spirits market. We have plans to launch locally bottled VAT 69 scotch with our local partner Lucio Co, one of the Philippines' largest retailers, duty free operators and international spirits importers, with the intent of broadening whisky price points to better compete with beer and local spirits. Innovation in ready to drink is also part of our strategy to compete in the beer occasion and Smirnoff Ice will be launched in the coming months.

Another market where we have laid strong foundations is Indonesia. Indonesia is home to more than 160 million LDA consumers. While a significant proportion of the population abstains from drinking for religious reasons, the TBA market is sizeable and given the expected increase in wealth in coming years, is attractive.

We currently have a key partnership with PT Dima, who is our distributor for beer, ready to drink and local spirits. This coupled with our recent route to consumer work has helped us access approximately 90% of the on-trade universe for our core brands. Capitalising on core learnings from many other Diageo markets, particularly in Africa and leveraging the current scale we have in beer, we will expand our participation into RTD and local spirits through our investment in local supply and production capability. Our portfolio has expanded to include Smirnoff Ice in three variants, locally produced Gilbey's gin and vodka and Guinness Zero, a non-alcoholic variant.

Moving on now to a couple of our developed markets. In Korea, we have almost 40% share of whisky and historically, we had largely focused on the very profitable traditional on-trade channel. However, this channel accounts for only 11% of TBA consumption. While we will continue to leverage our strength in this channel with innovation playing an important role, we aim to participate more broadly in the growing TBA market. Hence, we have up-weighted our focus behind other channels, in particular, the off-trade, casual hangout and food on-trade, where we are adding 23 sales people to increase coverage and distribution of our portfolio of international spirits, ready to drink brands and Guinness. We are strengthening our position in the off-trade through new pack formats to make international spirits more affordable and the new Smirnoff 21cl is a good example of this.

My goal is to shift our business in Korea from being a scotch and traditional on-trade centred business to one with a significant participation in a vibrant whisky category, strength in premium beer, mainstream vodka and ready to drink with a route to consumer that gives us scale in the important channels in the market.

In Australia, we have a strong business with broad representation across channels and categories. This mature TBA market still has plenty of interesting growth opportunities in reserve, premium core and RTD. We will continue to strengthen our premium core brands with Bundaberg, Smirnoff and Johnnie Walker, investing behind these brands for the medium-term.

We will continue to explore innovation opportunities across the spirits portfolio, both to generate new news and interest on our premium core brands while capturing growth of higher priced brands in the market through innovations such as Bundaberg Small batch. Given the size of the bourbon category within the Australian market, Bulleit bourbon has enormous potential in this market and Australia is already our third largest market for Bulleit net sales.

Ready to drink has a long history of competing in the beer occasion in Australia and this segment represents over 10% of the TBA market in value terms. Traditional pre-mix offerings such as Bundaberg & Cola are most impacted by the unfavourable tax regime for spirits. But through offering compelling innovations in the category, many which compete in wine occasions, we can unlock growth as demonstrated in our first-half results.

In addition to the above, we are focused on sell out and driving depletions across all of our markets. This has been a key priority for us as an executive community and I wanted to share the enablers behind making this happen, as well as some examples of how this has started to reap benefits for us.

One of the key enablers is the work we have done on the route to consumer agenda in the region. Let me start with Thailand. This is a market that has experienced severe volatility in recent times, but through our RTC programmes we have expanded our on-trade coverage into new channels and regions, gaining share from local spirit occasions and resulting in an additional 4 points of share gain in scotch in the first half of this fiscal.

We have also enhanced our sales force capability across the Asia Pacific region and incentivised sales teams on depletions. The ability to measure and track sell out and in store sales drivers is critical to be able to reward on this basis. To support this initiative we have made significant investments in technology in most of our markets to enable us to better track our coverage, call rates, distribution and activation. We are using sophisticated handheld devices which allow our sales teams to capture information real time which is then sent to our sales operations centres for analysis and market teams, including the General Manager, will review performance versus stated sell out objectives to assess sales force effectiveness.

I mentioned earlier that we are in different stages of investment across countries and there are a few countries that we haven’t spoken much about previously but which present an exciting opportunity for Diageo. We do not have time to go through many of these, but let me highlight a couple.

Cambodia and Laos are markets that offer great opportunities for Diageo brands. With promising economic trends, growing populations, and significant TBA profit pools we continue, through our SEA emerging markets business, to develop and expand our participation.

Myanmar is another country where I see significant potential. The country is in the process of transforming from one of Southeast Asia’s poorest states into an emerging economy, attracting significant foreign investment and GDP has grown around 6% per annum in the last three years. The pace of change in Myanmar is extraordinary. Currently, local whiskey represents a large proportion of the market and while we do not currently have a presence in this country, it is an interesting market and we are exploring opportunities.

So in summary, our current participation in Asia Pacific is strong, but narrow. We want to not only build on our position in international spirits but also to broaden our footprint in this region. We have a clear understanding of what this looks like by market.

In addition, some of our route to consumer work has sharpened this thinking as well as giving us a clear understanding that scale matters and can provide a competitive advantage.

I have provided some individual market examples of how we are beginning to widen our footprint and, while the approach does vary by market, there are some key themes for the region. First we will continue to look to gain share in international spirits and leverage the growth of affluent and high net worth individuals to continue to premiumise.

Second, as we have done in many emerging markets in other regions, we will participate in more price points with both new formats of our international spirits brands as well as through local spirits and we will leverage the scale that we already have, or that we can access through our partners, to deliver this.

Third, we will gain share from the refreshment and food channels through our ready to drink and spirits offerings.

Overall, the shape of our business in the region will change as we unlock and accelerate growth across our markets. I feel terrific about the future of our Asia Pacific business. I recognise that by their nature, these markets are volatile and as such, the path to growth is uneven. However, we are building a business for the short, medium and the long-term and I am convinced this strategy will accelerate our performance and be a key driver of growth for Diageo long into the future.

So let’s now open the line and Nick and I are happy to take all of your questions.

Question and Answer Session

Ian Shackleton - Nomura International

Yes, good afternoon, Sam. Good afternoon, Nick. I had a few questions around the distribution footprint. I think when you were talking about China you talked about some working together by salesmen across the different distribution structures. Could you just talk a little bit? I mean, I think at the moment you’ve got sort of three distribution structures to spirits which sounds like too many. I mean, how do you bring those together and what’s the timeframe?

I guess the wider question on distribution is you didn’t refer at all to the distribution JVs with Moet Hennessey which are still existing in quite a lot of the markets. How important is that for the future?

Sam Fischer

Right. Thanks, Ian. I will start off with China and some of the synergies that we are seeing, or we're realising through some of our entities. I mentioned the service agreement we have between Shuijingfang and Diageo China Limited. This is a service agreement that is focused on the south of China, in particular, Guangzhou, Guangdong Province, Fujian, and Dongguan. What we've done is we have, through the service agreement, is we are now distributing the Shuijingfang portfolio and the DCL portfolio through a single sales force. This is allowing us to access the focus food restaurant channel that I referred to and we have now, through the route to consumer work, clearly identified and segmented both the restaurant channel, the off-trade and major other on-trade. So, we're unlocking some scale with this and early results have been extremely positive.

In relation to how fast we plan to expand that, we are cementing learnings in relation to the south. We will continue to focus on ensuring that we unlock the opportunity that that combined portfolio offers and then we, in a controlled and phased way, will expand further throughout China.

Our MHD China, or Moet Hennessey Diageo China business, continues to be a priority for us in the execution of our Johnnie Walker portfolio. We have, in this business, seen some disruption as a result of anti-extravagance, but I think in the medium to longer term we are expecting recovery and this continues to be a priority route to consumer for us.

In relation to the other MHD joint ventures that we have across the region, again, they are prevalent in Thailand, in Malaysia, in Singapore and in Japan. We have seen continued growth as a result of these joint ventures and they will continue to be a priority for us in those markets as well.

Ian Shackleton

Just to summarise, should we expect ultimately the aim in China is to come down to two distribution structures - the Moet Hennessey structure and then another structure? Is that the end game?

Sam Fischer

I think that as we continue to learn we will continue to roll that out and should that continue to realise the kind of synergies that we've seen, I think we can expect that that is the end state, although I am not sure the exact time period.

Ian Shackleton

Very good. Thanks, Sam.

Andrea Pistacchi - Citigroup

Yes, hi. I have a couple of questions, please. Firstly on Korea. Now, you were talking earlier about your focus on new channels. Could you say how large scotch is still as a percentage of your sales in Korea?

And also in Korea, in the past 18 months, clearly, the trends have significantly improved compared to previous years. Is this a function partly of your focus on the new channels, but is scotch also declining less and more at, in your view, is a sustainable growth rate for you in South Korea going forward?

Then my second question is on Vietnam because Ivan recently, in a meeting here with analysts in London, I think he said something like that is an area which is not as strong as he would like it to be essentially. So, if you could expand a bit on this and on the lack of integration so far with Halico.

Sam Fischer

Sure. So, let me start with Korea. I think scotch continues to be a significant part of our Korean business and will be so in the short and medium-term. I think as we look to access the food on-trade and some of the new casual hangouts with brands like Guinness and RTD we would expect to see that reliance decline. But, scotch is still important for us in Korea.

You're right, over the recent period we have seen a stabilisation particularly in the TOT and particularly in scotch and I think really pleasingly, our business has been in growth for the first half and we expect that to continue in the full year. So, we're excited to expand the footprint. We are seeing positive trends on scotch, particularly our scotch, and we will look to see our reliance on scotch diminish over time as we expand into other channels.

In relation to Vietnam, you're right, we have an IMC in Vietnam and we have our Halico business in Vietnam of which we are a minority shareholder. There has been some challenges in the market economically and also competitively and this is a market that has been relatively stagnant for the recent period.

I think what's fascinating about Vietnam from my perspective is the massive opportunity that exists across TBA. We still see TBA largely dominated by beer which has almost 90% of it and the relatively immature spirits market. So, the opportunity Halico provides us and the synergies you mentioned are really about driving participation in spirits across TBA, expanding our footprint using the supply capability we have through Halico into western spirits categories and potentially RTD. So, there is an enormous opportunity for a discontinuity in Vietnam and I very much see Halico as integral to allowing us to access that.

Andrea Pistacchi

Thanks.

Catherine Rolland - Kepler Cheuvreux

Yes, good afternoon. Two questions for me if I may regarding China. First of all, could you tell us what you think about the further impact on the spirit business regarding the anti-extravagance measures? Do you think that we are going to have a further pressure on the market?

I just wanted also to know what is your view about the level of inventories currently in the trade in China. Do you think that in most cases we could have still further destocking?

Could you also share with us, if possible, your first views regarding what's going on at the moment regarding the Chinese New Year? Thank you.

Sam Fischer

Sure. Okay. As I mentioned in the script, I think that the anti-extravagance campaign has been incredibly disruptive in China. We've seen some significant channel shifts, particularly in relation to gifting, the off-trade and also in the traditional on-trade where some of the clampdowns that began in Dongguan have also had a significant impact. I expect that will continue into at least the first half of fiscal 2016 and we would see some improvement post that.

I think when I think about what we're doing though, and the strategy that we have in China, I feel quite confident. We have seen continued improvement in our baijiu business and the baijiu footprint that we have through Shuijingfang is allowing us an access into the food occasion which I think is incredibly important to our strategy. We know that baijiu is already well accepted in restaurants and the meal occasion in China, so I see that as a significant competitive advantage for us, giving us an opening particularly for our scotch portfolio.

So, I think what we've got with baijiu, what we've got with the Johnnie Walker houses in reserve, what we're doing with Haig Club to recruit into whisky during a period of discontinuity is really opening up some opportunities for us.

That said, from a category perspective and the impact in China, I see some room for improvement at the back half of F16.

In relation to stock, as we see the shifts across different channels, we are needing to adapt stock levels in various trade channels to this new norm and that is also having some impact. I see us, in the timeframe that I talked about, not only having some positive momentum in the category, but also returning to normal stock levels across the industry in the back half of F16.

So, that's a little bit about the anti-extravagance and some of the stock improvements that we are experiencing in China and that we expect to see.

In relation to CNY, it's early. We're just coming into the period. I haven't seen any data. I think it's fair to assume that CNY will be similar to last year and we might expect a few green shoots, but, that's all the information that I have at the moment.

Catherine Rolland

Okay. Thank you very much.

Colette Wright, Diageo

I have a question that has come in from Chris Pitcher. As the old Manager of Southeast Asia, Sam, can you give some colour to the overstocking which took place in 2012 and 2013 and how confident are you that the channel inventory will be at sustainable levels by the end of this calendar year and can you give some specific examples of what you have been putting in place to give visibility on this?

Sam Fischer

Sure. When we talk about Southeast Asia, there are many different markets to Southeast Asia and I talked a little bit in my script about the Philippines, in Indonesia, in Thailand. The one business that has been impacted by the destock has been the free trade zone business in Southeast Asia which is effectively a wholesale channel and this has been impacted particularly at a depletion level by some of the volatility we've seen globally in FX and the like.

We stated that we were going to destock at the start of this fiscal year. We are in the process of destocking and we have made progress up until the first half. We expect that we will continue to make progress and that that will continue into fiscal F16.

So, I think this is work in progress, but we understand the impact and we are on top of it.

In relation to what we're doing about it going forward, I think these wholesale channels have been treated as push channels traditionally. We've shifted our focus to sell out. We've defined inventory targets and we're tracking depletions through the channel to ensure that one, we understand clearly what's going on in relation to demand and volatility in market, and two, that we are only restocking to levels that we are comfortable with. So, there is a shift in the model here and it's taking some time for us to unwind, but we're confident that we will have it in hand going into the next fiscal.

Ian Shackleton

Yes, thanks for taking my follow-up. Specifically on Australia, I mean we've gone through a year or so where we've seen some quite dramatic reductions in profitability for consumer companies in Australia. We had results from Coca-Cola Amatil overnight that showed that. Are you still nervous that the whole profit pool for spirits and TBA could continue to decline in Australia looking forward?

Sam Fischer

Yes, hi, Ian. I also saw the CCA result and obviously we've been tracking some of the brewer results. Actually, we're really pleased with our Australian business. We grew share in the first half [*correction – Diageo gained share in some categories but maintained share overall*]. We grew our operating margin and that, even given some of the price challenges and I think some of our innovations have been outstanding in relation to providing some real excitement to that market.

Additionally, and this is something that may be less understood is we saw double digit growth on our reserve business in Australia. So, the whole premiumisation that's going on in there is something that I feel extremely excited about also.

There is no doubt that economically and at a consumer confidence level Australia has faced, is facing challenges. But I'm really confident that not only are we going back to our core brands of Bundaberg, Smirnoff and Johnnie Walker and making sure we are innovating on the core, but we're also looking at really interesting opportunities outside of the core, particularly in the areas of RTD and bourbon.

So, all in all, really pleased with where our Australia business sits today. No doubt some challenges economically and at a consumer level going forward, but I think a really sound strategy to continue our momentum.

Ian Shackleton

Thanks, Sam. Thank you.

Thomas Russo - Gardner, Russo & Gardner

Hi. Good morning, Sam. A couple of questions. What is the role of local spirits in your region, local spirits owned by Diageo in general and in particular I'm thinking about India where the very, very low price sector seems to have product that makes its way to Africa and other parts of the world? I'm wondering what you do to exploit your regional brands.

The second has to do with the role of social media. Unilever talks about using smartphones and radios that they deliver for free. How much are you using social media and then how confident are you that the loyalties that come from social media will be enduring rather than merely passing?

Sam Fischer

I just lost the last part of that question.

Thomas Russo

That was the enduring loyalties that might arise from social media since it seems to be a medium that prioritises the next new thing.

Sam Fischer

Yes. Let me start with local spirits owned by Diageo. Across different markets we are still relatively infant in relation to our innovation agenda on local spirits. I mean we are looking at international spirits brands like Vat 69 in the Philippines, or Gilbey's in Indonesia, and Benmore in Thailand and we are looking at innovating off those and reaching new price points through local manufacturing and some of the COGs efficiencies we get through that. So, I think that's something that we're interested in.

As we look to gather more and more consumer insights from more and more markets and develop the portfolio more fully I think we will look at innovating local spirits brands, particularly brands like Orijin which have been phenomenally successful in Africa.

So, in relation to the USL brands, obviously this has been a recent acquisition and if there is opportunities to leverage what we have in India and the expertise we have in India, we are certainly looking to do that.

In relation to social media, there is absolutely no doubt this is massively interesting for us and we are experimenting with social media all over the patch. I mean, when I look at the conversations we're having in China with Tencent and with Alibaba, leveraging social media platforms like WeChat with over 450 million users, leveraging Dianping, which is a restaurant site with 100 million visits a week that recommends restaurants and how we might be able to use that to help support our meal focus. Looking at the eCommerce space in China and how we build a presence there that leverages development that is going on. In all of these instances we are participating and we are looking to expand our participation.

The same can be said in Indonesia which has an incredibly high internet penetration. The Philippines, Vietnam, in all instances, digital and social media platforms are really integral to all of our marketing plans.

Thomas Russo

You mentioned, Sam, one other point is the local manufacturing. I just have a sense, do the brand attributes not have a place of origin representation in those markets when you talk about local manufacturing?

Sam Fischer

Yes.

Thomas Russo

What do you do with the place of origin recommendation or references, if it is important in those markets?

Sam Fischer

It depends very much on local labelling regulations. If we're supporting raw materials or bulk spirits, I think we can refer to origin, but we probably need to, on the label, include bottled in market.

Thomas Russo

Thank you.

Andrea Pistacchi

Hi. Thanks again. A question on the Middle East which typically has been a hub where not all of the product you sell there is actually consumed there. Some of it goes to other countries. So, considering the issues you've had in Southeast Asia, what visibility do you have on what wholesalers are actually doing in the Middle East and ultimately on stock levels there?

Sam Fischer

The Middle East is not a part of my remit. In relation to how we track stock movements, we've got various internal measures and methods to try and ascertain source and to the extent that we can, we will take actions to try and limit those flows.

Andrea Pistacchi

Sorry, I hadn't realised, yes, it wasn't under your remit. Thanks.

Thomas Russo

I hope this is clear. Sam, you mentioned the personalisation packaging facility that you've initiated for the high-end premium. How much of that business historically had been gifting in China and how much will that be relevant to a world after we exit this new Chinese reality do you think?

Sam Fischer

Look, the interesting thing, the gifting, whilst it has been significantly impacted, I still see gifting as integral to the Chinese culture, particularly around key festive periods such as Chinese New Year. It will be business-to-business, or personal gifting, and, therefore, the centre that we have is all about really taking relevant Chinese insights and building them into, in particular, our spirits portfolio. So, for this Chinese New Year we have a sandblasted ram on the side of a Johnnie Walker Blue bottle in multiple colours that looks absolutely stunning and is completely sold out.

So, I still see gifting and the capability that we have in our luxury finishing centres as being integral to the continued growth and success of our super deluxe initiatives and others and I don't think that that's going to change at all going forward. In fact, it's likely to accelerate.

Thomas Russo

Thank you.

Colette Wright, Diageo

We have a question from Jason DeRise from UBS. Sam, how should we think about strategic decisions on the investment required for long-term sustainability of the business and the short-term pressure to generate profit in China?

Sam Fischer

I think in China we continue to invest across the key platforms we have in the market. We will continue to do that through, as I mentioned, all of the work we're doing on the Johnnie Walker Houses, the continued penetration of Blue Label and the continued drive into our meal on-trade. We will continue to invest behind Haig Club. We've been delighted with the performance of Haig Club in China. We have continued to see that make inroads, particularly in meal, but also in the modern on-trade channel and we will continue to invest in our baijiu and our route to market, or route to consumer initiatives.

I think we balance that with efficiencies. I mentioned previously Shuijingfang and some of the efficiencies we're hoping to unlock by bringing those two routes to consumers together. We will continue to drive margin through the reserve business which, as I mentioned, is significantly higher gross margin. As we continue to see recovery in the higher margin baijiu business, that will also contribute significantly to our profitability in China.

So, short-term, I think we look at efficiencies but we continue to invest and long-term we look towards profitability.

Nick Blazquez

Well, thank you very much for an interesting conversation. I hope you found that useful. If you do have any follow-up questions do not hesitate to contact us. We will be more than happy to provide any more answers to questions that you might have. We look forward to speaking to you in the future to tell you about how we are going to progress against building on our core and establish and broadening our participation into other categories and into other countries. So, thank you very much for calling in.

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