Diageo Europe, Russia & Turkey 'Call with the Presidents'
Leader: John Kennedy
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Operator: Hello and welcome to this investor call with the President of Diageo Europe, Russia and Turkey. Your call today will be hosted by the President of this region, Mr. John Kennedy.

We are now ready to start the call. Mr. Kennedy, please go ahead, sir.

John Kennedy: Welcome, everyone. It's John here and I would like to thank you for joining me today on the call, where I'm going to focus on the region of Europe, Russia and Turkey. I recently took on responsibility for India. I look forward to being part of shaping the way forward in that exciting business, however, for today's call we'll focus exclusively on Europe, Russia and Turkey. I will make some opening comments that will run about 15 minutes or so to give an overview of the business and then we should have plenty of time for Q&A after that.

This region contributed strongly to Diageo's overall F16 performance, delivering good organic sales growth a little over 4%. I'm going to talk today about each of the three markets separately, starting with the largest, Europe, which on its own represents about a fifth of Diageo's group net sales.

In Europe, within this market, we have almost 450 million LDA-plus consumers with an estimated 105 billion annual drinking occasions. Diageo's share of total spirits is at 9% [IWSR volume share], so there is real opportunity to gain share in this significant market through a focus on recruitment and accessing new consumer occasions.

We believe we have allocated the resource to the right strategic priorities to make that happen. Those include: very strong commercial execution capability across our recently enlarged and more effective Route to Consumer; delivering growth through our premium core portfolio of formidable brands that form the base of the Company; innovating to drive recruitment on our big brands and increase accessibility through a focus on new formats and channels; accelerating reserve by focusing on the mass luxury segment and our single malt whiskey portfolio. And of course by driving our productivity initiatives which cover net revenue management, marketing effectiveness, zero-based budgeting on indirect overhead, supply costs and organizational effectiveness, all to drive growth [and] margins.

Our results in Europe for FY16 and the momentum we have as we go into FY17 are the results of the implementation of these strategic initiatives. Europe grew net sales by 3% last year. That's the third consecutive year of improved performance. We gained share across this market, taking 30 basis points over the year and this is a trend that has been consistent with a cumulative share gain of 90 basis points over the last three years.

Brand and category performance was strong. Scotch up 2% with Johnnie Walker up nearly 4%. Baileys up 9%, Captain Morgan grew 7%, Tanqueray over 20%. And our reserve portfolio once again grew double digits at 13%. Guinness gained share and grew 2% year on year. These results tell a story of a market with momentum.

What I will do now is give you a brief update on each of those five strategic priorities and give you a sense of the work we're doing and what's to come. I want to start first by talking about the runway that we have created with our Route to Consumer. In my call with you last year I shared the progress made here and told you we had increased sales heads by 25% and improved the efficiency of our teams in a way that was allowing us to make 50% more calls than the prior year.

Now I can tell you that we have added 200 people to the sales team over the past two years. That is a 35% increase in the number of people who we have covering an increased outlet base. And that outlet base has gone up by 95%. Across our highest priority on- and off-trade outlets we are now regularly calling on over 100,000 outlets, double the number of two years ago and with a much stronger focus on key merchandising periods. We have been able to deliver our highest levels of availability and visibility in both the on and the off-trade.

It is not only about adding more sales people, it is also about the improved capabilities and effectiveness of the sales force through rigorous training programs and extensive use of automation tools. These tools allow us to make quicker and better decisions based off daily reported measures on sales out, key distribution points and merchandising execution. We also see further opportunities in the future through better delivery of what we call the perfect store by sub-channel and a focus on distributor management. I believe we will derive more benefit here in FY17. We have the coverage but we can still improve our precision of knowing exactly what is the right format, visibility and price point by different outlet type.

Finally, on Route to Consumer, also to talk briefly about e-commerce which is becoming an ever more important trade channel. Generally speaking, beverage alcohol is underdeveloped in the online environment, with currently about 3% of our total sales online. However, this industry dynamic is changing and we have a dedicated team focused on key account management, customer marketing and supply chain.

Over the past two years we have grown share in this business, which in turn has delivered high double-digit growth. And our market share positions online are consistently higher than our market share numbers offline. Across Route to Consumer, a tremendous amount has been done to give us a strong base and I think there's more to come and significant benefits that can be yielded.

Second up is our premium core brands. It is our second strategic priority to grow across the key brands which include Guinness, Baileys, Captain Morgan, Smirnoff, Johnnie Walker, J&B and Tanqueray. Together, they make up over half of Europe's net sales and improving the availability of these brands for consumers is critical to our ambition.

That availability is both mental and physical. The physical availability comes through the work that we do on Route to Consumer. And to build mental availability, our marketing focus has evolved significantly and I think it's stronger than it has been in years.

As you would expect, we have got a strategy by brand, each individual trademark. Let me touch on those. I will start with the biggest which is Guinness, representing over a fifth of Europe's net sales and one that grew in its largest markets.

In Ireland it was up 4% and in GB up 1% in net sales. This growth was delivered through innovations from the Brewers Project, especially a strong first full year of performance from Hop House 13 in Ireland and great activation around the rugby world cup in the first half of last fiscal. Market share for the full year was up 20 basis points in both GB and Ireland. I really feel the brand has momentum with consumers as we enter the new fiscal year.

Next up, on Baileys, where, particularly through success in Germany, Iberia and GB, we drove 9% net sales growth. We had more effective marketing behind up-weighted media. Sampling and serve communications were key in this, especially use of shorter media spots which were more tailored for a digital environment. Everybody knows Baileys, we just need to remind them about the brand. And reminding people how good it tastes is also a key driver.

We had a huge sampling program to get Liquid on Lips, which has delivered 2.5 million people sampled across FY16. We have done this in an increasingly efficient and effective way through various channels. The serve is also important and we've been working on finding some signature serves, like the flat white martinis that are working particularly well within the on-trade and helping us broaden the range of consumption occasions in which people can enjoy Baileys. So a great year on Bailey's that we feel really, really good about.

On Captain Morgan, another year of growth, up 7%. The strongest driver of growth here was from Captain Morgan Original Spiced Gold. We saw growth, particularly in our newer markets, with France being a notable success, where the brand nearly doubled. And we continue to build Captain as an icon of good times for the younger LPA-plus consumer. We ensure we've got strong physical availability, particularly in the on-trade. This is a brand with a lot of momentum. In GB the trademark is now the biggest rum brand in the on-trade and across Europe over the last five years. The average CAGR has been 18% growth.

Europe is also our second-biggest market for Smirnoff globally. Smirnoff Red is in growth across Europe and has gained share in its three biggest markets, GB, Ireland and Iberia. This success has been achieved through consistent activation behind our growth drivers, communication and culture through the We're Open platform, a great new coms platform for the brand. And then working through music and festival activation with the Smirnoff sound collective. We have also got a very strong ongoing push to ensure physical availability is robust in the off-trades. We will continue to drive the brand with this focus as we go through FY17.

On Johnnie Walker, we had net sales up 4%. That's a good year for the brand which we believe was driven by focus on a few big pan-European activation platforms. These included the Keep Walking communications campaign, expanding the Johnnie Walker and Ginger sampling program to reach more consumers and building Blue Label as an icon of luxury gifting. We will continue to focus through this year, including adding a fourth improvement driver which is innovation introducing Blenders' Batch. Red Rye is the first in a series of products under that banner, that has just launched and looks very promising.

Next, one of our local stars, J&B. Scotch actually had a tough year, net sales were down 6%. Spain is its biggest market. We do have marketing plans which are starting to stabilize the brand. A new brand coms platform and integration into major cultural events are starting to show positive results with recent market share gains. And these programs are being scaled up in this fiscal. And in France, the other big country for J&B, we did grow share thanks to a new brand campaign and strong promo strategy.

Finally, on premium core, just touch on gin, and of course Tanqueray, our lead brand there. We have a fantastic gin portfolio which accounts for 28% share of gin across Europe. What I want to ensure is we take full advantage of the category growth which is still running at double digits here. We have invested significantly last year and up-weighted again this year behind

Tanqueray London Dry which is key to our performance in this category. We grew share in FY16 and net sales went up 18%, that's on top of 24% the previous year. This success has been achieved by increasing distribution in the right outlets with improved visibility and bartender support in the on-trade and strong display activity in the off-trade. FY17 will see a continuation of that activity behind Tanqueray and an acceleration of Gordon's. Gordon's grew 5% last year and we're just in the midst of a major relaunch and a new pack on that brand that we think bodes well.

Our third strategic priority is innovation. At this point 10% of Europe's sales now come from innovation; that's a significant increase versus three or four years ago. It has become a consistent and reliable growth driver for getting our whole Europe business back into growth.

More recently, we've seen innovation continue to play a key role through Hop House 13 Lager in Ireland and GB was a standout success in FY16. Captain Morgan White also doing well in its second year, over 150,000 cases. As I've mentioned, we're just launching Red Rye Finish Johnnie Walker, the first in our Blenders' Batch series going out across all parts of Europe.

We also launched Smirnoff cider this summer in GB; that's off to a good start. When I look at the pipeline we've got teed up for the next three years, I feel good about the level of growth we can drive and critically the way we can use innovation to recruit new consumers to our premium core brands.

And innovation's impact is broader than new brands and products. I mentioned earlier the importance of accessibility in terms of new formats and trade channels. Formats presents a real opportunity to access more occasions. As an example, we're seeing great results behind our focus on extending our brands into premix format, and therefore competing successfully across categories with our leading brand portfolio. Gordon's and Captain Morgan RTD, which are our biggest individual premix products, were up 16% and 20%, respectively, last year. And given where RTDs are positioned in stores, it shows we are effectively taking our spirit brand into competition with beer and cider.

Innovating in trade channels as well is important. We want to be at the cutting edge of a changing landscape of how and where brands are found and consumed. One area we've focused on is what we call the third space. The third space is neither off- nor on-trade; it's where consumers are now increasingly choosing to socialize. These venues cover festivals, markets, pop-up art, even offices. We already have a purpose and an ambition in this area and last year we executed over 700 events in what we call the third space.

The importance of this phenomena is not only about a fair share of a new distribution channel, but also the importance of capturing occasions where we know millennial consumers are present. It is an opportunity we set up to capture, so you can expect to hear more about that in the future.

Number four is reserve. The business now represents 18% of spirits net sales in Europe. It continues to drive growth and positive mix, growing by double digits again last year. Our market share is now 22% and I believe with a strong heritage, quality and crafted credentials behind our brands, that performance is sustainable.

More than half of our reserve portfolio consists of our great range of malt whiskeys, which grew sales by 7% and are gaining share across Europe. If they didn't exist and I had the opportunity to design a new category from scratch, to tap into current millennial consumer trends, I'd invent malt whiskey. Malts provide the story, the heritage, the craft credentials and the variety that consumers are increasingly looking for. And our portfolio is second to none in that area. Just in FY16 we expanded the portfolio again with the launch of Dalwhinnie Winter's Gold, Lagavulin 8 Year Old and Oban Little Bay, all of them exceeding our expectations.

In addition to our malt whiskeys we're also are winning with our luxury portfolio. In FY16 Europe saw strong net sales growth in the brands participating in mass luxury. Don Julio was up 30%; Ketel One, 27%; Tanqueray Ten, 42%; Bulleit, 79%; Ciroc, 35%. This performance on Ciroc takes the brand to be the leading super premium vodka in GB. I believe the momentum we have in reserve will continue to be a big driver for us in the future.

Finally, productivity, our fifth priority. The goal here is to deliver on a broad productivity agenda which sets out to improve the efficiency and the effectiveness of the business. We already had momentum behind productivity and have been embedding a change in culture focused on driving this agenda.

The benefits from being more productive are already fueling investment behind growth and supporting improvements in margin. We have had a long-standing focus on ensuring we drive out inefficiencies in Europe. Europe is leading Diageo on a number of the productivity work streams and we have major plans here with clear targets, driven down to a country level.

I'll just give you a flavor of a couple of areas where we expect to deliver benefits this year. Firstly, zero-based budgeting. Our FY17 planning process has embraced zero-based budgeting to increase both efficiency and effectiveness of our indirect overhead spend. This is expected to deliver a 13% reduction in indirect during this year.

Secondly, on marketing efficiency and effectiveness, we expect we'll see further procurement benefits delivered in FY17, similar to what we achieved last year. And on effectiveness, Europe is leading the work in this area. We have a single Europe-wide execution plan and are using econometrics to decide where to allocate marketing spend by country and by brand for the best return, both short and long term.

We stepped up our use of data analytics and econometrics to judge the level of effectiveness achieved here. The feedback on this is then being shared very quickly to ensure we course correct and put the money where we get the biggest return. This process required the analysis of some significant data sets. However, our improved capability here has allowed us to actually double the number of brand and country units that we monitor in detail.

With one business plan and more extensive use of data, we are continuing on a journey to maximize getting scale efficiencies and ensure better execution across the board. So lots going on in productivity that we think will yield real benefit.

Summarizing on Europe, our performance in FY16 has demonstrated that the strategy is working and it has set us on a course to deliver sustainable performance. I believe this trajectory is sustainable because our brands are well-placed to continue growing share. Reserve has real momentum. We have got confidence that we can fuel growth as well as expanding margin through our productivity agenda.

We have only just really completed the implementation of the major pieces of Route to Consumer and that will continue to yield benefits for us. The Europe business can deliver sustainable growth in the low single-digit range and improved margins, driven by execution of this strategy.

So the whole region, I would balance this with a more challenging outlook in our other markets, Russia and Turkey. These two markets represent 16% of the region and are facing some challenges and uncertainty of growth prospects in the near term. Russia is the smaller of the two; it's under 1% of total Diageo group net sales. However, conditions remain challenging and the outlook is uncertain.

Our approach here is to continue to enhance our strong Route to Consumer and position ourselves well to be ready for when the economy does recover. We have the appropriate cost base now and are focused on a couple of key parts of the portfolio, particularly scotch and reserve.

Scotch is the core of our business; it represents over 60% of turnover. Johnnie Walker is our largest brand and held share over the years, supported by strong performance from the super deluxe range. Reserve brands overall represent about 10% of the business, but are growing at 30%; so a promising trend there.

Then, looking at Turkey. This is the market that grew net sales at 6%. Within that, Raki was up 3% with Diageo gaining over a point of share and premiumizing the mix within that business. In scotch we saw double-digit growth supported by strong category performance. However, we do see uncertainty right now. The political situation will likely have a impact locally, but also it's created a sharp reduction in tourism that we have been seeing throughout the summer.

That said, we have a solid local Raki business. Turkey does have GDP growth in the mid single digits and a growing legal purchasing age population. Our Route to Consumer in Turkey is one of our best globally, so I believe the opportunity here makes our position attractive in the longer term.

So in summary, I hope you will agree we have a strong business overall in the Europe, Russia and Turkey region. We have a strategy that is working and we can see that in the results that are coming through. So it is one that gives us confidence in our ability to contribute to Diageo's overall mid-term goals. With that, I'm going to pause and we will open the line for questions and look forward to hearing from some of you on the phone.

Operator: Sanjeet Aujla, Credit Suisse.

Sanjeet Aujla: Hi, John, thanks for the presentation. Just a quick question on the pricing environment across Western Europe -- clearly we can see with the strong growth in reserve you have had a very strong mix in recent years. But when looking at your headline price mix for Western Europe, it's been flat to slightly negative. Can you give us an update on how you're seeing pricing evolving? Is that still challenging across the markets there?

John Kennedy: I think that's an important question, as we look at the pricing trends, particularly in the off-trade. They are tough, with the growth of discounters. And competition from the major grocers head-to-head is driving some level of deflation.

However, if you look at the combination of things that we're doing, which include ambitiously driving the reserve portfolio which does drive a big price mix benefit and will continue, an innovation pipeline that's specifically geared around driving top-line and bottom-line growth. Actually, our pipeline of new products are significantly accretive on gross margin.

And then the productivity work that we're doing to make sure we're driving costs out everywhere, including the COGS of the individual product, gives us confidence that we can get a level of gross and net margin expansion in line with the guidance that we've given for the next few years. So realistically, it is a challenging environment but we think we've got the right set of tools in place to ensure that we expand our margin.

Sanjeet Aujla: Got it. And on Russia, you had a lot of price mix coming through last year. Is that continuing into FY17? And overall do you expect Russia to drive positive sales growth this year or do you think it's more challenged than that?

John Kennedy: A lot of that did come through last year. We think what will happen is that will continue through the first half and then flatten out in the second half of the year, because of the timing of the price increases. We took several increases that probably covered about half of the impact of the ruble devaluation.

We are just keeping an eye on balancing, making sure that we protect our margins while making sure that we are competitive in the marketplace. We think that we have got that about right.

Sanjeet Aujla: And finally, what's the split of your business in Turkey between Raki and the international brands?

John Kennedy: What is the question? What's the split between them?

Sanjeet Aujla: What's the split between Raki and the international brands in Turkey?

John Kennedy: It's about 80% Raki and then about 10% whiskey and 10% vodka.

Sanjeet Aujla: Great, thanks, John.

Operator: Olivier Nicolai, Morgan Stanley.

Olivier Nicolai: Good afternoon, John. Just a couple of questions, you mentioned eCommerce. Wanted to know, is the product mix in eCommerce similar to the region? Is it actually accretive to margins?

Second question would be on Spain, could you give us an update on the trending in Spain? Is the growth only coming from gin or do you see some upside for scotch? Thank you very much.

John Kennedy: Sure. I think eCommerce, digital commerce, it isn't one answer. What we're seeing is a variety of situations that have slightly different margins associated with them. But what I would say is we do believe that we can -- our full portfolio can thrive in the digital environment, and deliver healthy pricing and margins because of a couple of things.

One is the mix does tend to be good. There is a, in beverage alcohol, there is a natural fit with our luxury portfolio in an online environment where you can personalize products and where special events, like a Black Friday, are particularly suited to our luxury and our reserve brands.

And then as you look across the pure eTailers and the bricks-and-clicks customers, what we're seeing is that we are, by growing our own key account management skills with these customers, we are able to deliver a pricing that has reasonable margins associated with it. And I think we're delivering value to the customers because we've improved our own shopper marketing capability online. We actually have two dozen people now who are dedicated to figuring out what does online shopping look like.

On the question on Spain, yes, interesting in Spain, people are really coming back to the on-trades. Just in the last 3 to 6 months we have seen a 5% or 6% uplift in Nielsen measures in Spanish on-trade and value. That is a big improvement versus last year and two years ago. So it is not just gin, it is the whole spirits category.

Within that massive uptick in tourist trade, which we think will continue, we have tailored our approach around that. We've taken our field sales force and we now take 75% of our field sales people and relocate them to tourist locations for periods in the buildup to peak in summer. That's having significant benefit. So, feeling encouraged about the broad trend in Spain right now.

Olivier Nicolai: Thank you very much.

Operator: Trevor Stirling, Bernstein.

Trevor Stirling: Afternoon, John. Three questions from my side, please, John. First place, concerning Turkey, you referenced that you've seen disruption in the tourist trade in Turkey. But is the impact of the political unrest spilling over into the domestic market as well?

Second question is in Ireland, Hop House is clearly doing very well. Craft beer, I think, is up to about a 3% market share as well. Who is losing out in the Irish beer market at the moment?

And the third question, have you seen any impact at all of Brexit on the GB market?

John Kennedy: Got it, Trevor. Hello to you as well.

I will take those in order. In Turkey, what we have seen is political, and particularly the security unrest leading to a downturn in the domestic on-trade. So it is beyond tourism.

For those of you who are not that familiar with our Raki business, the interesting thing about that is it's particularly consumed in restaurants, in the same way wine would be in other countries and at home. That business actually has proven pretty resilient. It's more categories like vodka that have been hit by that on-trade downturn. So relative to others, we're in a pretty good position there.

On the beer front, on Hop House 13, we're up to -- certainly the winner is Hop House 13. We're up to about 3% share of lager in Ireland. And, Trevor, you would remember, for a new brand that is a very significant share increase. It seems to have a benefit on Guinness as well, just because of the halo impact of being from the Guinness portfolio.

In terms of winners and losers, I think what we're starting to see is the kind of trend we had seen in other countries like the US where the biggest mainstay lager brands that had the vast majority of share from the last generation are being nibbled away at and eroding some of that position.

Then on Brexit, we're not complacent about Brexit, and do believe that, medium term, there are things that we need to be tuned into. Our current trading does not show any significant downturn, either in GB or on the continent. In terms of our confidence in this year's fiscal plan, it remains. But it is something that we're staying very close to.

Trevor Stirling: Thanks very much, John.

Operator: Simon Hales, Barclays.

Simon Hales: Hi, John. I wanted to follow up. You painted a very positive picture about the momentum in your business as you got into 2017, particularly in Europe, putting aside Russia and Turkey. I think the momentum was particularly strong in the second half of the last fiscal year, yet you said in your closing remarks you thought low single-digit growth was the order of the day as we think for the full-year FY17. Where is the disconnect there? Because I think you exit the year probably near a 4% top-line growth.

Where are you a little bit more nervous? Because you talked about strong growth continuing for premium core, sustained a very strong growth you see in reserve. Is it nervousness, perhaps, around Brexit and other issues as you go through the year that is tempering those expectations a little bit?

John Kennedy: I wouldn't say our expectations are tempered. I believe we will sustain what we did in FY16 going forward. What that essentially means is, in particularly a spirits market that's maybe somewhere between flat and up 1%, and then a GB Ireland on-trade beer market that's still down 1% or 2%, we expect to get that low single-digit growth we achieved last year really by carving out market share through the execution of the plans we have got. That's what it takes.

What I would say-- continuing to get 30 bps plus in market share in a competitive market is, I'd feel pretty good about. And that's what it translates to, in terms of numbers for us.

Now, are we uncertain about the external environment? I think we're aware that it is a little bit unpredictable, and the combination of, as Trevor mentioned, Brexit, any economic slowdown, as well as just political uncertainty in a number of countries may have an impact. But on balance, we feel like we can plow through that and deliver the numbers that I was talking about.

Simon Hales: Can I follow with a second one and ask you a little bit more about J&B? Because clearly you said there's been some recent signs of maybe a move towards some stabilization in Spain. I wonder if you could talk a little bit more about what you're actually doing with the brand there, and also in France as well, to try and have finally move that brand back to growth or at least stability over the next 24 months.

John Kennedy: Yes, it is an important brand for us, particularly in Spain and France. I think the thing you have to do with J&B is step back and look at the long-term picture.

Particularly in Spain, there has been a massive change in the market over 10-plus years where a market that predominantly focused on very late-night consumption of whiskey in the on-trade has shifted to lower-tempo earlier-evening occasions. That's why gin is benefiting significantly. All Scotch whiskies have been hit because of that. So, part of it is a long-term market dynamic that we've seen.

However, there was a period where the work was not good enough on J&B. We cycled through several marketing campaigns, but I think we've cracked that now. We're about 18 months in to a consistent set of communication platforms that you'll see in the advertising in-store, in major cultural events like the Benicassim Festival which we're a major sponsor of.

And much bigger presence in the on-trade where our route to consumer work is -- we've been doing more in Spain almost than any other country. That has translated into, in the rolling three months, we are winning share in whiskey in the Spanish on-trade. That is a good sign. Disappointed with the net sales result from last year, but feeling much better about Spain this year.

And the French team have always been on top of J&B. Actually it's been relatively stable there and they have gained share this year. So I expect that to continue. The signs are that we should get reasonable results on this important brand.

Simon Hales: Thank you.

Operator: Fernando Ferreira, Bank of America.

Fernando Ferreira: Hi, John, thanks for taking the questions. I have two questions, please.

First one, following up on the premium penetration and the growth we have seen there on the reserve portfolio, when we look at the overall share that has of your mix, it's still lower than what it is in the US for Diageo. So the question is, do you see that getting to the same share of the overall mix as you have in the US? And how long do you think it takes for a similar penetration of the premium and reserve? That would be the first question.

And then second question, wanted to get a few anecdotal evidences or what you are seeing in your region regarding the savings plan and the ZBB. How advanced or how has it changed really on a day-to-day basis for the managers and for the people overall in your region?

John Kennedy: Got it, Fernando. On reserve, you're exactly right. We talk internally about how Europe is the global capital for luxury. If you look at most categories, there's a very high development index on the luxury end of a consumer goods category.

In spirits, though, it is underdeveloped, and the US is further ahead. When we benchmark against that, and when we look at whether the trends indicate that we can close that gap, generally the answer is yes. It does support us driving the type of growth that we have seen for four years.

I think the average would be about 15% NSV growth on a category that represents almost 20% of our sales and is margin-enhancing. So we have to execute well, but I feel very good about the opportunity to continue to get significant growth there.

On productivity, overall there's no real change in terms of the culture and the attitude of the Europe business. For a number of years we have been highly focused on driving efficiencies here, because we have to be as we went through the euro crisis. The culture and the attitude, everyone is, every dollar you save is a dollar you can invest in driving growth of the Business.

I think the one thing that has changed as we have embarked on this global plan is that we are now more aided and supported by a set of specific tools around zero-based budgeting, our net revenue management, by a specific set of processes and ways of working that really ensure that the execution is very good. That's giving me confidence. And actually people feel encouraged about that translating into continuing to deliver a significant price. So no change on the attitude towards productivity, but it's just becoming more systematized in the Business.

Fernando Ferreira: Got it. Thanks so much, John.

Operator: Chris Pitcher, Redburn.

Chris Pitcher: Thanks very much, John, a couple of questions. The first one is following up on productivity. Perhaps this is overly simplified, but you talked about how you'd increase your sales resources by 30%, increase the number of outlets you're covering by 90%. If I look at the development of net sales over the last couple of years, it's only been up 4%.

In terms of productivity per capita, have you now got a sunk cost in your sales force that you now expect to really start to sweat in terms of getting the operating leverage through there, in terms of ongoing margin growth? Do you need to put more sales people down from FY17 onwards?

Then a follow-up question on scotch, following on from the currency movement, is there scope, do you think, to adjust pricing on the lower end of the portfolio in Europe? And at the group level, do you talk about primary scotch? There are large areas of Europe that there's a good opportunity for primary scotch. Is that something you are looking at?

John Kennedy: Yes, Chris, on the overhead and the sales question, you're exactly right. Really the formula is, now that we have got -- I think we've got the muscle in place in front-end sales, and I expect that to be a big part of what generates consistent sales growth. At the same time, the productivity work around organizational effectiveness is looking in depth across all parts of the Business, particularly the functions, to make sure that any low-hanging fruit, any inefficiency is squeezed out.

Between the two, what I think we're going to do is drive our overhead-to-NSV ratio to a level that I believe will be top-quartile, best-in-class across major consumer goods companies in Europe. And that work is planned into the productivity work, and I feel confident that we'll be able to execute against that. Yes, I think there's more progress to be made there on those ratios.

On your points on pricing, both in Europe and globally we're looking at a couple of opportunities on scotch, and we were looking at them even before the sterling devaluation from Brexit, one of them being what we call primary products, which are more competitive in price. We think, as we looked at the size of prize, there is a significant amount of volume to go for there. Some of it's in Europe, some of it's in other markets, but as part of driving our overall scotch performance, there is a work stream dedicated to going after that. Don't have exact numbers on it, but we think it will be a good contributor to scotch performance for Diageo.

Chris Pitcher: Thank you very much.

Operator: Edward Mundy, Jefferies.

Edward Mundy: Hi, John, afternoon. Three questions, please. First on stock levels and inventory in Europe, are there any potential overhangs, in particular in Turkey? Second, in zero-based budgeting, you mentioned you've got better tools and processes in place, but have you changed the centralization at all as you fully embed changing culture and productivity?

The third question is really around the monitoring of returns of marketing dollars. You mentioned that you are increasing the number of brands and country units. You able to quantify where we are in that evolution, and how many more brands and country units are still to be brought in there as you better monitor the returns on investment?

John Kennedy: Thanks, Edward. On the stock question, Turkey is in very good shape because we have a very strong distributor management capability there. It's very sell-out focused. We have got great physical availability of our brands, but it is a just-in-time approach and there's not a lot of stock in trade.

Its across many countries of Europe, obviously trade practices with our customers vary slightly. But broadly, as you would have heard from all of our global coms, everything we're doing is about becoming more precise and more focused on measuring sell-out at a retail level, and making sure that is where our energy is focused. And part of having great sell-out organization is making sure you're getting a clear demand signal and you are not confused by stock levels that you have got in trade.

I feel pretty confident that despite the fact that customers continue to want to lower inventories and drive their cash performance, that we have been working effectively to build the sell-out culture and have pretty good understanding of stock levels and trade, and don't expect those to have any significant impact on performance.

You asked a third question, I think it was on the econometrics point on how many of those units will we -- those brand country units will we cover. We expect to get up to about 80% plus of our net sales, and we think that will be a good measure.

I did not cover it today, but for those of you who were on the call last year, one of the other things we've done a lot of work on through procurement is we've dramatically reduced the number of agencies we work with, the number of marketing programs that we have in Europe, and increased the scale of those that have survived. We consider operating at real scale an area we can develop competitive advantage.

We took the marketing program down from about 140 three years ago to under 50 last year. They're better programs. As you can imagine, all the creative fees, all the agencies, all the man-hours that went into creating that long tail of programs have allowed us to generate a lot of productivity. It's both at the procurements create end of it, as well as the data analytic work on measuring the effectiveness in trade.

Edward Mundy: Thank you. And zero-based budgeting, you mentioned you got the tools and processes, but have you changed incentivization at all as you really embrace this culture of productivity?

John Kennedy: Incentives for our people, you mean?

Edward Mundy: Yes.

John Kennedy: We have not changed our reward programs. Obviously, better delivery of profit drives bigger reward for everybody.

What I would say though is -- and what people are very comfortable with is, as part of being one Europe, we are all very comfortable with saying, look, there is one way we're going to do this. There's one way we're going to do T&E and customer entertainment and travel and hotels and using consultancies and subscription. Because of the scale of the Europe market, we are able to very quickly institutionalize the best practice that we pull together. That is why we are actually planning on a significant double-digit decrease in indirects this year.

Edward Mundy: Great, thank you.

Operator: Anthony Bucalo, HSBC.

Anthony Bucalo: Thank you for taking the question, John. Just two things -- one, you talked about innovation. I'm sorry, I think I need a clarification on this. It was 10% of sales, or 10% of your increase in sales is now based on innovation? Could you give a reminder of the definition of innovation and how much of that is coming from either reserve or beer or where that falls out?

The second question is about the sustainability of the Spanish trends right now, and whether there are dots to connect between the drop in tourism in Turkey and the increase in tourism in Spain? Is this a robbing Peter to pay Paul moment? Or is this actually a sustainable outlook for Spain for the near future?

John Kennedy: Great, Anthony. Thanks for those questions. Innovation -- the 10% is basically saying that 10% of our total sales are from new products. And our definition of new products is literally new products, new liquids that have been introduced within the last five years. That number was probably around 6% for Europe three or four years ago.

The actual growth of that portfolio of products is about 30% a year. So that is a turnover of a couple hundred million, growing at 30% a year, so it's a big impact for us. And it's pretty balanced.

If you look across the categories, we've always been strong in white spirits and in rum, but increasingly through our whiskey innovations, what we're doing on malts, and a lot of success in beer in the last 18 months. You're seeing a nice balance of growth coming across all of the major categories.

On the Spain question, yes, I think some of the tourism will come from North Africa and Middle East. But there's no doubt that the trend in the market, particularly nationally in the on-trade, has a big domestic to it. So there is a, I believe, a significant change in behavior that we would expect to last for a period of time, not just for one or two summers.

Anthony Bucalo: Okay, so you think Spain can hold onto these growth rates for at least the near term or the medium term?

John Kennedy: I think the on-trades numbers are really strong. Whether it stays up at that 6%, 7%, I don't know, but it's going to be in positive territory for the next couple of years.

Anthony Bucalo: Is the primary driver gin or is the primary driver scotch or is it both?

John Kennedy: Recently, like rolling-three, rolling-six months, you're seeing growth across all categories. What you have seen longer term is gin growing disproportionately at a double-digit level. That trend, it's slowed down slightly but it's still very strong. Obviously we've seen that across Europe as well, which is why we have upped our game, particularly on the Tanqueray brand.

Anthony Bucalo: Great, thank you very much.

Operator: Brett Cooper, Consumer Edge.

Brett Cooper: Thanks for taking the question; I have three. First on the online, who was undershared in the channel? And then what is your view on the development of it over the medium term?

On efficiency, can you just talk about how your view on the duration of efficiency programs have evolved over the years? And then finally, on margin evolution, I was hoping you could give us some breakout between country mix and efficiencies net of reinvestments that you've seen over the last few years? Thanks.

John Kennedy: Brett, on online, when you say efficiency, are you talking about margins or what specifically?

Brett Cooper: Sorry, separate question. Specifically in the online rate, you said you had a better share there than you did in the balance of the channel. So who is the one that is undershared within that space? And then if it's 3% of your sales today, what's the view three, five years out?

John Kennedy: Good questions. I think online, it is a big player, so we're winning; our key competitors are losing. It's the major spirit company compounds across those.

In terms of the long-term prospect, it's a bit hard to tell but if we're at 3% in TBA, in beverage alcohol, consumer goods tend to be at 8% on average, and there's some categories that obviously you would know about that spike up to 20% and 30%. So we feel like there's very significant headroom here.

What we're doing is gearing our internal capability resources and plans around growing that at multiples. I could not tell you exactly where we'll be when, but I would expect a very significant increase, and I'm determined that Diageo is going to be at the leading edge of winning in that channel.

On the efficiency piece, I assume you're talking about the econometrics and where the spend may or may not go by country and brand based on that? Is that what you were getting at?

Brett Cooper: Yes. I would assume that when you guys started this journey, given the macro environment, there is a view as to what the efficiency was. At least from the outside looking in, it would seem like the sustainability or duration of being able to deliver those efficiencies has extended over time. I was wondering, as you're multiple years into this program, what is the learning over the last several years that you can take forward?

John Kennedy: I think that is a key point, which is that any sense that there is a temporary push or a project initiative around driving efficiency and productivity in this business is dead. And it is a permanent way of working with an expectation of permanent benefits coming from being smarter and leaner and faster across all of those work streams that I identified.

What I personally found over time is that as you grab the low-hanging fruit in one area, there's always something else that opens up. We are putting a tremendous amount of work into what we call net revenue management right now, which is a major part of our P&L that we believe we can yield benefits from with a deeper level of interrogation. We're really just looking at what we do now as a continuous and rolling set of goals and productivity where the particular components on programs at any one point in time might shift back and forth. I don't know if that gets at what you're talking about, but that's my take.

Brett Cooper: That's helpful.

John Kennedy: Great, thanks, Brett.

Brett Cooper: Thank you.

Operator: Laurence Whyatt, SocGen.

Laurence Whyatt: Hi, just three questions from me. On your A&P, you say you've made some savings in the procurement. But wanted to understand how your share of voice has changed, and if there are any brands that have significantly benefited or lost out as a result of that?

The second one, on the whiskey portfolio, you mentioned your single malts are doing very well, as they have a prominent site that millennials are looking for. Just wondering how that makes you think about your blended whiskey portfolio?

Finally, with your innovations, you got a couple of different types of innovations with different products such as, you have different finishings on some of the whiskey portfolios, but then you got flavors coming through in other brands, such as Bailey's. I'm wondering, given flavors have been quite problematic on a number of categories, how you think about flavors going forward in innovations? Thank you.

John Kennedy: Thanks, Laurence. So, on the procurement piece, the two things we're measuring on the brands is physical availability and then mental availability, which the share of voice piece plays into.

On the physical availability, it's interesting, this new route to consumer strength that we've got, we have some brands, like for example Tanqueray Ten that we decided last year that we were going to have 10,000 new points of distribution on that brand within 12 months, and delivered against that. So if you look at the presence of our brands in outlets, it is improving.

On the mental availability share of voice piece, yes, we're tracking that and our total media spend has gone from about GBP65 million to about GBP90 million in the last three years. So as part of all that efficiency and squeezing out non-working investment in marketing, we are finding that we are able to up-weight a lot the media spend. Feeling good that, broadly, all the premium core brands are moving in the right direction on that.

On the whiskey piece, yes, blended whiskey, the key to blended whiskey is Johnnie Walker, which had a very strong year last year with sales growth of 4%. Actually, the plans are coming together well on Johnnie Walker. The brand has always had a great platform on Keep Walking.

We have a wide range of new communication materials going out that we think are very strong. Some of them will break over the next few days. We have got a scale program in Johnnie Walker and ginger, which actually just makes drinking whiskey a lot easier and accessible for a lot of consumers who sometimes wonder, how am I supposed to drink it and can I only have it straight?

On innovation, I think with innovation, the thing with, you called it flavors. What we're finding is new products that bring to the fore the craft, the history, the lore of making these brands is really interesting to people. So we did it on Tanqueray with Malacca Strait and Bloomsbury. We're doing it now on Walker with Red Rye Finish.

What we're seeing is it's positive for the brand equity. We also have figured out a lot of the principles how to merchandise, which makes sure that as you launch the new product, you use it as a big platform to merchandise your core range and drive sales of that.

So I actually think the formula is pretty good and feel like, no, we will not be dealing with flavors that come out for one season and then drop dramatically and create a problem in the future. We're pretty smart on that formula now. So thanks for those questions.

Laurence Whyatt: Thank you.

Operator: Thank you. There are no further questions at this time, sir. Please continue.

John Kennedy: Good. Listen, I think we might have run over by a minute or two. So I will close very quickly and just say thank you for taking the time to join. I appreciate the questions.

The comments I made about the strategy we have well executed, giving us the opportunity to sustain the performance we've had, grow market share, deliver low single-digit growth, stands. And we are getting on with executing against those with confidence and energy. Look forward to speaking to you on the next call, if not before. Take care.

Operator: Ladies and gentlemen, that does conclude our conference for today. Thank you all for participating. You may now disconnect.

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