Diageo – Brunch-time call with the presidents – Latin America & Caribbean

Alberto Gavazzi – President Diageo Latin America & Caribbean (LAC)
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Alberto Gavazzi:
Good morning, everyone and a very good afternoon to those of you dialing in from Europe. I'm really delighted to be here with you again. So, similar to last year's call, I'm going to talk about Diageo's business in Latin America and the Caribbean for about 25 minutes or so. And then, we'll open it up for questions.

So, let me start by reminding you that LAC is an exciting and growing market but also, a historically volatile one. Therefore, we're focused on delivering sustainable growth while navigating the current conditions in the region.

We're in a strong position in the current environment with good momentum in many of our markets and outperforming our competition. Moreover, in scotch, which is the biggest part of our business, we're seeing share gain in across 90 percent of our key battlegrounds.

Even in Brazil, the political and economic environment has impacted demand, we're gaining share in scotch. Our Reserve business is performing well. And we're expanding focus on the lower end of our portfolio to continue to drive recruitment. To bring this to life on this call, I'm going to structure my remarks in three sections.

First, the opportunity we see in LAC, and our strategy to capture it. Second, the changes that we have been making to drive sustainable growth. And finally, I will share some of the actions that we are taking to deliver our strategy and provide examples from our individual markets.

The opportunity for Diageo in LAC is big. And the beverage alcohol market will benefit over the long-term from a growing and wealthier population. The legal purchasing age population will grow faster than the total population, adding an additional seven million people every year until 2020. In addition, the emerging middle class will continue to expand with 70 percent of the region's population expecting to have annual incomes over 15,000 by 2020.

In a region where beer and local mainstream spirits account for 80 percent of beverage alcohol sales, we believe that we can drive higher penetration of premium spirits as consumer income rises. Within premium spirits, scotch is the biggest category with almost 60 percent share.

However, penetration is still low when compared to other mature markets. In a similar way, there is significant opportunity to drive penetration of other categories like vodka, rum, tequila, and gin.

We're the clear leaders in the premium segment in the region, selling four out of every ten bottles. This strong position is built in our leadership in scotch where our share across LAC is almost 70 percent. It is the strength of brands like Johnnie Walker, Buchanan's, Old Parr, which give us this enviable position.

More recently, as I will describe later, we are also accelerating recruitment into the category with our primary scotches like Black & White, White Horse, and Vat 69. Our strategy to deliver on this opportunity is aligned behind the principles that I laid out on our last call last year.

First, we will continue to expand our leading position in scotch, not only the premium segments, but also expanding further into standards and primary. Here, our focus will be on recruiting new emerging middle class consumers and driving premiumisation.

Second, we will accelerate our diversification into other categories by leveraging Diageo's great portfolio in vodka, rum, tequila, and ready-to-drink; and by stepping up innovation.

Finally, in order to drive total local spirits growth, we will motivate consumers to choose spirits more frequently in key occasions.

Now, I'd like to spend a few minutes on the changes we have been making to deliver sustainable growth. Our aim is to get better at navigating economic and currency cycles to become a reliable compounder of growth. And we believe that we have made some good progress on this front.

Some of these changes are; first, we have rationalized our portfolio to drive clear focus on spirits. We have exited beer in Jamaica after completing a successful turnaround of that business. And also, sold wine in Argentina. At the same time, in Argentina, we have strengthened our spirits business by appointing a new distributor who will transform the route to consumer for our international spirits brands. We have also acquired a 100 percent ownership of Don Julio in Mexico, cementing our participation in that fast growing and super premium tequila segment.

Second, we have taken steps to reduce the volatility associated with certain channels and countries. In the export channel in West LAC, we completed a de-stocking process at the end of F15. And we're now less exposed to the volatility associated with this channel. However, we will continue to closely monitor stock levels to make sure that we keep it under control in the future.

In Venezuela, we have a strong local business with a good position in rums, vodka, gin, and ready-to-drink. Our decision to use a consolidation exchange rate that recognises the real rate of the local inflation has further reduced the size of Venezuela to less than one percent of the region's sales; but with the benefit of also reducing the volatility associated with our Venezuelan operations. Here, we have been working very hard and now have a business that is sustainable, based on our local portfolio. We will continue to pursue opportunities to import scotch. But it will be incremental to the base business.

Third, we're also building a scenario planning muscle to enable us to better respond to the changes in the external environment. Pricing is an area where we clearly have done this. Given the inflation and the currency volatility we face, we need to carefully balance between protecting margins and sustaining consumer demand for our brands in order to drive share and category growth.

Our approach has been to take phased price increases while closely monitoring consumer reaction and improving brand equity to sustain marketing investment. For example, in Columbia where the currency has devalued approximately 30 percent over the last 16 months, we have almost fully recovered the FX transaction impact through three phased price increases while the business continues to grow. On the other hand, in Brazil, we're being more cautious given the weaker consumer confidence. And we have only taken prices to cover the recent tax increase and part of the transaction impact of devaluation. In general, I can say that we are pricing at a minimum ahead of local inflation in every market.

Taxes are another area where we're being proactive. In the current economic environment, governments will most likely be looking to protect their revenues and the spirits industry could see an increase in taxes. We are therefore, anticipating and engaging with governments to deliver the best possible outcome for all parties on this front.

Next, we have stepped up our focus on productivity and cash as key drivers of our performance. As a few examples of how we're driving out costs, we have renegotiated our media agreements across LAC, leveraging our scale to deliver savings of 15 percent on average in F16.

In Brazil, procurement savings will not only cover input inflation; but also generate additional savings. Logistics costs per case will be one percent below last year; and also beating inflation. And the conversion costs at Ypioca will rank this year as the lowest across Diageo's spirits' manufacturing sites.

LAC markets are well into the assessment phase of the global productivity program that we have announced. We will be implementing zero based budgeting for indirect spends as part of our F17 planning cycle. Detailed work on net revenue management is starting in Mexico as one of the global pilots. And plans have been agreed in other markets. On the cash front, we're targeting strong delivery this year well ahead of 100 percent cash conversation rate as a result of our continuous focus on working capital reduction initiatives across markets.

And finally, we're also securing our plans by building a strong local talent pipeline through investment and capabilities in multi-year talent planning. This year, we're once again being recognized as one of the top great places to work in many of our countries where we operate, including Mexico, Columbia, Venezuelan, Peru, Costa Rica just to name a few.

I will now share some of the actions that we are taking to deliver our strategy. I will briefly talk about how we're growing scotch, expanding into other categories, and stepping up execution to motivate consumers to choose spirits and within spirits our brands, more frequently in key occasions.

Let me start by talking about scotch. In line with this strategy that I described before, we are focused not only on leveraging but also strengthening our leading position on premium and super premium segments, as well as expanding further into standard and primary to drive category growth. Some of the things that we have done in this space are as follows.

We launched the Johnnie Walker, “Joy Will Take You Further”, campaign, which is a next chapter of the extremely successful Keep Walking campaign. This campaign is resonating very well with consumers since we are talking to them about optimism in a very challenging environment. Johnnie Walker continues to be our flagship scotch brand. And reported 11 percent net sales growth in the first half. At the same time, we fully revamped Buchanan's, our number two scotch brand in LAC, with both a totally redesigned bottle, and a new “good versus great” campaign. The re-launch has been extremely successful, driving strong double digit growth for Buchanan's in its biggest markets such as Mexico and Columbia.

We have also increased the location driven marketing and activation across the region. For example, in Mexico, where we were targeting to make scotch the gift of choice for Father's Day. Last year, depletions were up 29 percent during this period. And we intend to beat this goal this year. We're also increasingly participating at scale in traditional non-scotch occasions like local fairs and festivals.

This year, we have made a decision to accelerate our primary scotch agenda through Black & White, Vat 69, and White Horse. In order to make sure that we maintain scotch portfolio activated across all price points, even when we have to take price. And therefore, recruit consumers especially during periods of pressure on disposable income. This is a clear example of how we can effectively leverage our portfolio to respond to the external environment. Over the past 18 month, primary scotch has become has become eight percent of our total scotch sales from five percent in the past. The price of our primary scotches might be lower. However, the margins remain very attractive. We are also bottling locally in some markets to further improve margins.

In Mexico, primary scotch is the fastest growing segment. And the key recruitment engine for the category. Here, we're rapidly gaining share with Black & White, which has grown its share in the segment from 4 to 19 percent in the last two years. In Brazil, we are also activating Black & White, which is now locally bottled. And we're also seeing strong share gains. In Chile, Sandy Mac, another of our primary scotch brands is performing very well and growing 45 percent versus last year as we position it as an accessible option for middle class consumers.

Moving to our higher end. Reserve brands are now over ten percent of our total scotch sales. Reserve is usually less impacted by the external environment and we are seeing strong growth as a result of disproportionate efforts to build capabilities and to execute brilliantly against our proven Reserve model.

Johnnie Walker Gold and Johnnie Walker Blue are driving our growth in Reserve scotch. We recently reintroduced Green Label and re-launched the Buchanan Special Reserve, both with strong initial results.

Outside of scotch, we have been aggressively expanding our portfolios across individual markets. As a result, our vodka brands, mainly Smirnoff and Ciroc; and Tequila with Don Julio; Liqueurs with Baileys; and Cachaca with Ypioca now account for over 20 percent of our spirits business. We also play in the super premium segments with our Zacapa Rum, Bulleit Bourbon, and Tanqueray Ten gin.

Innovation is a key driver of our diversification strategy as we launched additional variants of spirits and RTDs that complement our portfolio to drive recruitment.

I will now spend some time on execution. To deliver sustainable growth, we need to have effective execution, which I believe is about being disciplined on standards, targets, and incentives. We must recognise that in difficult times, consumers are become more discerning in their purchasing habits. Therefore, execution is even more crucial in periods of low consumer confidence given the relevance of unplanned purchase as a sales driver in our category.

In LAC, we are strengthening our route to consumer and improving execution based on four mandatory commercial standards; customer planning and performance management; distribution and execution standards; rewards and commercial score cards.

Each market's maturity level is assessed annually against these standards with improvement plans agreed directly with me. We are already seeing the benefits of this approach in many markets. For example, in Brazil, we have increased share on-shelf availability by 80 percentage points, up to 96 percent in the off-trade. And we're activating this ability at 25 percent more outlets.

Also, across West LAC for the first half of F16, we increased our point of sale activation reached by 56 percent together with 93 percent on-time in full execution, two percentage points ahead of last year. I think this is a comprehensive summary of how we're tackling the opportunity, managing volatility, and winning in doing so.

Next, I'll talk about what we're doing in each of our markets to drive sustainable growth. Let me begin with Brazil where as I said before, the economic and political environment continues to be very challenging. Here, with high inflation and a currency under considerable pressure, consumer's confidence and hence, over all consumption, has been impacted. In the first half of our fiscal year, net sales were up 12 percent as a result of moderate price and positive shipment phasing ahead of announced tax increases that became effective early in December. However, depletions volumes declined in the high single digit range. And therefore, the growth we saw in H1 will unwind in H2. Our executive team in Brazil is energized and focused on navigating the storm. We're investing behind our brands, our route to consumer, and our talent pipeline so that we can emerge from this downturn with higher share and stronger than our competitors.

In the first half, we further increased our leadership share in a decline in scotch category by gaining 60 basis points driven by Johnnie Walker and Black & White. Outside of scotch, we have historically built a scaled vodka business in Brazil with Smirnoff which we're strengthening through innovation. Reserve has also showed double digit growth in the first half driven by Ciroc, Ketel One, Zacapa, and Tanqueray Ten.

Our first half results include an impairment charge in respect of the Ypioca brand and goodwill mostly to significant adverse changes in the local tax regulations. As part of our plan to grow the brand, this year we launched a new national campaign. And also accelerated our innovation portfolio. First with Ypioca honey and lime and with more coming in the pipeline in the near future.

We're also expanding our distribution footprint into channel and outlets where we have low presence like mass on-trade through an alliance with another fast moving consumer good company. Furthermore, given its low conversion costs, we're increasingly leveraging Ypioca as a production site. The brand remains a priority for us. And we'll continue to make all of the required changes to accelerate our performance.

Moving on to West LAC, the domestic market grew net sales three percent in the first half driven by Peru, Chile, and Central America. The export channels remain challenged due to this currency volatility with depletion declining double digits. Our scotch share increased four percentage points up to 58 percent. And we were gaining share in vodka with Smirnoff in most key battlegrounds. Smirnoff in Argentina is a great success story where over the past three years, we have increased our share from 16 to 41 percent driven by consistent focus, investment, and accelerated local production.

Next is Mexico where we're seeing a very different situation from Brazil. The economy is growing at steady rates of two percent and unemployment is low. However, currency has also been volatile. Diageo's participation in the recent years has been positively transformed by the accelerated growth of our scotch portfolio; specifically Johnnie Walker, Buchanan's, and Black & White.

More recently, we have regained control of Smirnoff in Mexico and completed the Don Julio acquisition. No other player in Mexico has the breadth of category participation including scotch, rum, vodka, and tequila. We are the clear value leaders in spirits with 24 percent on a past 12 month basis. And almost nine percentage points ahead of the closest competitor. Moreover, recently we reached 30 percent share in the wholesaler channel on a past two month basis, which is a major milestone. Net sales were up 20 percent in the first half, with scotch and Reserve brands up double digits driven by a strong Johnnie Walker and Buchanan's performance. Black & White net sales grew 87 percent reflecting success on the House of Buchanan's campaign and strong focus in the on-trade activation. A robust turnaround plan has been implemented for Smirnoff while the start was lower than anticipated, the brand fundamentals are slowly improving. We have successfully completed the integration of Don Julio operations into Diageo Mexico. Don Julio is now the fastest growing tequila brand in Mexico growing at nearly double the rate of the category. Moreover, I'm happy to say that we're beating our Don Julio acquisition business case. And we expect this strength to continue.

I expect this strong underlying depletion in share growth to continue in H2. However, reported shipment and net sales growth in the second half will be slower as we rebase Don Julio intercompany sales from Mexico to the U.S.; which were classified as external sales in Q4 last year. This rebase will impact total LAC F16 net sale growth by approximately two percentage points.

Last but not definitely not least is Columbia. Here the economy has been impacted by low oil prices, significant devaluation, and higher inflation. However our performance is rock solid. Scotch is the largest portion of our net sales. And we are by far, the leader in the category of 79 percent share. During the first half, our scotch business grew double digits, gained share by one percentage point, and drove category growth despite price increases to cover devaluation.

Johnnie Walker and Old Parr grew double digits, while Buchanan's delivered a stunning 37 percent growth and saw share gains on the back of the re-launch of the new bottle. As we look to widen our portfolio, gin and vodka categories hosted net sales growth over 40 and 50 percent respectively. Although, from a small base, mostly driven by innovation and Reserve brands.

Reserve brands grew double digit in the first half driven by Johnnie Walker Reserve, Buchanan's 18, and Ciroc as we accelerated sales drivers like on premise menus and trained bartenders on our Reserve portfolio.

I hope this gives you a good insight into what we're doing in our markets to drive sustainable growth. Looking ahead in our second half of F16, LAC net sales will become softer than its first half as we work through the Brazil pre-tax increase buy–in and the rebasing of the Don Julio intercompany sales. This will result in full year sales growing low single digits. Brazil will continue to be challenging in the short-term. However, as I shared with you, we have strong momentum in many of our markets. And we're gaining share across the region. This gives me confidence that we can deliver sustainable mid single digit growth, net sales growth in the medium term.

So, let me sum up before we go into questions. The opportunity in LAC remains attractive. And we're progressively building a business that can deliver sustainable growth in a volatile environment becoming a reliable compounder of growth.

We're making good progress against our long-term strategy to further strengthen our scotch business by leveraging the breadth of our scotch portfolio and leverage our competitive advantage to accelerate diversification into other categories recruiting new consumers, and accessing new occasions.

We currently have a rock solid business across the region despite challenges in some markets like Brazil. We have adjusted our execution to effectively navigate the current environment, expanded focus on both the top and bottom ends of our portfolio and carefully manage our pricing strategy.

As a result, we're outperforming the competition. We're also strengthening our route to consumer, productivity, talent pipeline, and brand building as we prepare to emerge stronger.

I continue to be excited about long-term prospect of spirits and our business in the region. And I am confident that we will have strong fundamentals in place to drive sustainable growth.

Now, I'd be happy to take any of your questions.

Olivier Nicolai – Morgan Stanley:

Hi, good morning, Alberto. Three questions please – first of all how much pricing do you take in Brazil for scotch just to assess…….I'm just trying to have an idea of what has been the real increase in prices there.

You mentioned also Don Julio exceptional growth in Mexico. We also know that it's growing in the U.S. Do you think you have enough capacity in the current production site for Don Julio?

And lastly, you gave us an indication for organic sales growth for the full year. Looking at margins, the margins were down about a 100 bps in H1. Should we assume the same thing for H2 as well? Thank you very much.

Alberto Gavazzi:

Thank you Olivier. So, let me start with pricing in Brazil. We have taken about 18 percent price in Brazil in two phases. We had phased that in two, which is as I said not sufficient to fully recover the full devaluation. We expect to continue to be driving pricing in Brazil as consumer confidence strengthens. However, across all of our markets, I would say that is probably the most challenging one for us to be able to drive pricing. Not because of the tax increase or the devaluation, but really driven by the low consumer confidence. As we see this getting stronger into the future, we'll continue to put pressure on pricing and covering our margin growth in that market as well.

In terms of Don Julio, yes, we're seeing good growth on the brand. I think the integration of Don Julio as I stated was extremely successful into Mexico. And we're seeing good growth as you mentioned also in the U.S. For the time being, yes, we do have enough capacity to sustain our growth. We want to continue to drive value growth of this brand. So, we're not really in pursuit of a very rapid volume growth. We would want to continue at a very premium end, driving the premiumisation of the category. But for the time being, we are OK on our capacity to continue to drive our growth into the future.

And your last question on margins. Yes, we were impacted as I said of about 100 basis points into the beginning of H1, which is what we reported. Going into H2, we will be working our ways through the tax increase in Brazil. So, as you are aware, the full impact of that tax increase is coming into the second half. So, we probably will continue to be challenged on the margin front closing more or less in the same way we did our H1 figures.

Olivier Nicolai:

Thank you very much.

Sanjeet Aujla – Credit Suisse

Thanks Alberto. Can you just give us a sense of what underlying depletions are doing across the business? And what proportion of your underlying depletions do you think you can measure with a strong degree of accuracy? Thanks.

Alberto Gavazzi:

OK, so thanks Sanjeet. Depletions is our obsession right now. We're really focusing on measuring depletions across – each one of our markets, through distributors, and key accounts, on-trade. We're really monitoring depletions and forecasting all of our S&OPs in every market on our depletion base. In most of our markets, depletions are ahead of our sell-in, which is exactly where we want them to be. The one market where we're working through this is Brazil. Because as I have told you, we have made a presale ahead of tax increases in H1. And now, we're working our way through putting our depletions in line with – our shipments in line with our depletions. So, we're still working our way through in the market. But this was planned. And we expect to close the fiscal year fully in line again. The rest of the markets, we have depletions ahead of shipments.

Sanjeet Aujla:

Thanks and are you happy with the stock levels at this moment in time particularly across the export channels?

Alberto Gavazzi:

Yes, we're happy with the stock levels everywhere. And also, closing the question that you have made before, we think that we can cover about 80 to 90 percent of our depletions very effectively.

Sanjeet Aujla:

Many thanks.

Laurence Whyatt – Societe Generale:

Hi there, and just a couple from me, if that's all right. You mentioned that there's a few countries in which you're worried about potential tax increases. I was wondering if you could give us an indication of any of those in particular. And what are the timing of those tax increases? And on Ypioca you mentioned that you had increased government regulations. I was just wondering if you could let us know what those new regulations were? And whether they could potentially impact any of your other brands? Thank you.

Alberto Gavazzi:

OK, well I don't think I said anything in terms of government regulations. We don't have any big change in terms of government regulations in the region. Those obviously we continue to monitor going forward. But there isn't anything that is adversely impacting our business right now. In terms of tax increases, obviously the big one is Brazil. And that was unforecasted. It's something that hit us very strongly not only in the spirits industry, but other industries such as cosmetics as well. And that was a very strong increase on IPI, which is industrialized product tax in Brazil. So, we're working our ways through that. And in terms of other countries, the only other country was Venezuela and Ecuador that have changed taxes.

Ecuador is not really sizable for us. And there's no other country that giving any indication on that. But my comment was more on if we are proactive with the government and showing that actually taking tax increases sometimes can adversely impact their revenue growth; which is the case in Brazil right now. Then, we believe that we can work with the government to find a solution that can help them increase their revenue and at the same time, not damage business dynamics. So, if they just go on a unilateral move of a 30 percent tax increase like happened in Brazil, the result is very clear that it impact consumptions especially as countries are going through a recession. And therefore, the total revenue that the government is going to see is going to be reduced. So, that is something that hasn't worked either for consumers, or the industry, or the government. And we need to work closely to avoid any situation like that in the future.

Laurence Whyatt:

Thank you very much.

Trevor Sterling - Bernstein:

Hi Alberto, two questions of my end please Alberto. The first one in Brazil where you've priced to cover the tax and part of the FX are you able to keep parallel imports under control? You talked about Columbia. You fully recovered the transaction of that. That probably means that in dollar terms, the price of scotch in Brazil is maybe 20 percent lower than it is in some of the neighboring countries. So, maybe you could talk a little bit about that? And the second thing is just to double check that (expect) low single digits for the full year for the region. And of that, two percentage points was the Don Julio reclassification effect. So, are we right in thinking about it, that the underlying net sales therefore, was more like mid-single digits?

Alberto Gavazzi:

OK, Trevor, so answering the first question on price in Brazil. The taxes in our region are quite high on our product. So, once you nationalise the product, then you pay taxes, it becomes virtually impossible for any parallel to happen across the patch. Parallel does happen in our region through the export channels as I – as you certainly know. But those are fully dollarized. And therefore, as you are also were aware, the impact on those in terms of dollars is direct. So, you wouldn't be seeing any parallel coming through in Brazil; nor a product from Brazil going anywhere else as a result of the progressive catch up on pricing in that market.

In terms of the underlying growth rate, we – yes, you're right in assuming that would be a positive sum into the equation. And that would drive us to still be within the low single digit rates. But just possibly closer to the higher end of that.

Trevor Sterling:

Great. Thank you very much Alberto.

Alberto Gavazzi:

Sure.

Chris Wickham – Whitman Howard:

Yes, and thanks Alberto. Just two things from me. I mean, obviously there's a plan-o-gram within Diageo and the whole brands of your global giants. I mean, I'm clearly…you know, I think Johnnie Walker, Smirnoff and Captain Morgan are the most useful of those to you. And I was just wondering where you stand on the likes of

Baileys, Tanqueray, and potentially Guinness. And then, just in sort of like getting more holistic about the question from Trevor. You said towards the end of your presentation; you know, this will be a reliable compounder of growth. I mean, if you strip out, sort of currency movements, and potentially sort of intermittent economic headwinds, what's your view of the long-term sort of contributions or the underlying contribution you can get in terms of either price? In terms of both price mix and in terms of volume for the region?

Alberto Gavazzi:
OK, hi Chris. So, let me start with the last one. So obviously it's hard in LAC to strip out anything. Because as you know, it has been a very volatile region for as long as I remember it. We're in a moment of stronger volatility right now. So, answering your question, my goal is to become a mid single digit range compounder regardless of the external environment, right. So, be able to create some immunity into the future around the external environment, and be able to deliver that. And eventually, if economies are in a different place, that could change and improve. But the goal is mid-single digit range for the future.

In terms of the plan-o-gram of the strong brands. The strategy is to diversify into the brands that you have mentioned basically for two reasons. There's nothing wrong in having a strong scotch business. It is the most profitable category in the region. And I want that to be as strong as we possibly can have it.

So, we want to continue to grow scotch as fast as or faster than ever; and continue to push on that front. But we also have some other amazing brands that we can put out there and improve the cocktail perception, if you like from consumers; and start recruiting more aggressively from other categories. So, Tanqueray, just to pick up on one of the brands that you mentioned. It is probably today the fastest growing brand in LAC. We see gins growing in Columbia, Brazil, Mexico, West LAC, Chile. Most of our markets are seeing a very strong gin performance, a high double digit growth performance that is. And Tanqueray is leading the way into that both with London dry and Tanqueray 10. So, we're really putting a lot of attention into that growing segment. And we're already the leaders of the gin segment in Latin America.

Baileys is also an important brand for us in places like Mexico and like Columbia. Baileys, we invest strongest especially on Mother's Day. That is a very big consumer occasion for us for Bailey's. And we drive that quite strongly every year. And so, then beyond that we have made some local acquisitions as you are very aware. Like Don Julio or like Ypioca to help us in the joining or diversifying into other categories to the local plays as well. So, some of those diversifications can also be inorganic as these two would state. So, yes, so driving strong Diageo brands becomes a strong priority for us as well in the region.

Chris Wickham:
Sure. And that mid-single digits, that refers to?

Alberto Gavazzi:
Refers to, sorry?

Chris Wickham:

The mid-single digit you're talking to as the range …..

Alberto Gavazzi:

Yes, in terms of your question….in terms of a compound of……The middle single digit was Baileys.

Chris Wickham:

Yes, but you talked about the mid – the whole region being a very volatile region. But underneath it all being a mid single digit range compounder.

Alberto Gavazzi:

Yes.

Chris Wickham:

So, that's in revenue, yes?

Alberto Gavazzi:

Yes.

Chris Wickham:

OK. So, and then in terms of contribution, it should be faster than that given you've got sort of ZBB on the indirects and everything else like that?

Alberto Gavazzi:

Correct, that's the goal.

Chris Wickham:

OK, and that's great. Thanks very much.

Stephanie D'Ath - BAML:

Hi Alberto. I have three questions, please. The first one is on trends. So, you are focusing a lot on premium spirits. Could you maybe share with us if premium spirits is really taking share against the local spirits and against beer? And maybe what your beer strategy is in your region? And my second question relates to which region has the biggest potential for you in the region? And then finally in terms of merger and acquisition, what is your strategy? You mentioned earlier it had focused on cash generation. Where do you intend to use it? Thank you.

Alberto Gavazzi:

Thanks Stephanie. Can I just clarify the second question?

Stephanie D'Ath:

Which country has the biggest potential you find in the next maybe five years?

Alberto Gavazzi:

OK, thank you. So, let me start with that one. Clearly Mexico is a country that's doing extremely well for us. It's a very attractive market both in terms of its size and its profitability. So, the Mexican consumer enjoys consuming more premium marks. And obviously we're very well positioned all categories to take advantage of that trend. So, I would say Mexico is definitely one of those markets.

We continue to see Brazil as an attractive market into the future. We're obviously going through a turmoil in Brazil. But we continue to believe that Brazil is a driver of growth for us in the region.

We have Columbia emerging quite strongly as well, very reliably over the years in helping us drive growth in Latin America. Columbia is another market that the premium marks are mostly enjoyed. And it's driving a lot of growth for us.

Then across West LAC, we would see some other smaller markets. I would like to think of Peru as our next Columbia. Peru is a market that is emerging strongly. And a few year ago we had Columbia where Peru is. So, that's clearly a market of focusing attention for us. And we're doing quite well in that market.

And we also see Dom Rep and Panama as attractive growth markets for us in the future. But those are really from a much smaller base. So, those would be the main ones in my head.

In terms of driving premium spirits; yes, driving Reserve is – it has always been a priority. But one of the things that we have learned as we go through this recession is that consumers that are enjoying those higher equities, they tend to be less affected by the recession. And therefore, as the impact on that part of the business is smaller. So therefore, we're are putting a disproportionate amount of attention to make sure that we strengthen that business also to strengthen our margin position across the region. So, we will continue to drive growth through Reserve way ahead of the growth that we have across the rest of the portfolio.

And answering your M&A question, we obviously continued to attentive to anything that might be good for us out there in terms of strengthening our portfolio. But I would say that we are in a very good position today. Our main markets, we have a strong portfolio. We have still a massive opportunity to diversify beyond scotch by bringing some of our international premium brands into Latin America. So, that's exactly what we're going to do. So, my vision for the region is really to have more of a portfolio that would mirror a mature market like the U.S. for instance. And be able to offer consumers a bigger variety of Diageo's products to enjoy. So, that would be a priority for me right now.

Stephanie D'Ath:

OK, thank you. And maybe just on the strategy for beer and Guinness. Is there any?

Alberto Gavazzi:

Yes, well, we divested from as I said from Red Stripe, which was more of a tactical play for us. We spent a few years on – providing a turnaround on that business, which we successfully have done and positioned it for selling. So, we had about 54 consecutive months of growth in Jamaica which was fantastic for Red Stripe. And we have – we're playing with Guinness in the Caribbean right now. But there is no significant plan to aggressively expand on that brand for the time being. We see a bigger opportunity across the focus on spirits right now.

Stephanie D'Ath:

OK, thank you.

Alberto Gavazzi:

Thank you.

Simon Hales - Barclays:

Thank you. Hi Alberto. A few questions, if I can. Firstly, you talked about your core focus on depletions rather than shipments in the region. As far as just for the managing stock levels goes now, what new systems have you actually put in place that weren't there before to actually keep an eye on stock levels in trade?

Secondly, could you just explain again to me, you know, what the two percent headwind is on the Don Julio brand? I kind of missed some of your comments as you made them in your remarks. And finally, just with regards to the expansion to standard scotch segments in the market.

Where do you think you're really sourcing consumer share from there? Is it coming from beer consumers? Or, are you seeing obviously down trading given the macro backdrop? You know, where are you really seeing the wins there?

Alberto Gavazzi:

Hi Simon. OK, and let me start with the last one. So, the standard and primary scotch are very good opportunities for us to grow our business and continue to recruit consumers as we're moving prices up of the whole ladder.

So, introducing primary more aggressive, that is to occupy the place that it was before occupied by standards. And standard the place that was before occupied by deluxe, or some of the deluxe brands, and so on, and so forth. So, as we were feeling the pressure for currency, we are following that strategy. It is a strategy that's proving to be very effective in a number of different markets. We have different marks that we are driving that growth from. In Mexico specifically, which is one of our most successful markets, we are using Black & White. Black & White is a brand that comes from Buchanan's. Not many people know that across the region. But we actually went out to make it very clear to consumers that Black & White is a whisky from the House of Buchanan's. Now, Buchanan's is one of the most appreciated whiskies in Mexico, a brand that has a very very strong image. And that we invested on the franchise for many years. Therefore, just by positioning that, the House of Buchanan's, we do not need to support Black & White as aggressively. We don't need to build that brand from zero, from scratch. And that makes the attractiveness of that proposition much better. So, we have much lower rates of A&P. We can be quite successful in the introduction of that brand, which has become the fastest grower – growing brand in that primary segment.

The same thing would happen with other brands such as White Horse in Brazil or Vat 69 in West LAC. So, really investing to occupy price points that were – and maintain those price points; and continue to recruit consumers aggressively. So, once the economies comes back, these consumers are then able to trade back into the more premium brands as we have seen before.

The source of growth of those brands has been other local spirits. We have seen very little cannibalization through the rest of our portfolio. So, we're seeing Black & White growing; for instance, we're still seeing growth on Red Label in Mexico. So, we're seeing no recruitment outside of the premium end of our scotch, if you like into the lower end. Or quite the contrary – it's mostly new consumers into the category, which is exactly what we wanted to achieve.

In terms of depletions focus. Yes, we have been building much more instruments to help us put a strong control around that. We have invested strongly on IS for instance. Over the region, I think we're in the fastest investors across the Diageo. Just to catch up in terms of controls and systems that can help us get a better hold of our depletion focus. We're managing our S&OP processes on a monthly basis with participation of all of the senior managers including the general manager in driving that process. We're making every single general manager be seen as driving S&OP effectively based on depletions. And those depletions are the ones that are informing our shipments on scotch. So, we're constantly revisiting that and improving that performance. We're conducting physical counts in our – some of our customers…Some of them even by external players like – one of the three big accounting firms. We're even doing (work) with some customer using some external accounting firms as well to help us get a better hold of those stocks. But we're putting in a number of different measures including contracts with these distributors. And their remuneration based on carrying a good amount of stock rather than excessive amount of stock. That enables us to not only react more aggressively, if there's any slow down or acceleration. But also to have more focus of these customers on a constant performance on execution rather than occasional negotiations based on stock positions that they might have or not have. So, I think that has been I would say if you ask me; having discipline on that front has been one of the key reasons why we're gaining share across the region so aggressively. It's that discipline and I say huge focus on the sellout is what's driving us and not just, you know, not a much better marketing. It is much more, our ability to execute more effectively is what's driving that growth – is efficiency versus competition rather than just better marketing campaigns and things like that.

On the two percent issue on Don Julio, this was an error occurred last year where we classified some export sales into the U.S. back in the Mexico numbers. And we're obviously overlapping that this year. And that accounts for – so those are export sales into the U.S. - on Don Julio that accounts for about two percent of the total Latin American net sales. So, it was a sizable, a relatively sizable issue that we're dealing with this year. And obviously, it is bringing our Mexican numbers down and in consequence, our Latin Americans numbers down by two percent.

Simon Hales:
Brilliant, understood, and one just quick follow-up, if I can. And just on margins, clearly, you talked about margin pressure continuing through Fiscal '16.

But as you look into 2017, and given the comments you made about the efficiency measures of the ZBB; and the measures that you're adopting in the region. I mean, are you, you know, confident you'll see margin expansion next year in the region?

Alberto Gavazzi:
Yes. So, next year we will still be overlapping some of the tax increase in Brazil. So, we're going to have a full year of tax increase as opposed to six months is what we have. So, we will be working very aggressively on the productivity agenda. We're just revisiting the productivity agenda two weeks ago with Ivan and Kathy down in Brazil. And there is a very impressive number of actions being taken to try to mitigate most of the impact of that tax to already put us in a position to go back and grow margin. Across the rest of LAC, yes, to your answer.

We can see margin improvement going into next year; not only driven by the productivity agenda. But also by pricing agenda and by our focus on Reserve business units.

So, the answer is yes, I would see our margin situation progressing as we go into H2 and progressing as we go into the next fiscal year.

Simon Hales:
Perfect, thank you very much.

Alberto Gavazzi:
Thank you.

Andrea Pistacchi - Citi:
Yes, hi Alberto, and thank you. I have three questions, please. The first two on competition. Now, that the beer players are pushing more their international brands, particularly in Brazil and in Mexico, albeit from a small base. Does this mean more competition to you? Or, do you see…in your view is there quite a significant difference in the consumption occasion between international spirits and international beer? The second thing on competition is within international spirits, how would you see the environment changing in LAC, if at all – in particular as you focus more on your primary scotch propositions? Do you expect this to attract more competition from a second tier scotch players who possibly don't have enough aged inventory to play in the premium or in the high end space?

And then, the third question please on your stock levels. You said you're happy with your stock levels. Would you classify them as low – as below normal or normal now? In other words, would you expect somewhat of a restocking cycle or a bit of the restocking as the – as the environment improves?

Alberto Gavazzi:
OK, Andrea, let me start with your first question. So, competition on premium beer, yes, we've been seeing some more action on the premium beer. The beer companies have been declaring that they want to grow the premium end of spirits for years now. And in some countries we're starting to see some success. In other countries, that is still very small. But we do not see a slow down on any of our marks as a result of that growth. Some of the occasions are different. Others, mainly off trade might overlap each other. But we're feeling no impact or slow down on our spirits growth as a result of beer. In fact, I would say that if you look at the premium end of the international spirits, we continue to grow faster than beer and faster than premium beer as well. So, we are in a good position. Total spirits in LAC doesn't grow faster than beer. But it's driven by the lower end spirits that are being eaten up partially by beer and partially by the international spirits. But a segment that we play in for years already now, we're seeing faster growth than beer.

In terms of your question around primary scotch. We're actually the ones who are late to that party. So, the competition have been investing on that segment for quite some time. Our share of market is greater on standard, deluxe and super deluxe than it is on primary. But, we have in the past, I would say decided consciously not to participate in there because we were able to recruit effectively with our standard business. We didn't need to go into primary to do that. Today, it is more intelligent for us to participate on that given the pressure on currency. So, we have been going in there and aggressively recruiting share from competition.

That is starting point is recruiting share from competition on that segment. And obviously, together with them recruiting from local spirits. But we've been gaining share rapidly. And our goal is that at a minimum to have the same share we have on the more premium segment. So, we continue to see accelerated growth on that front for us into the future as we continue to climb share in primary whiskies.

In terms of the stock level, I would say they are where we want them to be. And so, different channels would have different stock levels. So, even within a market, you would see us practicing policy with a wholesaler, which is different than the key account; which is different than the distributor. So, we have a policy in terms of our general country, how much we want to have. But also, as we go into sub-channels, we have a clarity amongst our organisation and our customers on what those stock levels are. And we have been already on this journey. We've been on this journey for the past two, two and a half years. So, I'd say they are where they need to be.

Andrea Pistacchi:

If I may, a very quick follow-up. Typically the price points of your primary scotch in relation to say Johnnie Walker Red. What percentage – how much lower than Johnnie Walker Red are they typically?

Alberto Gavazzi:

They could vary by a range of 60 to 80 percent. So, just to give you and clarify that point. Whichever category we play in, we try to play in….we try to occupy the premium spaces. So, I give you the example of Black & White in Mexico. Black & White is 30 percent the second player, which is a competitor brand…the most expensive that is, right, which is the leader of the set – which is the leader of the segment. And we're charging 30 percent premium to that brand and growing faster. So, we want to play on that segment. But we won't go at the lower pricing values. We want to play where there is attractive margin for us to play and have a better margin than our competition. So, we can invest more in our propositions and grow faster. So, this has been a formula for the premium ends. And that's exactly the same formula we're applying to the primary sector. And it's working. So, you won't see us occupying the lowest price positionings on those segments.

Andrea Pistacchi:

Very clear, thanks.

Alberto Gavazzi:

Thank you.

Chris Pitcher - Redburn:

Thanks so much. I've got three questions to finish up on. Thank you for the bit more clarity on what's going on in Mexico. If I understand this correctly, therefore, that will have distorted your fiscal '15 organic revenue number in Mexico; almost accounting for all of it. Could you just give us a bit more clarity on what we should think about what organic growth was in Mexico? And whether that – those sales are distorting that? Then secondly, I appreciate the scotch consumption habits are very different in Latin America to the rest of the world. But are you seeing any sort of early uptake in single malts? Or, is it still very much a blended market out there?

And lastly, can you give us a rough idea of what the, sort of Free Trade Zone area now – these sort of exports markets you referred is as a percentage of the LATAM business is now? Because it feels like that's now found a base level. Thanks.

Alberto Gavazzi:

OK, let me start with the single malt. So, single malt is a reserve opportunity for us. It's still very niche and still very small. We…..no player has aggressively invested on malt in Latin America. But we're starting to bring in some propositions like Singleton and like Cardhu. Cardhu is the core of Johnnie Walker. And we're starting to market Cardhu in our region. We want to be in the front of driving that segment. But consumers in Latin

America, they appreciate blends and higher marks of blends more still. But we will be driving growth on malts as well. But it's nothing that would be of any significance these days.

In terms of border and Free Trade Zone, combined it's around seven percent of our business. It continued to be a smaller portion as we see more growth on other markets. So, it's about seven percent in our business.

And to your question, Chris on Mexico. No, you will not see a rebase on our organic numbers in Mexico. It was not included in the organics. And yes, in the total external reported numbers of the company. So, you won't see any change on that front.

Chris Pitcher:
Thank you. And just in terms of the border Free Trade Zone; could you just confirm what that was at say the peak before the destocking – just to understand the trends there?

Alberto Gavazzi:
It was about maybe 20 or 25 percent of – yes, about 20 percent of LAC.

Chris Pitcher:
Great, thank you very much for the clarification.

Alberto Gavazzi:
Sure.

Alberto Gavazzi:
OK, so I just wanted to take this opportunity to thank everybody for listening to me and to my remarks about Latin America and the Caribbean. I hope this clarified your questions. I hope I have answered your questions as well. And I'm looking forward to connecting with you in the future. Cheers.