Diageo 2018 interim results Investor Q&A transcript
Ivan Menezes & Kathy Mikells
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Ivan M. Menezes: Hello, everyone, and Kathy and I welcome everyone to the call. I'll make a few brief opening comments and then open the line for questions. Hopefully, you've had a chance to look at our results.

I'm pleased with the results we've delivered this half. The strong performance reflects consistent and rigorous execution of our strategy through our 6 execution priorities. We've delivered, as you can see, 4.2% organic net sales growth, volume was up 1.8%, organic margins expanded 81 basis points. We had strong cash from our operations of GBP 1 billion and pre-exceptional EPS grew 9.4%.

So we've delivered another consistent half with broad-based top line growth across all regions. We increased our marketing investment by 7 % and delivered operating margin expansion. Our productivity program is continuing to progress at pace and the impact is showing up in our results. And we've delivered now our results consistent with our medium-term guidance.

However, not everything is firing on all cylinders, and we still have plenty of opportunity to go for to improve. This performance demonstrates the resilience of Diageo. One of the strengths of the company is the breadth of our portfolio, combined with our truly global geographic reach.

So our financial performance expectations for the year remain unchanged. We remain confident in our ability to deliver consistent mid-single-digit top line growth and 175 basis points of operating margin expansion in the 3 years ending June 2019.

So with that, let me now open it up for questions.

Fernando Ferreira: Thanks for the question, Ivan. I have 3 questions, if I may. The first one in the U.S. I mean, since you decided to up-weight your marketing spend there, can you let us know how your internal metric's showing in terms of share of voice in the industry and brand equity across the key brands in your portfolio, please?

And then second one was about pricing in your portfolio overall. It has been quite muted in recent years. But now that the currency is going against you and growth is recovering in the world, how do you feel about like-for-like pricing ahead?

And lastly, maybe for Kathy. You mentioned on the webcast the 35 bps of margin benefits, right, that were brought forward into the first half, which leads to an underlying margin performance of around 40, 45 basis points. Is that a reasonable assumption for the back half of the year? Or would you point out to anything else like increased marketing spend in the second half? Thank you.

Ivan M. Menezes: OK. I'll take the first 2, Fernando, and I'll ask Kathy to handle the third.

If you look at our overall U.S. Spirits performance, I am confident in the improving quality of underlying performance we are seeing in the U.S. We're growing share in all categories, except vodka. Indeed, if you take super premium vodka out, our business is growing 5.5 % in the U.S. This is also a half where we're lapping bigger innovation from last year. So the underlying business without innovation is better. To your question, we have up-weighted marketing, but the nature of brand marketing and investment in the spirits businesses, it takes time. So what do we look at? We look at the underlying brand equity measures. And when we look at the brand health on brands like Captain Morgan, Johnnie Walker, Crown Royal, Smirnoff, they are all improving. And that's the leading indicator for us of future performance. You've seen the up-weight in the U.S. We grew marketing 8 % in US Spirits. We intend to keep the up-weight as we go into the second half. But brands of this size in this market that's highly competitive takes time and -- but we are encouraged by the quality of the marketing programs and the impact it's having on equity, and indeed, our share performance in every category other than vodka. And on vodka, we've got strong plans of up-weight and actually more innovative plans on the brands as we go forward into H2 and beyond.

Your second question on pricing. You're right, pricing is still somewhat muted. It's at about the same level as we got last year, a little over 1 percentage point. We are seeing encouraging signs where we're recovering pricing more strongly in parts of Latin America and in Asia. I do expect over time [to improve], particularly as we deploy our net revenue management capabilities. We now have made significant investments in net revenue management across the company. We have a system called Polaris, which has built all the data and analytics, we have recruited people in. And over time, I would expect pricing and net revenue management to be a more positive lever for us. But you can see, we're still benefiting from good price and mix in these numbers. Mix continues to be a positive. But pricing will improve over time. And right now, we see it broadly in line with prior year. Kathy?

Kathryn A. Mikells: And on margin, I guess, I would start that question by just reiterating what our midterm guidance has been on margin. So 175 basis points for the 3-year period ended fiscal '19. We delivered 37 basis points of organic margin improvement in the last fiscal year, right? So just the straight math. As we have 138 basis points left to deliver in 2 fiscal years, fiscal '18 and '19, if that was even, it'd be about 70 basis points. But we've been very clear to say it's going to be back-weighted towards fiscal '19 what we have remaining to deliver. You are correct, we specifically pointed to the fact that we had accelerated some employee benefit savings. And that meant we had 35 basis points of additional benefit in margin in the half. In addition to that, I would say versus where we were at the start of the year, we have saved a little bit more A&P into the back half. Hopefully, that gives you good color on half-over-half.

Olivier Nicolai: Just 2 questions on China and the U.S. First of all, on China, you had 80 % growth in White Spirits. That's very impressive. Was it helped at all by potentially some early shipments ahead of the Chinese New Year? And what is the underlying growth of that? I know you took control of Shui Jing Fang in 2012 and you had a few difficult years after that. Are you back to the 2012 volumes even now?

The second question is on the U.S. Regarding Ketel One, you appear a bit more confident about this brand at the end of last year. Do you see the decline being broad based between the on-trade and the off-trade? Or is there any specific states where you guys are losing share? But it would be great if you could give us a bit, yes, more ideas on why you're confident that this brand can recover?

Ivan M. Menezes: Sure. On China, Olivier, underlying performance of Shui Jing Fang, as you've seen these numbers, is really strong. If you look at what we've done since the anti-extravagance move went into China and the business went through a big correction, we have really strengthened this business. The route to market, our sales and distribution system is much stronger. Our brand marketing on Shui Jing Fang has significantly improved, and we've up-weighted marketing. Our innovation is much stronger. We've got a strong leadership team. And this team is really performing and executing very well.

When I go to China, I meet our distributors in the baijiu business every year, and I have to say the confidence we have from the distribution system against the brand continues to be very strong. The scale of the business is at its peak. So it's ahead of where it was in the pre-anti-extravagance period. And we're very confident about the growth in the high end of the baijiu market, which is where we participate. Brand health is really strong. It continues to build. We've got geographic expansion opportunities. And what this number shows, the 80/75 % on Shui Jing Fang growth in the half is underlying performance in the business. Now I don't expect our business to keep growing at that rate. But I certainly expect it to keep growing at strong double digit for a while because the category is healthy and the brand is resonating. And with China moving to more of a consumption economy, this business has much greater quality because it's private consumption that's driving the bulk of the growth.

On Ketel One, I would say the brand is still strong in the on-trade. It has a disproportionate [weight] compared to our portfolio. It does well in the on-trade. And it indeed has strong bartender love or endorsement still. The business has stopped largely because of what's happening in super premium vodka; it's highly competitive, as you know. The price premiums in certain states were too high. And Deirdre and the team have been correcting that so that we get within $6/$7 of the other big competitor that's growing rapidly. As we go into the second half, we have a couple of new things, but it's early days, but I'd say we're encouraged by. We've got the Ketel Your soda campaign. You know the huge growth in vodka soda in America, particularly with women, a lot of that consumption is moving away from wine. And we've got a targeted campaign against it. We also have a platform of 100 % non-GMO, which is playing to trend on Ketel One. And as we go into the second half, we have some exciting plans which I won't discuss right now but we believe will make a difference to improving the trajectory on Ketel One going into H2 and into fiscal '19.

Edward Mundy: Two questions, please. The first is on your transaction hedging for fiscal '19. Kathy, are you able to give any commentary on how much hedging you have there as you think about currency for next year? And then the second question is coming back to the U.S. I think back in July, you had expected overall performance in US Spirits to continue to improve, and I think that since it has been omitted partly because the industry itself has slowed a little bit and partly given ongoing challenges in vodka. How do you think about the opportunity for Casamigos, which is going to be included in organic for fiscal '19? Do you think you're going to be in a position to see sequential improvement in fiscal '19 relative to '18?

Kathryn A. Mikells: So I'll go ahead and I'll start with the question that you asked about FX. As you know, our overall kind of hedging policy is that we take, I'll call it a “stairstep approach” and so we're always more hedged on a near-term basis than a longer-term basis. And so as I look out to fiscal '19 for transaction benefits, which is where our hedging program flows through. Right now, I would say, it's immaterial on the basis of where current spot rates are at.

Ivan M. Menezes: And Ed, on the U.S. performance, in Casamigos in particular. Firstly, tequila is really hot, and the big gainers in ultra-premium tequila right now in the U.S. are Don Julio and Casamigos. You can see our overall tequila business has grown 43 %, excluding Casamigos, because it's not in organic. But if you look at underlying Casamigos performance, I'm really delighted with the momentum we are seeing. In Nielsen, it was up 70 %. In this half, in NABCA, it's almost doubled. And it's got a lot of runway because it still growing distributions both in the on and off-trade and entering into more outlets and bars. So as we go into fiscal '19, I do expect the growth of Casamigos will be accretive and add to the performance of Diageo. But again, I think stepping back, what I would just point to again is the portfolio in total in the US Spirits business, other than vodka, we are growing share in every category. And I'd say I expect that to be also sustained as we go forward. Casamigos will add to our growth going into fiscal '19.

Edward Mundy: Just to follow up on tequila. You've obviously seen in the industry news that Bacardi and Patron are teaming up there, which certainly gives Patron a slightly bigger footprint in the U.S., also stronger footprint in the U.S. Do you think that's going to have any impact on your prospects for both Don Julio and Casamigos? And coming back to Casamigos, are you able to quantify what type of an impact you think it might have on your North America growth from an organic perspective?

Ivan M. Menezes: On the second one, no, I won't quantify it. We wouldn't disclose what our plans are there. But on your first point, you just have to look at the share performance of Don Julio and Casamigos. We're growing way ahead of the category, and we see a lot of room for us to both in category growth and in us taking share of ultra-premium Tequila. So I couldn't be happier to have these 2 brands in our portfolio. And all the marketing in them is very strong, it's resonating more and more. Don Julio really has very exciting performance coming through. Very strong in the on-trade. The brand call is going up a lot. And we're growing many times faster than the category with both those brands. And I'd expect that to continue.

Trevor J. Stirling: Two questions from my side, please. For the first one, Ivan, you alluded in the call that not everything is firing in all cylinders despite a good first half. You talked about U.S. vodka. Can you maybe just give us a bit more color of where else you think there's room for improvement? And a second question for Kathy. Kathy, you commented that you expect the corporate tax rate for this year to fall about 1 percentage point as a result of the U.S. tax changes. But you will have an extra 6 months of benefit in F '19. So should we expect a further decline in the corporate tax rate in F '19?

Ivan M. Menezes: Sure, I'll take the first. If you look at, firstly, areas where we've been hit, Trevor, by, I'd say, external factors that have made business tough, I'd point to East Africa, where the election uncertainty in the first half hurt our performance in Kenya. It did hurt all consumer businesses. I'm pleased to say that situation is stabilizing. I expect to do better there. If you look to India on the top line, because of the highway ban and the route-to-market changes, you see top line growth in India was only 2 %. I'd certainly expect to do better there. If you look in Latin America, we were hit in certain markets by the hurricanes on scotch, whiskey. Colombia had a big shift in its tax regime, which hurt super deluxe scotch, Buchanan's in particular. So those are things I would expect us to do better in. On the category front, vodka is our challenge in the U.S. And again, we've got the plans for Ciroc. This will take time, so I'm not calling when it will reverse. But stepping back from it all, I'll just say what I want you to take away is what you're seeing in the last few periods over the last couple of years is the resilience and the predictability of the business has gone up. We have the capacity to take the volatility, to take the shocks in certain markets and ensure we deliver consistent, resilient performance. And that to me is the real hallmark of the Diageo we want to create.

Kathryn Mikells: And then with respect to tax, I'd start with saying we're not going to guide tax rate for fiscal '19 as we stand here today. As you know, tax is pretty complex including what's going to be our expected mix of profit across the globe. I would point to this other element of the tax changes in the U.S that will come into effect for Diageo in fiscal '19 relative to fiscal '18. So when we look at that all around, we just don't think it's going to be material incrementally in our tax rate next year. But again, we have to take everything into consideration and we'll guide to that as we call the fiscal year out.

Ivan M. Menezes: Trevor, there's one other point I alluded to earlier in terms of improvement opportunities, and it is net revenue management. If I look at how we are executing on brand marketing, on innovation, on route to consumer, we've made significant improvements. We're in the middle of the journey on net revenue management. And in the next couple of years, I expect Diageo to get much better at it. So that's an area of opportunity, too.

Simon Hales: Just a couple of quick ones, please. Firstly, I mean, Kathy, you mentioned in your presentation and we've talked about it a bit on the call the marketing phasing in a shifting as little bit in 2H. I wonder if you could give a bit more detail on perhaps where that is, and in particular geographies we should be thinking about and are seeing less of a margin benefit in the second half as a result of that. And then secondly, back to India. Ivan, you talked in your prepared remarks about your confidence in hitting those the mid- to high-teen margin targets. What sort of time frame should we be thinking about now for you getting to that, given all the disruption we've seen in that market over the last 18 months?

Kathryn Mikells: OK. So I'll start out and talking about marketing phasing. So I just want to be clear, that's the relative to kind of where we started at the beginning of the year, and we thought about what we did think our phasing was going to be. And relative to the beginning of the year, we think phasing on A&P is a little bit a move to the second half, right? You don't have to think about year-over-year, what's going to go on, and we did start to up-weight marketing in the second half of last year in places like the U.S. So as I look at that overall thinking about margin and how it looked half-over-half, we have a little phasing of A&P but we did start up-weighting A&P in the second half of last year. Now clearly, we're going to continue to be focused on the areas of focus that we talked about from the beginning of the year, and that's really the U.S. and scotch. But I'd also say as you look through our results, you can see that we up-weighted marketing in every one of our regions, just to differing degrees.

Ivan M. Menezes: On India, Simon, I'd say, if you look at the shape of the P&L that's come through in this period, it really reflects our strategy in action. The top line was subdued because of the external shocks of route-to-market changes and the highway ban still playing through. But if you go through the P&L, we expanded gross margins 200 basis points. Again, very tight productivity on cost of goods, but also better pricing that the team is now delivering. We're getting better pricing in more states. That's coming through. If you look at overheads, it's down 10 % in the period.

And then look at our marketing investment, it's up 20 %. And overall operating margins have expanded just over 100 basis points in this period. So to me, this really reflects the execution of our strategy in action. We will see steady improvement in margins in India. I'd say back to our guidance, it's medium term. We're seeing in the next 3 to 5 years, we will get to that level. But you can see the actions we are taking delivering [results]. The mix will improve as we put our focus on Prestige and Above. And that will help margins as well.

James E. Jones: I thought, Kathy, your comment in your prepared remarks that you're confident in improving capability to invest in effective marketing activity was very interesting where you put it. A lot of your peers in other categories in consumer staples are clearly struggling to do this. As far as I want to know, what's different either about the spirits category or about Diageo that enables you to find ways to deploy increased marketing effectively?

Kathryn A. Mikells: And so specifically, we've made a very big investment in something we call a marketing catalyst tool, which gives us better data and information to actually measure the effectiveness of our program. And so just to give a couple of examples of how we're utilizing that, so this was the first year we were able to use this tool in our planning process, so that helped us in looking at where did we think we could more effectively deploy our spend kind up on a regional basis and on a brand basis. And then if I dive into the details to try and bring this alive, I'll use India as an example. So India, in using this tool, looked specifically at McDowell's and their marketing spend across different states in India, and they were able to reallocate it to get improved effectiveness of that spend. On another brand, Royal Challenge, they looked at that and said: “hey, I have better information now on the effectiveness across different media channels” and they changed their mix across media channels. And so those are the kinds of things on the ground that people are doing. And this is a tool that sits on every one of our marketer's desktop now. So in addition to using it for planning, they're using it on an ongoing basis to further optimize their spend during the course of the year. So we have much better data and information, and we're able to measure more accurately what our programs are doing for us to over time basically improve the returns of those programs. So it's really a Diageo-specific commentary in terms of a muscle that we're strongly building across the company.

James E Jones: So by the sound what you're saying, this hopefully is good for several years?

Kathryn Mikells: Yes. And one of the things I would point to when I talked earlier about kind of margin and that we expect stronger results in fiscal '19 are actually programs like this and some of the things that Ivan was speaking to in terms of the muscle we're building around net revenue management and that we're investing in those areas, but I think they will deliver more for us in fiscal '19.

Laurence Whyatt: Three technical ones for me, if that's OK. On FX, you're expecting about GBP 60 million of profit benefit this year, and I understand that's largely from translation and you don't give any guidance for next year. But if you did know currency hedging, what would that GBP 60 million become? The second question is on the employee benefit cost savings that you managed to get in the first half and were expecting in the second half. Can you let us know what they -- what those are? Is that sort of pensions or benefits or company cars, whatever it is? And finally, you get about 45 % of your profits from the U.S. and the tax rate there has dropped from 35 % to 21 %. Why is there only a 1 % tax benefit? Given the math, you would expect slightly higher number than that.

Kathryn A. Mikells: So let's start with the first question. I just want to make a clarification. So at the current FX rate that we provided, we're expecting at the OP level a negative impact of GBP 60 million. And overall, when I look at for the year kind of the transaction-positive impact, it's roughly similar in size on the positive side. So obviously, translation being a bigger much impact that's offsetting that. And then your second question, that's really broad in terms of overall what we were doing on employee benefits and being able to accelerate that into the half, but I wouldn't point to any particular item there. And then, I guess, the last question with respect to the U.S., we have a quite a big U.S. business. And so like most people with a quite big U.S. business, we weren't paying that headline tax rate overall to start with. And so looking at everything that's kind of included in the change in regulation, this is the positive impact that it has on us.

Brett Cooper: In the prepared remarks, you said that you expected more margin expansion to come through in '19 as there's less cost to absorb. I mean, that would imply that this program are targeted singular and not ongoing. Is there a reason to believe that there isn't an opportunity post F '19? And maybe you can talk about your experience in some regions where you've had a longer cost-control journey like in Europe?

Kathryn A. Mikells: What I meant in that remark is that there's certain costs associated with the productivity program and phasing and what we're doing in certain years. And we don't call out that an exceptional. We're just kind of carrying it in our overall cost. And so I'll just point to a couple of the things that we've talked about that we expect to have bigger dividends and benefits for us in fiscal '19, the catalyst tool that helped us with marketing effectiveness, similar tools that we're building in order to help us with net revenue management. There's a cost to implementing those things, right? And once they're implemented, then we're seeing more of the benefits in later years. And so it isn't at all to suggest that what we're really looking to do in the company is build a culture of improved efficiency and effectiveness as an expectation and a muscle across the company. I think we're really seeing that.

As we're continuing in the program, I think that's coming through in our results, the cost savings on COGS, being able to offset inflation and still do a little bit of gross margin improvement and especially what you're seeing come through on overhead reduction and our all other expenses really delivering strongly to give us that 81 basis points of organic improvement in the half. But if you take it up a level, I'd say, success in the "productivity" is that we're just looking to get more efficient and more effective every day of the week, every month of the year, every year, year in and year out, and that's what you should expect from us. And I think when Ivan mentioned that we're always going for more, this is a place where we're absolutely always going for more.

Sanjeet Aujla: A couple of questions for me, please. Firstly, my understanding from the Presidents call with Deirdre was that there was an expectation to accelerate the performance in US Spirits this year versus the 3.4 last year. Is that still the message? And if so, it implies you need to do over 4 % in the second half. So what are the moving parts to get there? And secondly, scotch has been weak. There's some one-off negatives there. How confident are you that you can accelerate the performance there in the second half? And then just a technical one on CapEx. Your CapEx guidance is now quite a bit lower than have started the year. What are the moving parts there?

Ivan M. Menezes: Sure. On the U.S. as I talked about, Sanjeet, the business other than vodka has good momentum, right? If you take super-premium vodka out, we grew 5.5 %. Vodka is incredibly competitive and only getting more. And we're not going to call the pace of how we get the vodka improvement to come through. All I can say is that we are confident that we can deliver U.S. performance in line with our guidance and expectations overall for the company, and we will not lay out exactly when we will get to industry growth rate.

What I would also say is our confidence in the quality of marketing across the portfolio and on the vodka brands improves every month, and that's why you see the up-weight in the investment in marketing that we're doing.

On scotch, I am confident, and I think that the bellwether brand to look at in scotch is Johnnie Walker. It is the most global and it's the biggest brand and it really leads the category. And as you see in the period, we grew Johnnie Walker at 7 %. And then we had a number of specific issues, Colombia tax change impacting Buchanan's and Old Parr. We had certain markets in Asia like Korea, where Windsor is still tough. Our single malts will do better. And again, we had a series of specific market situations which depressed our single malts performance. So we're feeling good about scotch and particularly feeling good about Johnnie Walker. Buchanan's is in good health, malts has good potential to grow faster. And we are also investing more behind scotch. I mean, the U.S. and scotch are our 2 priorities for up-weighted investment.

Kathryn A. Mikells: And then with regard to CapEx, we did bring overall our expectation for full year spending down. It's really just the phasing of some of the bigger projects. So we have a number of projects underway in Africa, including a very large new brewery that we're in the process of beginning to build in Kenya. And so those projects are just phasing a little bit behind what our original expectation is. Similarly, projects that we have in North America, including barrel warehouses, and I think you're aware of the experimental brewery and barrel facility that we're building outside of Baltimore. Just the phasing of funding on those projects are coming in a little bit more slowly than we had expected when we gave that guidance at the beginning of the year.

Mitchell Collett: Just staying with North America, I appreciate you don't want to reiterate that growth will accelerate this year. But I suppose I'm just thinking 1.5 months ago, Deirdre thought it would. I wondered, what had changed? Is the market getting slightly slower? And do you have any perspective on why that might be given that you're taking share in most of your categories excluding vodka? Then there was a comment in the release about net sales growing ahead of depletions. Can you perhaps quantify the difference between the 2 in the U.S.? And then finally, in India, I gather there are some additional states taking control of distribution. Could you comment on whether you expect that to impact your performance in India going forward or not?

Ivan M. Menezes: Yes. Mitch, on the U.S., the market growth rate, medium term, long term, are confident that spirits still have a good trajectory of growth and trading up. And the most recent data you see, NABCA, strong; Nielsen, a little weaker as we went into December. We don't see anything systemic in that because the fundamentals and as we look at demographics and taste changes that are happening in the U.S., we remain confident on the health of the US Spirits sector industries. It's grown, certain years, above 4 %. It can drop a bit below 4%. But underlying, strong. Our business -- and again, we are very much focused on the fundamentals and the health of our business. And I would just point to a couple of brands where we were struggling a few years ago which are now in much better shape. If you look at Captain Morgan and you look at Baileys, which a few years ago were in tough shape, they are now in much stronger shape. We're doing the same on vodka. It will take time because it's intensely competitive. And so I expect us to improve the performance. But nothing has fundamentally changed other than the intense competition in that category. But overall, we're doing the right things. We're playing a sustained, consistent game across our portfolio. And the portfolio is more resilient. And as I mentioned earlier, we offer less innovation in these numbers than we had on the prior year, which I view as a good thing because it's really supporting the resilience of the portfolio.

Kathryn A. Mikells: And then you had asked to comment on just shipments relative to depletions. We look to be transparent about this. We really manage it more over the course of a year, but it was immaterial in the half. And then you also asked about India and the impact just from changes in route to market. That impacted us in the half. India is a place where there were a number of things that took place in the last year and in this year that are causing kind of more variability because we've obviously lapsed now demonetisation in India. We've seen now GST be put in place. And then obviously in the half, we were still impacted by the Supreme Court ruling, which had certain outlets located close to highways ultimately closed down.

Those route to market changes will still have an impact, especially as we go into the next quarter. But I would say, we're continuing to lap demonetisation, and we're getting further away from the highway band as well as the second Supreme Court ruling, which made a clarification with regard to large urban centers. And so we'd expect some of those impacts to continue to improve.

Matthew Webb: Two questions, please. Firstly, you mentioned that you had a higher rate of growth in maturing stock in the period to make future demand for scotch in North America and whiskey. I was wondering if you're willing to share your long-term volume growth planning assumptions on those 2 categories. I think that's certainly you've done in the past on scotch, at least. I'm particularly interested in whether those assumptions have changed at all based on the success you're having with Johnnie Walker and primary scotch on the positive side or any concerns that surround possible effect of Brexit on the negative side. And then the second question. I was just wondering if you could go into any more detail on the pricing pressures you're facing in South Africa. Is that just in vodka or is that scotch as well? And where is that increased competition coming from?

Kathryn A. Mikells: So I'll start just talking about maturing stock. And so I think it's important when you look at our free cash flow, overall, we continue to make good gains in working capital. We did have a bigger investment in maturing stock in the half. But we ultimately lay down liquid based on long-term trends. And I've talked about this a little bit before in the past. But as we look at scotch, which, as you know, a very large category for Diageo, we're really laying down liquid with an expectation of, call it, 2 % to 3 % for the volume growth over the long term. And so we're very consistent in how we manage that. We don't kind of move production around a lot half-to-half or year-to-year on the basis of kind of small changes that we might see. And we would take a similar approach now as we think about North American whiskey. But I think it's important when you look at our cash flow bridge, that underneath that, we continue to make really good gains in working capital, including maturing liquids to the side. We made gains on all the lines of working capital, and we're very focused on average working capital management. And our average working capital improved 67 basis points average working capital as a % of net sales. So that's the place where I feel like the muscles are quite strong across the business and just producing really solid cash flow period to period.

Ivan M. Menezes: On South Africa, the pricing pressure is really coming from beer and a bit from local spirits like brandy. But beers become intensely competitive in South Africa and that does have an impact across into the spirits sector as well. But I'd say that's the primary shift in the competitive dynamic.

Matthew Webb: And is that primarily affecting vodka or does that affect your scotch significantly as well?

Ivan M. Menezes: Yes, more vodka. Smirnoff 1818 is what's most impacted by it.

Alicia Ann Forry: Just a few questions. Quickly, on vodka, you mentioned vodka growth exc the U.S. market is 4%. I wonder if you can tell us a little bit about which maybe brands and/or markets are driving that. And can you remind us how much of your vodka sales are in the U.S.? Secondly, on India, you noted that Prestige and Above is growing close to 6 %, which implies the Popular segment may be down around 4%. Clearly, some of this is the highway ban, some your own deemphasizing of the low end. My question is, how should we think about growth in that Popular segment over the medium term? And over what time frame can we expect growth to improve? And has GST changed your view of how quickly you can shift Indian consumers to the Prestige and Above segment?

Ivan M. Menezes: Sure. On vodka, 40 % of our vodka business is outside North America. So 60 % is North America. Outside of North America, we grew 4 % in vodka. Both Ketel One and CIROC are doing really nicely, double-digit growth. And we've also seen improvement on Smirnoff in Asia and Latin America in the emerging markets. So that would give you a flavour of where the growth is in vodka. On India, our strategy is very clearly to grow in Prestige and Above. The consumer dynamic is very strongly in favour of trading up. This is the area where Diageo has been weaker historically in the company we acquired. And I'm pleased with the actions we're taking here. Brands like McDowell's No. 1, Royal Challenge, Antiquity and Signature have been renovated.

We're spending more on marketing. A&P went up 20 %. And that is our very deliberate strategy to grow Prestige and Above, which is about 2/3 of our business. But over time, I expect it to become a bigger proportion. On the popular brands, in the non-core states, as you know, we franchise them out. But in some key states, we have retained them where we believe the portfolio will give us an advantage in retail and trade execution. They did decline more and they were impacted by the factors you referred to, the external factors. I expect them to do a bit better, but they are not a strategic priority for us, though we would want to stabilize them and then really grow Prestige and Above much faster. The GST impact, actually, I give the team a lot of credit for the actions we have taken to mitigate GST. And that has the cost actions, working with our supply base, the productivity numbers that have come through. So we are in a better position to mitigate GST than we thought 6 months ago. And that in part is what's driving the strong margin improvement in the Indian business.

Andrea Pistacchi: I have 2 questions, please. Firstly, on emerging markets, which have been gradually but very steadily recovering. Still seeing it as a mixed bag though. So if you leave aside China and India, which we've talked about a lot, what areas or main countries, emerging markets do you feel, let's say, good about over the medium term, next couple of years? And conversely, where are you concerned or what do you think will still be potentially a bit of a drag? Second question on the U.K. where you had a very strong half year. I think you mentioned in the press release that was help a little bit by a technical factor, some benefit as you are lapping some inventory reduction last year. So how do you think about the business in the U.K.? From an underlying point of view, what would you sort of expect for the full year?

Ivan M. Menezes: Sure, Andrea. On the emerging markets, I'd say the nature of the emerging markets is we will always have ups and downs and we will always have certain challenges like the Colombia tax change or the Kenya election. However, if you look on an underlying basis, if I just walk across the regions, in Latin America, we have good momentum and we're growing share. So markets like Mexico, Brazil has come back strongly, I don't expect that to continue, it's a bit of a bounce back effect, which you're seeing in these numbers, so that will temper into the second half. But markets like Argentina, Peru, Chile were -- are solid. And Latin America grew 7 %.

Within Europe, I mean, Russia grew 13 %, Turkey grew 10 %. These are clearly businesses that are performing better and are solid. And in Asia, Southeast Asia, that collection of countries grew 10% just outside of China and India. We still have places we need to improve. But I'd say as we look at the second half as well, we do have challenges in certain markets. And that's why what we've guided to is we expect our full year performance to be in line with what we're doing right now. Everything is not going to accelerate. And we do have certain things where we're lapping like Brazil where the growth rate will slow down as we go into the second half.

Kathryn A. Mikells: And I'm happy to take the second question, was about U.K. and GB, which grew 7 % in the half. So last year, we specifically gained inventory efficiencies and sort of the channel to big retailers, right? And so that's the technical factor that we were lapping that kind of helped encourage a bit stronger result in the half. So I'd say as you look to the full year, we're absolutely expecting GB is going to continue to grow, just not quite at this rate, which was a bit favored by that technical factor.

Nico Von Stackelberg: I just wanted to follow up on the shipments question really. Could you please tell us the % for depletions versus your net sales, please?

Kathryn A. Mikells: No, we don't specifically disclose that. If you're relating to back to GB, I mean, if we were...

Nico Von Stackelberg: Sorry, the U.S. Sorry.

Kathryn A. Mikells: It was immaterial.

Nico Von Stackelberg: Right, but you did mention it in your presentation.

Kathryn A. Mikells: We just mentioned it to be transparent. It was immaterial. And again, I'll just back up. We kind of manage it over a full year. And occasionally, based on the timing that we have innovations, it can, in a half, be more material, especially if we have an innovation that's coming and it's large and it's towards the end of the half. So we specifically say it so that people know that there wasn't something materially going on with shipments and depletion.

Nico Von Stackelberg: OK. And could you -- going back to one of the initial questions in the call, you mentioned brand equity being strong for a number of the key categories in the U.S. Could you just update us on scotch and how the brand equity is scoring there on the back of the A&P?

Ivan M. Menezes: Johnnie Walker is building very nicely. I mean, if you look at the campaigns and investments we're running on Johnnie Walker, the Keep Walking America campaign has resonated really well. We now have a credentials campaign that's gone in, which, again, is doing well. Johnnie Walker Blue Label, the super deluxe of Johnnie Walker is in double-digit growth. So Buchanan's is a strong brand in the U.S. and we're investing strongly behind it also in the learnings we're getting out of Latin America. So on scotch, I'm feeling good on Johnnie Walker, Buchanan's. And malts, we need to do better, but we're really well positioned for that because the trend towards expensive malt whisky is very strong and we have a terrific collection of distilleries that we can perform better at. So feeling good about scotch.

Nico Von Stackelberg: OK. And I just have one more question, please. As I look for FY '18 and looking at consensus, I believe we're at around GBP 3.8 billion for the operating profit pre-exceptionals. How do you feel going into the next half, thinking that whether or not that's something you can beat? Or is that something that might be a bit of a stretch?

Kathryn A. Mikells: Yes. So we wouldn't comment specifically to that level of detail with respect to consensus. I'd say overall how we feel about the second half is that we're delivering very consistently across the business. I've talked a lot to kind of margin and margin phasing in the first half and the second half. Certainly, we feel like we're going to deliver a strong year.

Vincent Baron: I have a small question about scotch in China. You said that you have a strong double digit in Mainland China but is more than offset by a decline in Taiwan. Can you give me some colours on that, why Taiwan? What is going on over there?

Ivan M. Menezes: Sure. In Taiwan, there are some commercial issues in the scotch category which hit us in the early part of the half. I mean, there's concerns about that in the trade around counterfeit across the category, which has slowed demand a bit. It is coming back through. We see improvement in November and December. So I believe that's a temporary issue. The scotch market remains important, profitable and strong in Taiwan. And on Mainland China, our scotch whiskey business has done tremendously well. We have grown 3 points of market share. The high end of scotch is getting a lot of interest, both super deluxe, Johnnie Walker Blue and the high-end malts. And we've been running whiskey academies. We are building whiskey boutiques. It will be a long game, but we are confident that there's a high-end scotch whisky business to be built in China. And we're seeing the consumer interest really built over the last year. And so we're investing behind that and seeing very good growth in Mainland China. OK, the last question.

Jamie Norman: My questions are about gin. You've had a very good first half led by Tanqueray. Just wondered whether to what extent you're seeing new adopters by way of markets? Is that in Europe? And what sort of legs do you think the category has further afield? And the second question is that one of the few flies in the ointment in Europe was Spain, your own stronghold down again because of J&B. Just wondered the extent to which that could be offset by your gin portfolio taking off there?

Ivan M. Menezes: Sure. Jamie, the gin category, as you know, is very hot in Europe. It's hot in GB. It's actually strong in Spain, and it's spreading. And our performance in Europe has been really terrific, strong double-digit growth, both on Tanqueray and on Gordon's. And we see a lot of that growth coming by way of consumers coming into the early evening gin occasion, where they might have been drinking wine and beer and other categories. So I think we're on to a very exciting, sustained trend here. And the work we're doing on Tanqueray and Gordon's is very positive. In terms of trends around the rest of the world, it's little bit a pickup we're seeing in the high end of gin in pockets around the world. You are seeing it in parts of Latin America, a little bit of pickup in the U.S., not as strong yet. But I expect the trend will spread. And I do think we will get super premium and ultra-premium gin doing well in other parts of the world. That's why Tanqueray 10 for us in our reserve portfolio is getting a lot of focus in terms of building it in the on-trade, both Tanqueray and Tanqueray 10. Our business in Iberia actually on gin, we were up 10%. So as you point out, our challenge in Iberia was the scotch category is tough. J&B, that's where we took the hit. But the gin business is strong in Iberia.

Ivan M. Menezes: Great. Well, thanks, everyone, for calling in. Appreciate your interest in the company and look forward to seeing some of you as Kathy and I go on the road show. And otherwise, look forward to connecting again in July. Thank you very much.