Brunch time Call with the Presidents – LAC – 12 April 2019

Alberto Gavazzi

Good morning and good afternoon, everyone, and thank you for joining us for today's Diageo Latin American and Caribbean call. It's really great to be here with you again and to have the opportunity to provide you with more colour on our business in this dynamic region.

As you will expect, today's call will follow a similar format of previous years. I will spend around 20 minutes outlining the regional opportunity, our strategy and the developments we continue to make on two of our key enablers: route to consumer and productivity. As always, we will follow with the regular Q&A.

There are also a few slides that go with the call today and these have been made available to you already and will be available on diageo.com after the call.

Let me start by saying that the LAC region plays an important role in Diageo's strategic growth story.

Positive demographic and socio-economic fundamentals within the region continue to underpin the opportunity, as you can see on slide 2:

- Legal purchasing age population continues to grow faster than the total population. We expect around 7 million legal purchasing age consumers to enter the market annually over the medium term.
- The middle class continues to expand;
- And rising income continues to support premiumization trends

As a result of these factors, expectation for TBA volumes in the region, remain at 2% CAGR to 2022, with growth of spirits at premium and above price points expected to outpace this, as shown on slide 3.

Finally, spirits penetration remained relatively low compared to other parts of the world, giving us confidence in the potential for growth across the region. As I've said to you before, we are well-positioned against this opportunity as market leaders in international premium spirits, with nearly 70% value share in the scotch category. And it's the breadth of our portfolio to leverage this scale and expand into other categories.

The pillars of our regional strategy remain the same:

- First one is to continue to strengthen our leading position in scotch and continue to drive category growth;
- Second, to accelerate our diversification into other spirits categories;
- And finally, to create more opportunity for consumers to choose spirits over beer and wine.

We continue to evolve the way we execute these pillars, increasing our focus on areas such as e-commerce and innovation, both of which I will talk about later.

Our strategy is working, as can be seen through our consistent delivery of net sales growth over the last 3 and a half years. While volatility in the region remains – as we talked through our last call, the changes we have put in place over the last few years have significantly increased our ability to respond to these external pressures. These changes include:

- Strengthening our route to consumer; increasing our called-on universe by 13% over the last two years and at the same time improving our level of execution;
- Embedding a sell-out focus across our teams;
- Delayering our organization, driving productivity savings but also improving our agility and decision-making; and
- Improving our access to better quality data.

Achieving this level of change across the organization has only been possible because of our culture, our shared ambition and the level of engagement of our talent, which is amongst the highest in Diageo and across industry norms.

Our first half performance of 9% net sales growth was strong, even with a slower than anticipated recovery in Brazil. Strong performance across Mexico, Colombia and CCA drove growth, with some benefit, however, from both Colombia and CCA lapping softer comparatives versus last year.

While, in the short term the, economic environment is likely to remain uncertain, according to Euromonitor, real GDP across Latin America is expected to grow by 2% in 2019 versus 1.3% growth in 2018. Over the next 12 months, we will see whether the anticipated economic reforms in Brazil come through. In Mexico, although consumer confidence reached peak levels in February, there is still a level of uncertainty surrounding the impact of the change in government. However, balancing this, there's an expectation for accelerated economic growth through 2019 in Colombia off the back of greater political certainty. Overall, I continue to be cautiously optimistic about the outlook for the region.

Now let me bring some colour to our strategy with the help of some examples that bring to life our executional focus across the region.

Starting with scotch.

Scotch is the backbone of our business and continues to be healthy. It's the largest spirits category by value in the region and we have nearly 70% value share. With the breadth of our scotch portfolio and strength of our innovation, we are driving growth in the category. In 2017, we drove over three quarters of the value growth in scotch according to IWSR, as shown on slide 4. We have consistently executed against our strategy in scotch and remains focused on:

- Continuing to recruit and re-recruit consumers through our scale brands;
- Leveraging primary scotch to both recruit consumers into the category and retain those trading down;
- Driving innovation and the single malt opportunity that exists across LAC.

Johnnie Walker, our larger scale brand, has continued its growth trajectory, with net sales up 8% in H1. This was led by Johnnie Walker Black, which grew strong double-digit with growth across all key markets as consumers continued to premiumise. The successful launch of White Walker by Johnnie Walker also contributed to performance in the first half. I will talk about this and all of our innovation across the whole portfolio in more details later.

In Mexico, Johnnie Walker Black Label grew strong double-digit in H1 and took share. This was partially due to the brand's continued traction in the on-trade where we focus activation of the Johnnie Walker highball experience. The experience brought to life a variety of exciting ways for Johnnie Walker that can be enjoyed by consumers through four new cocktails that you can see on slide 5. Each one bringing out one of the four key malts in Johnnie Walker Black. The activity was all about getting liquid on lips and reached 2 million consumers.

Across Latin America and Caribbean, Johnnie Walker continued to focus on gifting at Christmas and Father's Day, particularly across reserve variants. In H1, we've built on previous success with Johnnie Walker pop-up stores. In PEBAC, we put pop-up stores in the most exclusive malls in Lima, Santiago and Guayaquil, reaching over seven million shoppers over the Christmas period and generating significant sales uplift.

Our other two scale brands, Buchanan's and Old Parr, both returned to growth in H1, up 8% and 5% respectively.

Strong performance of Buchanan's in Colombia was driven by holistic plan focused on increasing awareness and driving trial. Through comms, the plan expanded Buchanan's footprint into casual get-together occasions, created experiences, as well as Colombia's first cocktail challenge which I'll bring to life in more detail later. In Mexico, we increased our investment behind Buchanan's, launching a new comms platform in Q2 supported by a more robust promotional plan. We also launched Buchanan's Select 15-year-old, a blend of single malts that's bringing dynamism to the trademark and tapping into the growing malt trend. As a result, we are starting to see a more positive sell out trend for Buchanan's post price increases we took last year.

Old Parr is also showing sign of recovery with improving performance in the first half, albeit supported by lapping weak comparatives in the prior year. In Colombia, Old Parr's biggest market, the brand had been losing relevance with younger consumers in its core party occasion and its quality perception versus its peers had deteriorated. We relaunched the brand in F19 with a campaign centered around 'Old Parr invites you to flip the script,' set out on slide 6. This was a 360° campaign designed to increase the brand's relevancy amongst 25 to 34 years old. The new comms boosted awareness among the target audience and experiential activation took the form of pop-up bars in secret locations that were supported by influencers, including the popular Colombian singer, Sebastián Yatra, all of which drove our total reach on social media. A new bottle and pack design has been released to increase quality cues and shelf standout, and Old Parr 18 Years Old was launched towards the end of the half to bring new news and a premium halo effect to the trademark. Sell out is now an improving trajectory, and so far the campaign has reached over 10 million people.

Moving on from our scale brands, I'm really proud of the lead we have taken over the last few years in primary scotch. Primary plays a key role in our portfolio, supporting our overall scotch growth ambition, recruiting consumers by providing an affordable way of entering the category, as well as options across price points in times of economic volatility.

We continue to lead in primary scotch across Mexico, Brazil and Colombia, where Black & White is the number one brand in the segment and continues to perform strongly.

In Colombia, Black & White continued the strong trajectory of growth as the brand benefitted from changes in route to consumer, including a new sales force model to reach the small convenience channel. This has led to nearly 13,000 new points of sale for Black & White in H1.

Single malts are also an exciting opportunity across LAC. The category is still very small, but consumers are increasingly attracted to the exclusivity and differentiation offered by the craft and authenticity of our malts. Our single malts portfolio grew strong double-digit in H1. A third of that growth was driven by The Singleton, as it continues to win share in its largest market, Mexico.

Let me now talk to you about our second strategic pillar and what we have done to expand our reach beyond scotch. Led by Mexico, tequila continues to be a vibrant category. It is now our largest category outside of scotch and continues to deliver strong growth through Don Julio, our largest brand.

Don Julio is also an important component of our reserve agenda and grew double-digit through H1, gaining over 200 basis points of share in Mexico. In March 2018, we launched Don Julio Reposado Claro. This is our second variant within the cristalino segment, which Don Julio pioneered with the introduction of Don Julio 70. Cristalino tequila has become the most dynamic segment in the category in Mexico and is growing rapidly, particularly with the millennial consumers. Now with Don Julio Reposado Claro, we have created a cristalino at a more accessible price point that is extending the brand into new higher energy occasions, and as a result, successfully recruiting consumers into the trademark. Since launch, it has reached 90 basis points of value market share.

The next category I want to talk about is gin. The gin phenomenon is catching on across LAC, as the category continues to gain relevance. Gin has allowed us to broaden the occasion we play in, as gin taps into every early evening occasion as well as into food occasions. In the first half, we saw gin net sales grow over 75%, with strong performance across all markets and with Tanqueray expanding its position as the number one gin brand by value, while helping to grow our market share of the gin category to over 29% according to IWSR.

In Brazil, gin has doubled in size over the last year and Tanqueray has been the primary driver of category growth, primarily recruiting from outside of spirits. As we build consumer awareness and continue to execute at scale, Tanqueray has become a beacon for the category. Slide 7 shows our recent activation in São Paulo, where we set up the Tanqueray Mix gin bar within the three of our trend-leading accounts. This was the biggest Tanqueray campaign in the last few years and the PR generated reached 32 million people.

And in CCA, we are also leveraging the growing gin consumer trend with both Tanqueray and Gordon's in double-digit growth in H1. As part of our plan on Tanqueray, we have embedded the brand into our World Class and Cocktail Festival activations, educating our bartender community on Tanqueray and its copa glass perfect serve, as well as inspiring consumers to extend their repertoires not only to gin and tonic but also other gin cocktails.

Vodka is our third largest category and is in growth. Smirnoff continues to perform strongly, achieving double-digit net sales growth again in the first half. It continues to play a critical role in recruiting consumers into spirits and diversifying our portfolio through both Smirnoff Red and our innovation variants.

Before jumping to our third strategic pillar, I want to spend some time on innovation. Across all of our categories, innovation is an increasingly important contributor to the LAC growth story, having sustained a double-digit growth rate over the last eight years. We are focused on sustainable innovation that complements our portfolio offering, is rooted in consumer insight and recruits into our brands and the category.

I am really pleased with the success of our recent scotch innovations. From the recent launches of local innovation such as Old Parr 18 Years Old and Buchanan's Select 15 Years Old, to the speed and agility with which we launched the global innovation White Walker by Johnnie Walker, which through tapping into culture has opened up scotch to new audiences across the world, including consumers across LAC.

In Brazil, White Walker was selling at a pace of one bottle every two minutes in its opening week on thebar.com, where it launched as an exclusive with over 12,000 people having made early reservations to purchase it and continued to perform well ahead of expectations.

Despite these successes, we are not complacent. We take very seriously our role as leaders in keeping the scotch category vibrant. As a result, our innovation pipeline remains full as we are always looking to grow scotch beyond where our platform is today and expand it into new territories and consumption occasions.

Our innovation pipeline extends beyond scotch, as you can see on slide 8. I've already talked about Don Julio Reposado Claro but there are number of other innovations that tap into local consumer insight.

With Smirnoff, we continue to see success of our Smirnoff X1 innovation platform. Smirnoff gained over 100 basis points of share in Mexico, driven by the success of Smirnoff X1 Spicy Tamarind. At the end of Q4 F18, we launched Smirnoff X1 Lulo, which taps into local Colombian culture. The launch campaign reached 14 million people in the first month and X1 Lulo has won share from local spirits competitors. More recently, we launched Smirnoff Bitter Citrus in PEBAC to play in the aperitif occasion where Smirnoff doesn't traditionally play. It's early days, our initial results are positive.

In H1, we launched Tanqueray Sevilla and Gordon's Premium Pink Gin with positive results so far. In the second half, we plan to expand these across the region.

Now moving on to the third pillar of our LAC strategy, the opportunity we have to convert consumers to spirit from beer and wine. Even though this is a long-term opportunity, we are increasingly seeing more interest in cocktails, as shifting habits results in consumers looking for different experiences that are tailor-made for them and that offer exciting alternatives to their traditional repertoires. This is driving an evolution across the industry, awakening consumers to the versatility and mixability of spirits and unlocking the creativity, ingenuity of our bartenders. We have been at a forefront of this shift for many years, through our Learning for Life program that has trained over 90,000 bartenders, as well as through our World Class and Cocktail Week platforms. However, we are always looking for new ways to accelerate the cocktail revolution beyond this.

In Brazil, as we are running the third edition of the World Class Drinks Festival which reached 16 million people, we have built on the success we have had with the battle of the "The Best Caipiroska in Brazil" competition, brought to life on slide 9 and expanded into new platforms such as the São Paulo Taste Festival, which engages both consumers and bartenders behind both spirits and our brands.

In Colombia, Buchanan's tapped into culture, moving at speed to partner with trending local influences to create Colombia's first Cocktail Challenge. This created a huge buzz and helps show consumers how they can drink whisky in different ways, and outlets how they can drive incremental traffic. We achieved sales of 40,000 Buchanan's cocktails served in six days, increased traffic to participating outlets by 35% and reached over 1 million people across digital and social media.

Although I'm pleased with the progress we have made expanding beyond scotch, particularly with Tequila and Gin, and creating opportunities for consumers to choose spirits in increasing innovative ways, I believe there is still opportunity to do more.

Let me now update you on our work around route to consumer and productivity.

Route to consumer has been a priority for us in LAC over the last few years and continues to be so, but it's evolving. We have started by reviewing and making more structural changes to our route to consumer in many markets and that has progressively accelerated our focus on execution.

We continue to improve the basics, increasing our called-on universe where we can. For example, in Peru, it doubled through H1. We are also increasing the number of outlets where we are reaching minimum assortment and activation standards, which continue to increase year after year as you can see on slide 10. We continue to expand the use of Trax, the digital image recognition technology that enables real-time objective measurement of execution standards to provide insights and ultimately drive performance. Last year, I talked to you about the roll out and benefits in Brazil. It is now in use across Mexico, Argentina and Colombia.

We are also focused on developing our route to consumer through e-commerce. For instance, in Brazil, Diageo has now double-digit share on key customer e-commerce platforms and achieved triple-digit sales growth in H1. Although in absolute terms, this is still relatively small. We are also considering alternative ways of leveraging digital channels to reach our consumers. For example, we have recently partnered with Rappi, an on-demand delivery start-up active across major markets in Latin America. These types of partnerships not only contribute to increase the penetration of spirits in digital channels but also creates the opportunity for stronger insights from data analytics.

Finally, let me share an update on productivity, which drove a large part of our 365 basis point margin expansion in the first half. As you know, productivity provides the fuel for reinvestment behind our brands and across Diageo. We continue to see the benefits of the organizational design changes we've made in delayering the business, and continuously review our position to ensure we have the right model in place to drive speed, agility and efficiency. As a result, we saw a reduction in overheads of 10% through the first half.

We continue to strengthen our muscle in NRM, building on areas where we have already made headways such as formats and trade investment optimization. In Brazil, small sizes now account for 6% of total Smirnoff sales, up from 2% in the same period last year, and reduce trade spend over 1% of broad sales value in H1. We are also focused on continuing to build our capabilities across NRM, particularly in areas such as promotional effectiveness and proactive mix planning, as well as further embedding the NRM mindset across the organization.

Now let me quickly summarize before moving to questions.

We continue to see huge and exciting opportunity across the region as we develop our portfolio beyond scotch and recruit more consumers to spirits. This strategy is clear and it's working, as shown by the consistency of our results over the last 3 and a half years. We are reaping the benefits of the changes we have made with our organization, and while we continue to look for ways to evolve, we are now focused on driving the virtuous circle of growth across LAC. This is what gives me confidence that in the medium-term we can deliver between mid-single and high single-digit organic net sales growth, as well as operating margin expansion.

Operator, we can now open the line for more questions, please.

Operator: Thank you. As a remainder, if you would like to ask a question, please signal by pressing star one on your telephone keypad. We will now take our first question from Sanjeet Aujla of Credit Suisse. Please go ahead.

Sanjeet Aujla: Hi, Alberto. Thanks for the presentation. Three questions for me please. Firstly, on Brazil. Can you just talk a little bit about the health of the on-premise in recent months? You've seen that channel back to growth here and are consumer still down-trading? Secondly, just on agave cost. What's your outlook there and how much of your agave supply is now grown internally, as opposed to contracted? And thirdly, just on distribution. Can you just talk a little bit about the strategic rationale for the distribution agreement with Coke system in Chile and whether that can be replicated in other markets, please? Thanks.

Alberto Gavazzi: Good, Sanjeet. Thank you for your questions. First, let me start with Brazil. Brazil on-premise is continuing to be strong. It's a very relevant portion of our business and a lot of the growth in many categories is happening in the on-premise. Tanqueray is a very clear example, where you can see a lot of vitality in the on-premise. The model is shifting somehow in terms of where consumers decide to go, what time of the day they want to go out, so we have seen, for instance, a decrease in discos and nightclubs. But we see an increase on early night out in the on-premise. And a lot of that is fuelling the consumption and growth of our scotch, as well as expanding beyond scotch in cocktails. So on-premise continues to be healthy for us in Brazil.

Agave, interesting question on agave. I wish I could predict the cost of agave going forward. I don't know what it is. Our estimation is that for the next couple of years, agave cost will continue to be high and eventually will subside. There is a lot of plantation of agave plants now in Mexico as we track. Apparently, it's much bigger than actually the demand will be, so prices should be coming down once these plants start to mature.

In terms of our supply, we have enough supply to our growth plans, not only in Mexico but abroad as well. Both our own supply but what we buy from the market will guarantee that. We don't specify on what percentage we have around our own on what percentage we buy from the market, but I can share that we are in a healthy situation in regard to our prospects growth for Don Julio.

And in terms of distribution for Coke, good pick. It's a test that we are doing really in Chile with Coke. It's the first time we do something like this. Early results are really positive for us, and for them. And if this test is positive, eventually we can look into new places but right now what we want to do is learn through this process, learn what a wider distribution system like Coke can do for spirits, and how can we still concentrate in making spirits growth in the channels that are more relevant for us, for instance, versus soft drinks. So it needs to work for both organizations in the right way. But for the time being, we are satisfied with what we've been seeing. But again, very early days for us.

Sanjeet Aujla: Great. Thanks.

Alberto Gavazzi: Thank you.

Operator: We will now take our next question from Edward Mundy of Jeffries. Please go ahead.

Edward Mundy: Hi, Alberto. Three questions please. The first is on inventory. I think the move to a sell-out culture is pretty well embedded now at Diageo and within your division. Can you provide a bit of an update as to sort of where inventory levels are? Are they normalized? Could you remind us on sort of what channel to check if you do, to get comfort around levels of inventory so there isn't a mismatch between shipments and depletions?

The second question is on innovation. You kindly showed us the slide, I think slide 8, that showed a good growth contribution from innovation. Do you have a sense of to what proportion of your growth comes from innovation?

And then the third question is also on innovation. I mean, how do you think about sustainability of it? I think at H1, Ivan said at group level that 50% of innovation projects come from the recruit category relative to 30% four years ago. Do you have a sense as to how that compares for your region?

Alberto Gavazzi: Hi, Edward. Yes, let me start with the inventory level. We are satisfied with where our inventory levels are across all markets and all channels. So we have very healthy inventory levels across the patch in LAC.

Innovation, we don't – we are not specific about innovation growth for the region. I can tell you innovation is an increasingly more important area for us. In fact, I am united this week with my general managers, and we are discussing exactly the future pipeline for innovation and how can we keep it healthy. We have a very healthy pipeline for the next years to come. I think you would have noticed that innovation pipeline has strengthened across LAC over the last years, and I believe that we have enough pipeline to continue to show strength in the future years. And also we are using innovation much more in service of our ambition of growth, making sure that we launch, for instance, products that we'll recruit from outside areas that we are recruiting already. For instance, in scotch, we would extend with flavors to recruit outside of the existing scotch area or even extend beyond scotch to recruit consumers from beer and from wine, which will help us increasingly grow our business going forward, without cannibalizing – or reducing the cannibalization in our core business.

So, we are being far more strategic in how we approach innovation as well and with data analytics and learning more about it, I believe we are becoming more efficient as well.

Edward Mundy: Okay, thank you.

Alberto Gavazzi: Sure.

Operator: We will now take our next question from Simon Hales of Citi. Please go ahead.

Simon Hales: Thank you. Hi Alberto. Three questions please.

Alberto Gavazzi: Hi.

Simon Hales: Could you just talk a little bit about the medium-term outlook as you see it from a top line and a margin standpoint, to give us a little bit of a framework? I think historically on these calls; you've talked about mid-single-digit sort of sales growth broadly balanced between volume and price mix being where you were happy. But obviously, from a margin development standpoint to, the productivity savings have meant that sort of profit delivery has been very stronger for LATAM. Trying to get a feel for on a normalized basis if the productivity savings start to roll away, how we should think about the construction of your P&L?

And then maybe secondly, could I just go back to Ed's question around inventory levels. Are you able to put any numbers around perhaps how much inventory you now broadly see in some of your core markets relative to what the level of inventory you might have seen in those markets 5 or 10 years ago, just to give us some sort of idea of how the focus on the sell-out culture has changed there?

And then a final question. I wonder around – you haven't really talked about the beer business within Diageo and its potential much within the Latin American operations today. Is that an opportunity or is there so many other things that you'd got to do in spirits that that's sort of on the backburner at the moment?

Alberto Gavazzi: Okay. So, let me start with the medium-term guidance. As we said last year and as I restated also this year earlier, our medium-term guidance is – it continues to be middle single to high single-digit growth in Latin America. We are confident that the plans that we have in place can sustain the current level of performance that we are having.

And in terms of margin expansion, we also see continued margin improvement going forward. But again, this is a volatile region, as you know, so guaranteeing a certain level of margin expansion is difficult because there are months that we could go better and months that obviously are a little harder, depending on what happens in the economy. But I'm still very confident in terms of our productivity agenda.

As you've seen in H1, we have done really well on that front and we continue to look for opportunities to improve on productivity. So, I don't think we are close to exhausting all the opportunities. So, for instance, we just had our head office for Central American and Caribbean based in Miami and we took a decision to move this closer to consumers and customers. And we moved our Head Office in H1 into Panama, where, as a result of us being closer to consumers and customers, which was the main driver of this decision, also had a side-effect of reducing our cost of operating with that decision.

We moved about 70 people in the process, so we are really talking about a significant change in an environment that is less costly to operate than the one we were in before, and that also will bring business benefits. So, as we go by, we are learning new ways to improve our cost base and then be able to choose where we invest that money effectively, as opposed to just let it be sitting on the cost base.

Another example on offices would be, for instance, we measure the cost per employee on every office we have across the world, not just in the region. But I'm proud to say that in the region we are amongst top quartile performance across FMCGs in terms of the cost per employee in our office. We have been using hot desking already for years and we continue to implement that, where we have less desks than employees, given the nature of our business has a lot of traveling and obviously some people work from home as well in today's world with technology, so we are really becoming more effective on that front. To the point, that, for instance in Peru, we have moved our offices into WeWork, also in search for more of a good environment for our people, but at the same time, a cost-effective environment.

So productivity, the beauty of it in my view is that more you dig, the more you find. And therefore, I continue to see opportunities on NRM. I continue to see opportunity in overheads and cost base going forward.

In terms of our inventory, I can tell you we are in a far better position than we were five years ago. The numbers will vary, Simon, because, depending on the channel, depending on the markets, we need to stay in a different level of inventory not to run out of stocks. But I can tell you that we are very, very diligent on that front and we would run these inventories as close as they need to be for us not to have out of stock but be effective in terms of management of capital as well, so we are in a good level there again.

In terms of beer, we have a small beer business in CCA for years. You know that we divested from Red Stripe some years ago in Jamaica, but we continue to operate with Guinness in many markets in Central America and the Caribbean. And we have been looking for ways to expand this through partnerships. We will not get directly involved in beer for the time being because, as I stated, the opportunity in spirit is so big that I would rather have the organization focus in unlocking that. And once we have all of that done, then eventually beer becomes the new frontier. But we wouldn't wait for that, we are establishing some partnerships in some markets where we are going to start deploying Guinness in Latin America more widely. But again, our level of involvement on that is going to be minimal.

Simon Hales: Good. That’s very good. Very useful. Thank you.

Alberto Gavazzi: Thank you.

Operator: We will now take our next question from Fernando Ferreira of Bank of America.

Fernando Ferreira: Hey, Alberto. Thanks for the questions. I have one on the region and one on Brazil please. First one on the region. When you think about the top line growth opportunity you have there, I mean, can you share some numbers on what’s your share of total TBA and where you are sourcing most consumers in the region, if it is from beer or local spirits?

And then on Brazil. Can you talk a little bit about cachaça, please, I mean, both in terms of your plans for Ypióca, but also how much is the broader category still serving you as a source of market share gains to increase the penetration of your portfolio? Thank you.

Alberto Gavazzi: Hi Fernando. Starting with the region question, we are a very small fraction of total TBA still, which is why we believe that the opportunity for us to grow is very big. If I had to give you a number, it would be around 2% of TBA in terms of servings. If you think about how many drinks are consumed in Latin America. So really for us to continue to grow, as you can see, there is plenty of opportunity for us to do that.

Obviously, a lot of that consumption is at a price point that is much lower than the price point we like to operate in and where margins would be lower as well. And therefore not 100% of those number of servings would be attractive to Diageo. But in the future, as consumers premiumize and the economies continue to grow, we would see an increasing number of consumers migrating to a more profitable end of consumption.

In terms of cachaça, Ypióca is a great brand. What we have been doing is changing the strategy of focusing on white cachaça to actually focusing more on gold cachaça where the margins are more attractive. So we have been investing in convincing consumers to really enjoy a better product by trading up into gold and that has made, for instance, Ypióca Gold become the number one gold cachaça in the market. We have been growing double-digit Ypióca Gold, which is a fantastic result. And then our goal will continue to be to premiumize the cachaça category going forward because we believe that's where the value will be.

It continues to be a large opportunity for the long term. I don't believe it's a huge opportunity in terms – or transformational opportunity in the short term. There's a lot we need to do still with the government in terms of recognizing regulations for cachaça, and geographic origin as well, as tequila has done, as rum has done, as many other categories in the region have been able to do. We have been in constant conversation with the government in terms of getting cachaça to be recognized as a Brazilian asset, right, and hopefully we are evolving in that direction the future. So that's more of a long-term play for us.

But again summarizing, we are very satisfied with how Ypióca strategy of premiumizing has been playing, and again, this is how we know how to operate it by premiumizing consumers. So we feel very comfortable in this new strategy that we have sought for Ypióca.

Fernando Ferreira: That's great. Thank you. If I may ask just one more question on your strategy of moving the portfolio beyond scotch, as you talked about. Can you just share some ballpark numbers on how relevant each one of the main categories are as a percentage of your sales today, and maybe how that pie looked five or ten years ago?

Alberto Gavazzi: Yes, so the goal of moving beyond scotch is the following. The first thing we wanted to do in a region is really expand the category of scotch to the widest possible number of consumers, because it is the most profitable serving that we could possibly have out there. And that has made that scotch is the most profitable category across the region in every single market. So today, it is quite remarkable, although we take it for granted, the journey that we have been through with scotch in this part of the world where it's really the backbone, if you like, of the value in the spirits category everywhere.

Now the level of versatility that we have in scotch is good, but it can be much stronger when we look at other spirits. And that compliments the portfolio offering we have for consumers and hence, the strategy pillars that we've got. We diversified from scotch because, basically, in Latin America, consumers could choose to drink either scotch or beer or maybe a local drink like Caipiroska in Brazil or Caipirinha and Paloma in Mexico. And that was it. So it was really a dull offering for consumers.

Our goal is to increase the offering to something far more exciting and that's why we are pushing behind gin, we are pushing behind vodka, we are pushing behind tequila. We are pushing behind rum and working the cocktail revolution, which, if you like, is what has made spirits gain more share of throat year after year in mature markets. And we are seeing that happening now in our market as well with cocktails creating more excitement.

So answering your question, scotch represents over 60% of our business today and if we were to divide everything else, would be the other remaining. We want to continue to have scotch relevant, so in this strategy, it doesn't mean that scotch is going to diminish its importance because again, it is the backbone of what we do, and we'll continue to find ways of expanding penetration for scotch. But we think we are today in a more healthy position than we were before with less dependence on scotch and with profitable offerings as well outside of scotch. And Tanqueray would be a clear example where the level of profitability is equivalent to scotch.

Fernando Ferreira: That's great. Thank you.

Alberto Gavazzi: Sure.

Operator: We will now take our final question from Chris Pitcher of Redburn Southside. Please go ahead.

Chris Pitcher: Thank you very much. A couple of questions. Firstly, on your spirits strategy. You mentioned that a lot of consumption takes place at price points that you are not interested in, but the breweries are starting to bring out new products that can be sold at a lower price point. Are you taking any of the learnings from India and what you are doing in Africa to potentially start targeting that local alcohol at a sooner point?

And then secondly, in terms of how your business looks today, when the downturn happened, you were quite reliant on wholesalers and what you call, I think, the free trade areas. Have you seen any recovery in that or is the bulk of your business now what you would call sort of your domestic business? Could you give us a feel for what the split is today? Thanks.

Alberto Gavazzi: Hi Chris. So yes, there is opportunity on low margin alcohol for us to tap into, but the truth is the opportunity on higher margin continues to be so big that we would rather focus our resources and efforts on that before. So if you look, we have developed the primary category in the last three years from almost nothing to become a significant portion of our business, and we became market leaders on that. That is at attractive price points in terms of serving. So if you look at some of our primary offers, if you were to look at per serving price, it would be close to imported and premium beer in the market already.

So we are reaching a price point that is relatively aggressive for an imported product and we are satisfied with growing beyond that for the time being. Yes, we could tap into areas and clearly, we have a lot of relationship with what's happening in India and learn a lot from them. But for the time being, I believe that would be dilutive for us and we wouldn't want to be going down to that direction in the moment. I would much rather focus in really expanding beyond our platform existence.

As I said, gin – we have a large scotch category, we have a large tequila category and that's pretty much it. I mean, gin is still small, and it can grow a lot and we need to make it sustainable. Rum is a big opportunity for us at the premium end. Tequila needs to expand beyond Mexico into other markets. So, our homework is still pretty big, I would say, on the premium end, and then reserve as well, before we even attempt going lower. So that's the strategy we are following for the time being.

In terms of the free zones, it's a – we are far less dependent, if you like, on free zones than we were five years ago. That has been part of the strategy as we invested in route to consumer and we expanded route to consumers in the markets, was to be able to take the distribution of our products in our own hands. And this is paying the benefit for us because not only we are achieving more distribution locally, but we are being able to activate in the point of purchase as well in more accounts.

So we have much more of the business under our control these days, which is very healthy for an impulse-driven category such as ourselves. It would be almost the shift from growing a lot from wholesalers into growing more toward distributor model or a modern-trend model where we own not only the distribution, but also the execution and the point of purchase.

I don't anticipate us growing again the dependence on wholesalers as we had before. I don't think that would be strategically wise. So, while the free zones are stable for us right now, in terms of performance, I wouldn't want to see them growing beyond the place that they are today.

Chris Pitcher: Thank you very much.

Alberto Gavazzi: Sure.

Operator: This concludes today's question and answer session. I would now like to turn the call back to Mr. Gavazzi for any additional or closing remarks.

Alberto Gavazzi: Thank you. Well, I hope the call was useful for you to have a better understanding on why we continue to see a huge and exciting opportunity across the region, as we continue to develop our portfolio beyond scotch and continue to recruit more consumers to spirits. If you have any further questions, do not hesitate to call the IR team. We'll be happy to answer them, and I look forward to speaking to you on the next call if I don't have the chance to do that before. So today, thanks for your attention. Thanks for attending the call and hope to have a chance to speak to you soon. Thanks, and have a good day everybody. Bye.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.