Brunch-time call with the Presidents – Europe, Russia and Turkey

DIAGEO

John Kennedy

President, Diageo Europe, Russia and Turkey

Hello, everybody. John Kennedy here to host the brunch-time call with you. I'm going to be covering the total region of Europe, Russia and Turkey.

This is a large and profitable business accounting for about a quarter of Diageo's net sales. But I'm happy to say it is also a growing one. Now, the growth, although it's modest, represents a turnaround both for the industry and more importantly for Diageo, which is now on a trajectory of share gains across these markets.

Since I last talked to you we've made a couple of changes. We've combined Russia and our Eastern Europe markets and Turkey with my former responsibility for Western Europe. Russia and Turkey will remain as separate Diageo markets, whereas Eastern Europe will combine with Western Europe to form what we now call the Europe market.

Now, this is overall a diverse region with a mix of developed and emerging economies which have material difference in terms of growth prospects, demographics, beverage alcohol trends and in each of these markets I'm confident we've got the right strategy which, combined with our scale and portfolio, will allow us to compete to win.

During this call I will follow the usual format. I'll spend about 20 minutes giving you a flavour of what we're doing across the markets and why I believe we're well positioned to win. Then I'll open it up for questions from the audience.

Let's start with taking a look at the Diageo Europe market. By far the largest market accounting for over 80% of net sales in the region. Looking at our F15 results, our previous Western Europe market accounts for over 90% of the sales of this new Europe market with the remainder being in the Eastern Europe countries that were previously reported under the Russia and Eastern Europe hub. The integration of Eastern Europe into Western Europe will allow us to access scalable opportunities with pace and there is a lot of synergy between what we're already doing in Western Europe and our growth drivers in the Eastern Europe countries. So, I feel like that's a strong organisational step we're taking.

Today what I'm going to do is address Western Europe and Eastern Europe separately, but, in the future, we'll report the performance of the Diageo Europe market as a whole.

So, let me spend a few minutes on Western Europe. Now, we all know that the economic environment is still volatile, although it has improved compared to the lows reached at the height of the euro crisis. I'm not going to spend a lot of time on the macro environment. I'm going to instead focus on the interventions we've made to build a stronger platform for growth and share gains.

The overall market with over 270 million legal drinking age consumers is a large and valuable beverage alcohol market. Spirits, within it, has been declining for a number of years in volume, although there has been some value growth recently, but, primarily driven by tax increases. The trends in the market are still roughly the same, marginal decline in terms of overall volumes.

There are a lot of changes within the market though and consumers are moving in different directions. So, for example, while consumers are drinking less, they are moving towards lower tempo occasions. They're also more open to try different experiences and less loyal to a single brand or category than they would have been years ago.

While population growth is flat and overall the population is aging with nearly a third of consumers over 55, older consumers tend to be wealthier and are an opportunity given our leadership, particularly in luxury spirits.

The shift from on to off-trade has continued, but it is moderating and the on-trade in Western Europe is very big. Some occasions are changing. We're seeing much more tilt towards drinking earlier in the evening rather than late at night and see a growth in the after work aperitif occasion, which is one of the explanations for the very fast growth of the gin category.

In terms of the structure inside Diageo, over the last four years we've made changes to the way we operate in Western Europe to adapt to this changing macroeconomic and consumer environment. Perhaps the most transformational was the creation of Western Europe market about four years ago which allowed us to operate at scale in a more agile and efficient way. This has removed complexity and simplified decision-making. It's allowed us just as a market to focus much more clearly on the biggest priorities. The announcement of the creation of Diageo Continental Europe underneath that umbrella, under one commercial leader, is a next step in that direction.

In addition, we also have set up our new reserve function, invested behind route to consumer, step changed our execution of the innovation and embraced the next generation marketing principles, which are completely based around recruiting and re-recruiting consumers constantly. All of that is fuelled by driving out cost that we can reinvest where we drive higher growth.

Now, there is an improved performance. The business stabilised in F14 and last year, Western Europe was back in growth, the first time since the creation of the market.

We've also started to gain some share and have gained share of spirits two years in a row with a total of 70 basis points increase with brands such as Smirnoff, Baileys, Tanqueray, Captain Morgan and Johnnie Walker all gaining share last year.

We've also seen a significantly improved performance in beer with the Guinness brand in particular gaining share of the GB, Ireland total beer markets. So, we feel like we've got a platform to continue to grow, particularly because we believe we can continue to drive share gains.

Now, what I would like to do is just take a few minutes and give you an example in three or four different areas of the specific work we're doing that underpins that confidence. I'll start by taking a look at what we have done in reserve. This is a business that is extremely promising and our reserve business in total had sales growth of over 20% last year. That’s the fourth year in a row where we’ve had double-digit top line growth. The spirits category in Western Europe continues to premiumise as consumers want to have a taste of luxury in their everyday lives and spirits are an affordable luxury or treat that doesn’t break the bank. And, not only do we have a strong platform for growth because this part of the market is accelerating, we’re winning share. We took about a share point out of the market according to IWSR last year and over two years, almost three share points of the luxury spirits market.

Most of the major reserve brands have enjoyed double-digit growth. Don Julio, Tanqueray Ten, Zacapa, Ketel One, Bulleit Bourbon. Bulleit Bourbon in particular nearly doubled in sales last year.

Scotch malts, which are the biggest luxury spirits category in the region, outperformed the market for Diageo. We grew by 12% and won share. That’s a very strong performance for single malt whisky. A lot of that is driven by a focus on a few power brands - Singleton, Lagavulin and Talisker. What we’re happy with too is that the innovation platform for these brands where we’ve introduced flavour-led malts like Talisker Storm, Singleton Tailfire and Port Ruigh and Skye are performing very well. Actually, this year, the new malt products we introduced under those brands represents 20% of our total sales [volume], whereas they were only 7% a year ago.

Within that strong performance I just want to pull out Ciroc as well. This is a super brand. It was up 83% versus last year with performance equally balanced between new flavours like Ciroc Pineapple and the original vodka and this year we’ve launched the brand’s first ever marketing campaign in Europe. The campaign ‘On Arrival’ is a two year partnership with Mario Testino to capture people from around the world celebrating their moments of arrival and as you go around the hot spots of Europe from Mykonos to Ibiza to London, this is a brand that’s really on trend and we think will continue to win big.

Another place to talk about where we’re seeing a real tailwind is in gin. Gin is the fastest growing category in Western Europe at 10% and this is an area where we will up-weight our investment and we’ve got the right portfolio to win. We have standard, super premium, luxury price points with Gordon’s, Tanqueray London Dry and Tanqueray Ten. Tanqueray delivered a very strong performance in F15 with total sales up 24%. Last year we launched the ‘Above the Line’ campaign in four countries as well as put in more muscle into just driving distribution and visibility of the brand in outlet.

The Tanqueray campaign, which is aimed at highlighting the glamour of the brand, is doing well with consumers and Tanqueray Ten, where the new beautiful bottle we have which has a real 1920s art deco feel is moving off the shelves at a really rapid rate.

As I look forward over the next year what we’re going to do is put more effort into Gordon’s as well because we think there is a lot of opportunity at that price point to grow and Gordon’s isn’t just a big brand in GB. It’s got a significant market share in most of our European countries.

Now, earlier I mentioned how consumer trends are changing with consumers drinking less. At the same time they’re more open to trying new experiences and brands and in this context, it was essential that our marketing approach evolved and focused on recruitment and re-recruitment, ensuring we bring in as many consumers as possible into our brands on an ongoing basis. I just want to talk about how that's working in two of our biggest categories which are beer and scotch.

Beer, for those of you who haven't seen the exact numbers, is a huge part of the business. Nearly 30% of our net sales and actually, is a great example of deploying those marketing capabilities to good effect.

Last year Guinness was up 2% in Western Europe. That's the first time the brand was in growth in Ireland since 2008, which is very promising. We have seen a big change in the world of beer. Anyone going out to any local pub can see the move towards craft beers. The conversation now isn't really about the marketing campaigns and the latest ad. It's much more about the product and how it is made and its origins, the variety of products that you can actually purchase. As we looked at the market we felt there was a risk that Guinness could be seen as a maker of great ads rather than a maker of great beer. So, about 18 months ago we made a concerted effort to put beer back at the heart of our story and remind consumers about the brewing legacy of our company.

That was the campaign that we called 'Made of More'. That's been at scale in GB and Ireland for some time now. It is based on two drivers. The first is telling the story of the people behind the beer, which you can see coming through in all of our advertising now, and the second was igniting the innovation agenda through the creation of the Brewer's Project which is a scalable innovation platform that really reinforces the brewing credentials of the Guinness brand by allowing it to play in a space that's owned by craft beers. First we launched Guinness Dublin Porter and Guinness West Indies Porter, two innovations that leverage our heritage and expertise in stout and Porter. We followed those quickly with the launch of Hop House 13 lager in Ireland and that's a lager with more taste and character from Guinness. Here we used our strong route to market in Ireland to make this our biggest beer launch in about 25 years. In the first four months, over one million pints have been sold. We're really feeling that that's a very promising new product.

We finished the year launching Guinness Golden Ale in GB where we created a credible and sustainable scale play in premium bottled ale by extending the Brewer's Project range into the growing golden ale segment.

So, that's four big innovations in less than eight months across two countries, which were core to getting the Guinness brand back in growth and that's where I feel we really are showing that we can innovate at scale and with speed.

As of now, there is a lot of coverage on rugby and we have a great link with the sport and we will be doing a lot of activity to make sure that we further build the link between Guinness and rugby and the sense of community that that sport creates. If you haven't had a chance to see them, we've got some great new communication with Gareth Thomas from the Welsh team and Ashwin Willemse from the Springboks that's breaking on air now.

So, a lot of good news on beer that we think is putting us in a position to get sustainably better results across the category, particularly on the Guinness brand.

Scotch is the other giant category accounting for about 20% of our net sales. It is still the largest category in spirits category in our region and we're the market leader in what is a pretty fragmented category. Last year we held share, but that's not enough and we've got an ambition to actually grow share now. Our strategy is focused on three priorities that account for more than 80% of our turnover. One is reinvigorate Johnnie Walker, our biggest brand. Second, re-energise J&B, a super strong brand in France and Spain in particular and continue to win in malt where there is momentum and it's a big part of our reserve business.

Last year's performance on Johnnie Walker, we had net sales down 6%, was largely impacted by our decision to realign pricing in Benelux. I expect a much improved performance as we lap that change and I'm excited about the launch of the new 'Joy Will Take You Further. Keep Walking' campaign which many of you would have already seen at our headquarters in London in the last few days. We will launch this campaign at scale in five countries across Western Europe and then accelerate into more into fiscal 2017.

Last year we stabilised the decline at J&B and now it's time to get the brand back into growth. We are launching a new campaign in Spain that we think is promising. We're also ramping up our sales coverage of the on-trade very significantly. We increased our coverage by 60% last year and over a two-year timeframe have added 13,000 on-trade outlets that get direct call from Diageo that we didn't have before.

On the brand in particular, we want to make this brand relevant to millennials and in F16 we'll sponsor the international Festival of Benicassim, the most popular festival in Spain and the one that's got the biggest international draw. And, we also expect to drive further growth through innovation on continuing to build J&B Honey, which has been a successful flavoured whiskey entrant that's attracting actually new consumers into the brand.

So, there is more work to do on J&B, but a big improvement this year and I feel like the brand is in much better shape as we look at F16.

Let me just pick up on two big brands and make a couple of notes on those as well, Smirnoff and Baileys.

On Smirnoff, we are making significant progress. This is our largest brand by volume in Western Europe. In the second half of our fiscal we launched the 'We're Open' campaign in GB and Ireland, the two largest countries. It was well received and net sales in those markets were up 1% and we saw signs of equity growth as a result of the campaign.

This campaign is all about defining Smirnoff's brand and sharing it with consumers in culturally relevant moments for them. For example, we produced billboards expressing our point of view during the election in GB as well as during the same sex marriage referendum in Ireland which generated a very strong response on social media.

We've also developed a number of exciting sponsorships on the brand across BuzzFeed, Mixmag, Live Nation, and we're now embedded in the electronic music scene where we are sponsoring 14 major festivals across Europe which will reach over three million consumers.

From big chunks of F15, Smirnoff was the fastest growing brand [in absolute terms] according to Nielsen across Western Europe spirits. So, feeling good about the momentum on Smirnoff.

On to Baileys now. So, Western Europe is by far the largest market globally accounting for about 40% of global net sales. Now, our reported [organic] sales were down 3%. However, we were lapping the launch of Chocolat Luxe from last year and, as of today, Baileys is still the brand that is the, what we call, the most adored brand in Western Europe, with the highest number of consumers claiming a high degree of loyalty with very strong equity scores. Our job is to translate those equity scores into sustainable NSV growth and we did see some green shoots last year. For example, while the sales on the trademark were down 3% as we lapped the new product launch, Baileys' original sales were up 2% and sell-out for the brand was up between 2% and 3%. We're also seeing Baileys Chocolat Luxe settling in as a sustainable and strong high margin part of the overall trademark.

So, we feel like there is the combination of innovation and a positive response to the campaign. We've got a media right now. It means we should be able to get this business back into growth.

Also worth saying a couple of words on Captain Morgan, a brand that has been exceptionally successful and that represents a good example of how to launch a new brand into a market at scale. We started the up-weight and the intense focus on the Captain in 2008 when we launched the brand in Germany and Ireland. Since then, the brand has grown at a 20% CAGR and now holds around 14% share of rum across all of Western Europe. In some countries we are actually the leader. Last year we launched our global campaign "Live Like the Captain', which is working well and this year alone we've recruited more than two million consumers into the trademark across Western Europe and really we haven't touched a number of countries significantly like Greece, Italy, Spain. France has just started in the last 12 to 18 months. So a lot of opportunity there.

Let me talk about route to consumer as well, one of my favourite topics. As you will remember from last year, we were in the midst of a transformation of our route to consumer capability and coverage with a goal of doubling our retail coverage in a three-year period. In F15 we made a lot of progress against that. We added 130 new salespeople, which is up 25% from previous year. In addition, we've equipped and built the capabilities of these individuals so that their actual call rate per day is significantly higher. Therefore, we've had a 25% increase in number of heads, but we've had over a 50% increase in number of calls and, off the back of that, we are now calling on 80,000 of the best on and off-trade outlets across Western Europe, up 40% from last year. That is a huge change. Again, in F16 we'll add another 100 sales people, which will take our coverage to over 100,000 outlets.

It's also important to say that investment is fully funded by the savings we've had in non-sales facing roles over the last two years.

A word on e-commerce, which is an important part of route to consumer. Currently, the spirits category trends at about 3% of total sales online. That's much lower than a number of other consumer goods categories, so we think there is going to be very fast growth there. We've built our own team with an experienced General Manager to lead that charge and our initial work on key markets in GB, France and Germany have been promising where we've been growing sales at about 40% per annum [in Great Britain] and getting some big wins for individual brands like Baileys with key customers like Tesco where we do a major landing page promotion over the Christmas season. So, that's going to be another kicker from route to consumer on our growth.

So, as you saw in our results, Western Europe is finally back into growth and we've done it by focusing on increasing productivity and driving out cost. But there is more to do there. Since the Western Europe market was created, we've taken over £60m of cost from our overheads. That's nearly 20% off the total base. We've delayered, centralised our back office functions, leveraged shared services heavily and looked at every line of the P&L to take costs out. Last year alone on an organic basis we saved nearly £20m in overheads.

Outside of overheads, other areas of productivity for us have been the agencies we work with. A couple of years ago we were working with a 175 different marketing service agencies across Western Europe. We've got that number down to under 50 now. So, you can imagine the non-working investment that that shakes free. Just the savings from that alone more than funded the launch of Haig Club in the UK last year.

We've done the same type of work on our point of sales materials where we only have two point of sales suppliers in Western Europe and everyone has to order through the same online catalogue. On promotions, we've taken the number of agencies we worked with from 35 down to three and again, shaking out a lot of investment in fees that we really didn't need.

As I look at F16 and moving forward, I think there is significantly more that can be done on rationalising our SKUs, our supplier range, on retendering contracts on everything from agency work to logistics providers. As Ivan said, we plan to driving continuous productivity gains being part of the DNA of the business in the future.

Just let me touch on Eastern Europe. It accounts for about 5% of the newly created Diageo Europe market, but it is a big business because it's a major beverage alcohol market. Within Eastern Europe, Poland is by far the largest market where we operate through a local subsidiary while in all the other countries we operate the third party distributor. These can be attractive markets. Poland, for example, is one of the biggest European spirit countries. Very big in vodka, but that category is slowly declining while whisky has been growing steadily. It's doubled in size in the last five years and at over two million cases, is the fifth largest whisky country in Europe now.

Performance last year was weak. Net sales were down 11%. A lot of that was impacted by a significant buy-in versus a big excise increase in the previous fiscal year. However, during F15 we gained share in liquors, rum and deluxe Scotch.

Let me also touch base on two other markets in the region. Turkey first. Turkey is a large and attractive market. Every year there is over a million new legal drinking age consumers that come of age and with 50% of the servings still in beer, there is a significant opportunity for further spirits penetration increases.

Trading conditions are tough right now. Higher than expected duty increase in January, slowdown in GDP, significant currency devaluation and high inflation and a lot of political uncertainty right now and also, we're in a highly regulated sector where there has been certain marketing restrictions introduced just in the last couple of years. Despite all that, the performance of Mey Icki has been excellent. Net sales were up 3% last year and they've been growing at a CAGR of over 5% in the last three years and we have a strong team there who knows how to navigate these choppy waters and continue to deliver strong performance.

When marketing restrictions were introduced, which prevented us from talking to our consumers, our initial reaction was to focus our investment in the on-trade by improving the visibility of our brands and our trade terms with customers to increase share of outlets as the point of sale, the point of purchase became the real gain. However, we've now taken that challenge forward in other ways. We need to build the brand in the current environment, but we're also investing in mentoring, creating consumer bartender communities and sponsoring third party activities to develop on-trade outlets. We're also doing a heck of a lot on packaging. A lot of offers that every time our customers go to the store there is something new to engage excitement across the brands obviously and particularly Raki.

I would say for the sophisticated route to market, Mey Icki has been in instrumental in expanding international spirits. If you look at IWSR, Diageo has gained eight points of share since the acquisition of Mey across our international portfolio.

So I'm confident about the strength and quality of the work that that team is doing and that they will continue to drive growth.

Finally on Russia. Extremely challenging market these days. The Western sanctions, the events in Ukraine, oil prices, inflation, rouble devaluation, it has all led to a big drop in consumer confidence. This has had an impact on the spirits market. There is a big drop in consumption. There is also, because of liquidity problems, a lower level of stock being held by distributors. We've responded to those events. We've managed our costs by cutting back and making sure that as many of our procurement and supply contracts are in local currency rather than in dollars. We've taken price increases. We haven't completely followed inflation because we thought it would be too disruptive. But we're slowly and steadily taking price to make sure we maintain margin and, in this challenging environment, we did gain share in whisky, which is our key category.

Looking at F16, we're not forecasting that anything gets significantly better. So we will continue to be very focused on making sure we win at the point of purchase but managing our costs and managing our margins carefully.

So, just to sum up before we go to questions, it is a diverse region. Three quite different markets, but we think we have a strategy to win, particularly by growing share. In Russia and Turkey we've got strong local teams that can operate in uncertain environments and then in Europe, with the combination of Eastern Europe with Western Europe, we think we're in even better position to really leverage scale across our main growth drivers and our main must dos like route to consumer, reserve, innovation.

So, with these changes we have delivered good results in the last two years and feel like it puts us in a position to sustain that in the future.

Operator, let me just pause there and if you could open the line for questions, that would be great. thank you.

Question and Answer Session

Ian Shackleton - Nomura

Yes, good morning, John. I was particularly interested if you could just talk a little bit about some of the benefits that you see across your region from the combination of beer and spirits. I think you mentioned was it 30% of revenue was from beer. How does that work, particularly in those big markets of GB and Ireland?

John Kennedy

Are you talking about synergies between the two in terms of how we go to market? Sorry, I'm just checking the question. Do you want to know what the synergy is between beer and spirits portfolio together?

Ian Shackleton

Yes. I was particularly interested in the benefits that you see that come and I guess it's really talking about GB and Ireland in particular from having a portfolio of beer and spirits together.

John Kennedy

Yes. My view on that is what beer gives you, and let me know if you can hear me on the line, I just got a message that it might have been breaking up a minute ago, a big beer business requires frequent calling on a wide retail distribution base and when you marry a spirits portfolio to that, there is a significant benefit for the spirits portfolio. So, if you look at our share of spirits in Ireland and in GB in particular, although the brands individually are strong, there is an added benefit and synergy that other spirit operators don't have. You would see that obviously when we talk about building spirits in our African market as well. So, I think it is an advantage, Ian, that translates into market share gain.

Ian Shackleton

Okay. Thank you.

Andrew Stott - Bank of America Merrill Lynch

Yes, good afternoon. Just coming back to your last comments on Russia and Turkey. Could you just update us on the progress you're making on putting price increases through to offset some of these FX gains, or indeed, whether you're actually looking more to protect all in? Thank you.

John Kennedy

Thanks, Andrew. I think it's a different answer by each one of the markets, although they all have a similar state of affairs. In Russia, the approach we've taken is to take steady consistent price increases but not to 100% match the inflationary rise because we thought that would be too disruptive and have too big an impact on volume. So we have probably taken price increases that cover two-thirds of the inflation that's occurred based on devaluation and during the course of F16 we will take a couple of more price increases to continue to build the margin, preserve the margin that we've got and the business.

Raki in Turkey is a little bit different because 85% of our sales there, the COGS from the supply base are denominated in local currency. So, there isn't a need to cover a higher cost base like there is when it's mainly imported goods. So, we've taken price increases there, but they're more in tune with keeping in line with inflation and matching some of the tax excise increases rather than based on devaluation.

And then on the Eurozone, I mean look, pricing is tough, particularly in Continental Europe. You can see that in the off-trade retail consolidation and the pressure on manufacturers. So, we are taking some price, but we're getting more of our results through mix in a portfolio to the luxury brands and that is delivering some benefit. So, for example, we did increase margin by over 40 bps last year despite the tough price environment. So, there isn't one answer, but there is a variety of steps we're taking to make sure that we're looking after the bottom line.

Andrew Stott

Thanks, John.

Jamie Norman - Societe Generale

Hi, John. I wonder if you would give us a sense of how you see the lie of the land with the multiple retailers as Christmas is not that far away. I mean clearly, it's been a very tough backdrop in the UK as the discounters have vied for share and we've seen some more organised buying power in France. But I wonder if you could just give us a sort of general tour of the horizon on Western Europe in particular as you look through F16?

John Kennedy

I think there is a couple of themes that are consistent. The first one is what we were just discussing on pricing. There is no doubt that with the major off-trade customers across most of our big countries there is a lot of competition between the main retailers, the discounters, and that's leading to vying for offering the best value to consumer. Now, that backs up in terms of the pressure that's put on manufacturers on price increases and, you know, if you ask many retailers, price decreases that they're looking for and we don't think that's going to go away in a low inflation environment and where there is a number of buying groups being formed, particularly as we've seen in France over the last year through a combination of groups that are already top players in the market coming together. So, all of that will remain.

Now, there are a couple of other things to note though would be the on-trade was declining at a much more rapid rate three or four years ago. We still sell about 40% of the value of our brands through the on-trade and it's getting very close to matching the trends of the off-trade now. So, that's a more stable business where we are able to leverage our route to consumer more because we're dealing with a much more fragmented independent retail base.

The other piece to note at a macro level is the particular countries that have the best GDP forecast right now, or the most improved over the last couple of years are GB, Ireland, Spain. These are countries that represent a huge proposition of Diageo's business. So, that geographical mix we think is working in our favour and when you combine that with, despite the tough pricing impact, the mix benefit we're getting through both innovation where we've got higher margin products at our base and reserve, still allows us in that total environment to push hard for both top line and bottom line growth.

Jamie Norman

That's very helpful. Thank you.

Jonathan Fyfe - Mirabaud Securities

Hi. Morning. Two questions, please. I think at the top of the call you mentioned you saw some synergy benefits from merging Western Europe and Eastern Europe. Could you maybe talk about where you're seeing those benefits come from?

Secondly, you mentioned craft beer. I wondered if you could maybe talk about craft spirits in Europe. Thank you very much.

John Kennedy

Yes, sure. So, on Eastern Europe, as we've looked at the third party distributor countries that we operate in, what has become apparent is that the same things that are going to drive growth in those businesses are the ones that we've been working on in Western Europe. So, the reserve portfolio is still very underdeveloped in many of these countries, but accelerating fast, particularly in the major cities.

We haven't really had the strength of innovation pipeline in Eastern Europe and we think we can deploy a lot of the Western Europe products. A good example would be Captain Morgan White which is rolling across many countries right now to good effect.

We also think there is a big route to consumer opportunity. It's slightly different from Western Europe because of their distributor markets. But Diageo has a lot of capability developed around the world, particularly in the US, in managing third party distributors and we think we can raise the bar on our sales capability very significantly. So, although it is a small part of the business, there is a lot of tools that those guys can tap into right away through the proximity to the big functions in Western Europe and many of these businesses are growing. So, we think we can have a relatively modest size but fast growing business across many Eastern Europe countries that will have a positive impact for total Europe.

On the craft question, so craft spirits, craft beer, look, I think the basic consumer insight is the same. People are looking for products that have real authenticity, a genuine heritage, a sense of somebody, an individual, or people behind the brand rather than just a company. If you look at our spirits portfolio, I think we're really well positioned to take advantage of that.

A lot of the growth in the luxury portfolio is based on the same trend. People are buying more single malts now, significantly more than a couple of years ago because they actually want to know the story of Talisker and the distillery and its origins and there is a great heritage and history there. The same on Zacapa Rum which is a beautiful brand and product made in the mountains of Guatemala, again, with a fabulous history in terms of its origin.

So I think we're going to see the same trends. I think we're even better positioned in spirits to tap into those trends than beer just because of the breadth of brand portfolio we've got and kind of the history and back-story that we're able to tell on all of those.

Thanks, Jonathan.

Sanjeet Aujla - Credit Suisse

Hi, John. You talked about some of the reinvestment going into the business over the next few years. In that context, do you think the 40 basis points of margin expansion you achieved last fiscal year is sustainable over the next few years? Thanks.

John Kennedy

Yes, look, what we would expect to do is I've set a goal with my team across a few parameters. I expect to continue to win share, to drive some level of top line growth and get some level of margin expansion as well. What the exact number will be, we're not committing to, but I see the productivity work we're doing. That has to be of a scale that allows us to actually invest in the growth part of the business while still growing our operating margin. So, in terms of overall expectation, that's the guideline that I'm giving to people without setting on a specific number.

Sanjeet Aujla

That's great. Thanks.

Trevor Stirling - Sanford Bernstein

Hi, John. John, two quick questions from my side. One is you touched on the strength of gin in Spain. Have you seen any broader on-trade revival in Spain? I've seen some comment that maybe the whisky category at least has stabilised. Rum is still weak. The whisky has stabilised a bit. Are you seeing any increase in number of nightclubs and such things in Spain?

The second question is you've got a lot of activity in innovation in Ireland, the Hop House Lager. Any signs of early traction so far there?

John Kennedy

Yes, thanks, Trevor. On those two things, Spain, I mean there is two things we've seen in the Spain on-trade. One is versus five or ten years ago, the late night after midnight relief occasion has declined significantly. People are shifting much more towards early evening drinks which is why you've seen that tilt, one of the reasons you've seen the tilt into gin, and we expect that to continue.

Now, the good news in Spain is that the on-trade rate of decline for the market which was anywhere from 7% to 8% to 9% for a couple of years in a row has slowed significantly. There is still some level of decline, but it's by 1% or 2% and the feedback we're getting is that there is a definite change in consumer confidence there and that will underpin not a high level of growth, but a more stable market than we've operated in for a number of years. So, that is a big step in the right direction for Spain.

And, as I mentioned earlier on the call, the way we want to win within that flat market particularly is on route to consumer where we're not calling on, well, by the end of this year we'll be calling on between 13,000 and 14,000 on-trade outlets that never used to see a Diageo person across all the major cities in Spain.

On the Hop House 13 question, yes, the short answer is that product is exceeding expectations. It was an innovative launch. We didn't go out with advertising. We actually invited 1,000 bar owners to spend a day at St James's Gate just getting immersed in the brewing process and the crafting of this new product that we've got. That generated huge traction. The rate of sale we're seeing across many outlets, and we're in over 1,000 now, is very significant. So, it's early days. We're talking months rather than years. But within the Irish market, it's a big move and it looks like it has got some sustainability.

Trevor Sterling

Great. Thank you very much, John.

John Kennedy

Thanks, Trevor.

Okay, well, listen, thanks everyone for joining for the call and hopefully that gave you a bit more insight on where our time and attention in the business is focused. If you've got any follow-up questions just contact us by email. I'm happy to talk further. We obviously look forward to talking to you more at our results presentation and hopefully on this call when we do it again in the future.

In the meantime, you know, I'm confident that we've got this overall business, particularly the giant Europe market that we've created, in a position where despite pretty unpredictable external environment we can win. We can win in the marketplace and go after share gain and we believe that can translate into positive results in terms of both sales and profit. So, stay tuned. Hopefully we will be able to continue a strong story as we go through F16.

Thanks, everybody for joining the call and operator, if you could close it off now, that will be great.

[End]