Brunch-time Call with the Presidents - LAC

5 May 2015

Alberto Gavazzi – President, Diageo Latin America & Caribbean

Good afternoon or good morning everyone and thank you for joining us. For the last in our regular series of President Calls for this financial year, I am going to talk to you about our performance and future opportunities in Latin America & the Caribbean. We'll follow the usual format where I will give a brief overview of the business and an update on performance before we open the line-up for questions.

Latin America & Caribbean, or LAC, is a region of emerging markets that presents huge opportunities for Diageo. While the region is currently facing headwinds in terms of GDP growth, we continue to be confident in the long-term opportunity due to favourable demographics and low penetration of spirits. We forecast that the Legal Purchasing Age population will continue to grow faster than the total population as an additional 6.2 million people will reach Legal Purchasing Age every year until 2020, and also that the Emerging Middle Class will continue to expand, with over 450 million people who are expected to have household incomes over USD 15,000 by 2020.

The total beverage alcohol sector has enjoyed good growth of 7% over the last five years and our expectation is for this to continue at a similar pace in the medium term. Beer is growing faster than total spirits, however premium spirits growth is in line with beer. Penetration rates of whisky, the leading category in premium spirits, is only two thirds of that in developed markets, while vodka, rum and tequila are significantly under-represented with nearly half the rate of penetration we see in mature markets. This gives us confidence that there is still significant headroom for premium spirits to grow.

During the course of this fiscal year variables like declining oil prices, political instability in some countries and currency devaluation have created a tougher trading environment than we originally anticipated.

But this kind of volatility is nothing new in Latin America & Caribbean. We have experienced these economic cycles before and we stay the course during these turbulent times, investing to build our brands, our routes to consumer and our talent pipeline, so we emerge from the downturn with higher share and in better shape. And that's what we're doing now.

The core strategy that I outlined this time last year has not changed and shows our commitment to deliver Diageo's Performance Ambition. We will continue to expand our leading position in scotch, the biggest international spirits category in the region, with focus on recruiting new emerging middle class consumers and driving premiumization. We will also continue to broaden our business into other categories by leveraging Diageo's great portfolio in vodka, rum, tequila and ready-to-drink. Our firm intention is to accelerate recruitment into spirits in key occasions, and to grow our volume and value share on the way. I'll come onto how we are doing this as we go through business performance across the region.

In terms of performance, our LAC business is currently a story of two tales: domestic markets and the Free Trade Zone and Border Channels. You may recall that last year I explained that we were increasingly focused on creating efficiencies and enhancing discipline in execution in our domestic markets. That focus is paying off, and has translated into positive results quarter on quarter in our domestic business as a whole. Within the domestic markets, Venezuela has been strongly impacted by devaluation, but we continue to apply the same principles of efficiency and discipline. In the second tale, issues in the Free Trade Zone and Border channels will negatively impact overall LAC performance year to date. It is important to highlight that by the end of this fiscal year, together the Free Trade Zone and Border channels plus Venezuela will represent only 10% of total LAC sales.

I'd like to talk now about these two tales separately. First I'll talk about the issues in the Free Trade Zone and Border channels, and then I'll move to our domestic markets.

The Free Trade Zone and Border channels in Latin America & Caribbean are mainly concentrated in our WestLAC business. We estimate that underlying depletions are down over 15% this year as currency volatility has increased with the strength of the US dollar. In addition, we have reduced stock in the system by 3 months of sales based on current depletions. I expect volume will be therefore down over 500 thousand cases in this fiscal year and net sales down about 45%.

Finally, as a complement to these actions we will continue to manage these channels closely, and have retained a 3rd party to conduct inventory audits at the customer level to ensure that we can further react appropriately to changes in the trading environment.

Moving on to the Domestic markets, I will begin with Venezuela. During the last two years, our reporting FX rate for Venezuela has moved from 9 VEF per USD to 196 VEF per USD, which has led to considerable changes not just for the market, but for the region as a whole. In fiscal 2013, Venezuela reported net sales of £275m and represented nearly 20% of total LAC sales, driven mostly by scotch. At the end of last year, net sales for Venezuela were £80 million reported at 50 VEF per USD, representing 7% of LAC's net sales, and we expect this to be closer to £30m for F15 at the new rate, representing only 3% of total LAC net sales.

Access to dollars for imports has become increasingly difficult and continues to be the key challenge for our Venezuela business. This has led to a decline in scotch availability in the market. However, when we are able to secure imports into the market, consumer demand and the equity of our brands have proven to remain strong.

Together with strong efforts to enable scotch availability and maximize value, and despite challenges for local production in Venezuela, our focus has been to continue to build our locally-produced brands which will be the key driver for the sustainability of the business. We have increased our level of activity on our local rum, vodka, gin and ready-to-drink portfolio to adapt to changing market conditions and anticipate changes to consumer behaviours. We have invested in the growth of Gordon's vodka taking share from imported vodka and tripling net sales. Also, we have introduced a super-premium variant of our leading local rum Cacique to both leverage the strong premiumization trend in the category and capitalise on the switch from scotch to rum driven by limited scotch availability.

In Brazil performance has been affected by the economic and political situation, as well as by a currency under considerable pressure, all of which have impacted consumer confidence. Year to date, our top line growth remains relatively flat versus last year.

We continue to focus on sell out, and during the first half of this year we implemented a new commercial policy in order to mitigate pricing variances caused by different tax rates across states. We have also invested in expanding our route to consumer coverage and have grown the number of smaller retail and mainstream on-trade outlets that we reach. We have introduced incentive schemes to focus distributors on the right execution efforts to build our brands for the long term. For the first nine months, depletions are running ahead of shipments by two percentage points.

Another of our key focus areas in Brazil has been to expand our portfolio and recruit new consumers into spirits. As such, innovation has played an important role across categories. During the course of the year we have launched Smirnoff Peach flavour, Seagram's Seven Crown which aims to play in the emerging middle class, and Tanqueray. In scotch we have launched Old Parr Silver, Logan Legend, and Haig Club, this last for Duty Free only.

In total scotch we have 55% value share, almost 25pp ahead our closest competitor. Also, Black & White and Old Parr are showing double-digit growth. In vodka, Smirnoff continues to strengthen its #1 place in Brazil in terms of brand strength among spirits, with increased equity measures and penetration in target consumers after the introduction of our latest campaign.

On Ypioca, while it still remains very strong in its core region of the North East, we continue to push hard for development outside Ceara. Latest Nielsen readings showed that we have gained 0.7% volume share, year to date we are posting mid-single digit top line growth. Furthermore, we continue to leverage our Ypioca production facilities for other brands in the portfolio.

In Mexico, Diageo's participation in the recent years has been transformed by the accelerated growth of our scotch brands, and more recently by gaining control of Smirnoff and Don Julio. In scotch, our breadth across price points and our increased participation in the standard segment has enabled us to grow the category and increase our share. Black & White in the value segment, supported by the House of Buchanan's concept, has delivered accelerated recruitment in the emerging middle class, and contributed to net sales growth of 13% in total scotch. Performance has also benefitted from our work in route to consumer with great progress made in the wholesale and modern trade channels. We are working on developing spirits in the convenience channel, innovating with creative displays, increasing rate of sale and profitability. In the on-premise, latest data shows that we have reached leadership in both volume and value as a result of our continued effort to create new experiences for consumers.

On Smirnoff and Don Julio, I am proud to say that the integration process is progressing at pace across the commercial, marketing and supply fronts. In both cases, we were able to secure sales to customers on Day 1 after closing the transactions, and we also managed to fast-track Smirnoff into our commercial execution platform for the Holidays season. With the addition of these two incredible brands to our portfolio in Mexico, I believe Diageo has now the most exciting value proposition for both customers and consumers. No other player has the breadth of categories and brands along the price ladder including scotch, rum, vodka, liqueurs and tequila, which have led us to become the value share leader in Spirits with 24%, 7 points ahead of the closest competitor. In Reserve, we have continued to grow at a high double-digit rate, led by Zacapa and Johnnie Walker Blue Label, taking us to over 80% share in this segment. Our Reserve portfolio will now be further strengthened by a fantastic brand like Don Julio. In sum, Mexico is showing double-digit growth year to date.

Turning now to Colombia. This is a market that is also showing double-digit growth. Despite moderately increasing inflation and currency devaluation, there is a relative sense of optimism among consumers. Depletions of our brands are running in the mid-teens supported by value share gains in scotch, higher media investment and strong distribution gains. Focus and discipline on the implementation of the new customer service model is delivering double digit growth in the on-trade, and brilliant execution of our below-the-line investment. On top of this, our innovation pipeline is strong. The introduction of Baileys Coffee and Baileys Dulce de Leche has provided solid growth, while the successful launch of Old Parr Tribute is boosting total Old Parr trademark performance as well as category growth. Our Reserve business is also posting consistent +20% growth in depletions.

Last, but not least, our WestLAC domestic markets have also delivered strong performance in the high single digits. In Peru, our focus on sell out has meant we have better visibility on sales throughout the year and have enabled better planning. Argentina continues to see strong contribution from wine exports and overall depletions remain solid as we focus on sell out. In response to import restrictions on finished goods, we accelerated a local bottling initiative for scotch brands like Vat 69 and White Horse which are performing extremely well and driving share gains in scotch. We are also performing well in markets like Dominican Republic, Panama, Guatemala, and particularly in Jamaica, where Red Stripe is delivering double-digit growth.

Finally, and this applies across the region, I feel comfortable with our performance against competitors in terms of share, as we are winning in most of our key battlegrounds. Also, our focus on sell-out is helping us not only to improve our planning and stock management capabilities along the chain, but also our collections. Therefore, this year we expect to continue to deliver cash ahead of EBITDA. On margin expansion, while domestic markets show significant improvement, we are not expecting a material expansion this year when combined with Free Trade Zone and Border.

So, let me sum up before we go to questions.

In the year to date, strong growth of high single digits in domestic markets has been offset by the impact of currency movements on demand in the Free Trade Zone and Border Channel in West LAC. Venezuela is a now much smaller component of the regional P&L, following a protracted period of currency devaluation and our priority there is now building a stronger local business, as well as securing opportunities for imports.

Together Free Trade Zone and Border and Venezuela represent 10% of total LAC sales this year. Therefore, the role the rest of our domestic businesses has become increasingly important.

The domestic markets continue to perform ahead of the sector in aggregate We are focused on driving sell out and strengthening our portfolio across Premium Core, Reserve and Innovation, and developing our Route to Consumer to increase distribution, with the objective to drive stronger spirits penetration.

Overall I expect depletions to continue to run ahead of shipments as we head into Q4. While I don’t expect an immediate improvement in the macro-economic outlook, held back by weakness in domestic currencies and slower growth in the Brazilian economy, the medium term outlook remains favourable.

Now we have everything to play for. We have built a good platform but are investing to make it stronger. Our leadership in scotch gives us competitive advantage which we continue to build out into other categories, recruiting new consumers and penetrating new occasions. I continue to be excited about the long term prospects of spirits in the region and I am confident that our brands and portfolio breadth mean we are well positioned to benefit from a stronger consumer environment.

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

Question and Answer Session

Ian Shackleton - Nomura

Yes, good morning, Alberto. Three quick questions. You highlighted probably in Q4 there still will be some destocking. How do you think about FY16? Do we get into clear water at that stage?

Second question is really round the sales mix in scotch. Are you seeing any sign of deterioration in the mix? Is that something that worries you thinking about next year?

And the final question was really just going back to Q3. You had a particularly weak Q3. I think minus 10. I think there were some technical factors. Perhaps you just give us a few more details about those and how that impacts on Q4?

Alberto Gavazzi - President, Latin America and Caribbean

Yes. Hi, Ian. Let me answer all of those questions in order then. Q4 destocking. Let me separate those in to two tales I've been talking to you about. On domestic businesses we have been fine during the entire fiscal year. We dealt with what we needed to deal with last fiscal year, and as I stated earlier, our depletions are growing by 4 percentage points ahead of sell-in. So, on domestic business we are solid and we're good and you've seen good growth coming from most of those markets as well.

In terms of the Free Trade Zone and Border channels which is where the issues really lie, my biggest concern is not the level of stock that we have in the market. If I was going to look at the absolute number of cases in the system, that is not the concern. The biggest challenge we've got, Ian, would be to get us back into trading. So, getting depletions running again and they have been obviously affected by this huge devaluation that has been happening in the region. Let me bring a little bit of colour into that.

If you go back to when we had our call last year, we went into Q4 performing quite strongly in the Free Trade Zones and Borders and we were able to resume trading and stock levels were starting to reach a more reasonable position. Since November, we had a devaluation of over 30% in many currencies across the region and that has really put a stall into trading conditions in the system. So, when I now say that we have taken three months of stock this fiscal year out of the system it is based on a much smaller depletion [rate] than what is a normal depletion rate for this channel. If we were to resume the normal depletion rate, then we do not have excess of stock.

Going forward, my answer to you would be we will have to continue to monitor how trading conditions will continue to evolve. If there is continuous disruption in the currency environment, it is very likely it will take longer to resume. But if currency stabilises, then we're likely to improve our position going forward.

On the answer of going into F16 what is the expectation, again, it will depend on trading conditions. We are in a position where the Free [Trade] Zones and Border now represent a much smaller portion of our Latin American and Caribbean business. Therefore, the impact on total business is not expected to continue to be as big.

In terms of sales mix in scotch, no, we actually are continuing to see scotch improving on all fronts. On deluxe it is continuing to drive strong growth on our core markets with the exception obviously of Venezuela driven by availability. But it continues to drive strong growth. We are introducing new super premium variants like Old Parr Tribute to continue to drive [the] premiumisation agenda and our reserve agenda also continues to drive continuous growth on scotch.

What we have seen is the development of what we call the primary sector which is where Black & White and White Horse plays and we had seen an exponential growth on that front in a number of our markets driven by the advent of more purchasing power with the emerging middle class, which, by the way, is a fantastic phenomenon because we're recruiting these consumers early into scotch. As they acquire the taste of scotch, we can then trade them up in the ladder. So, it's much better for us to recruit them into scotch, which is our most profitable serving than in any other category.

I look with very positive eyes what's happening in the primary sector and our ability to drive high double, sometimes triple digit, growth out of the brands in that sector.

In terms of the Q3 sales, yes, we had an impact on Q3, you're right, in terms of phasing. More specifically in our West LAC businesses. There were some orders that were expected to come in Q3. They didn't. They will come into Q4 for a number of different reasons - delay in shipments, they missed the boat, and some other issues. But those, as we stated in Q3, those were phasing issues and will positively impact the performance in Q4.

Q3 has also been impacted by the Venezuelan devaluation and some fluctuation in the Border and Free Trade Zones. But, you will see some positive phasing impacting into Q4.

Ian Shackleton

So, Q4 we definitely should see positive momentum because of timing issues reversing in revenue and I guess for the full year you probably end up sort of flattish on net sales?

Alberto Gavazzi

Well, it depends a lot how we close Q4. In domestic businesses, as I said, we continue to see depletions ahead of shipments. So, it will put us in a good position to finish domestic business in the same trend that we have been having now. So, stronger high single digit numbers overall for the domestic business is our expectation for the closing.

And on Free Trade Zones and Border, we expect to see an improvement versus trading conditions in Q1, Q2, and Q3. Hard to predict how much, Ian, but at this stage it's coming in line with our expectations is what I can say.

Ian Shackleton

Very good. Lots of detail. Thanks very much indeed for that Alberto.

Alberto Gavazzi

Thank you.

Olivier Nicolai - Morgan Stanley

Hi. Good morning. Most of my questions have been answered already. Just one last on Venezuela. What percentage of your products are now imported versus locally produced? I assume it's, what, 100% locally produced and you don't ship scotch anymore?

Alberto Gavazzi

In Venezuela you mean, Olivier?

Olivier Nicolai

Yes.

Alberto Gavazzi

No. We are continuing to ship scotch into Venezuela as we acquire currencies. This fiscal year we have been able actually to access currencies through the government and we have been able to build sufficient [stocks] to supply a third of the market consumption. So, if we have scotch, Venezuela will continue to consume. To give you an idea, whenever there is scotch in the liquor stores, you know, it's quite amazing. If you imagine a launch of an iPhone 6 on any Apple store and there is a big queue in front, that's what you will see in Venezuela the day our deluxe products hit the liquor stores. So, whenever there is an ability to import, we're able to put the product in and we sell. Right now it should be about a third of the current demand.

In terms of your question, 75% of our business is now local and 25% of our business is now imported. What we want to do is build up a business that is not dependent on any imports, everything is locally produced, and we're able to have a strong and successful business on that. We're already market leaders in rum, as you know. We're very strong in gin. In our ready-to-drink we're market leaders as well. We want to develop a larger business in domestic production and then when we are able to access scotch, we will see that as an upside. Something that we will very much welcome because we can sell it at very high profits and value. But we won't be really to count on that as a fact going forward.

Olivier Nicolai

Perfect. Thank you very much.

Alberto Gavazzi

Thank you.

Andrea Pistacchi - Citigroup

Yes, hi. I have three questions, please. The first one on Brazil, the outlook in Brazil. You've had to take, I imagine, quite sharp price increases given the currency. What impact this is having and whether because of this and the macro you would expect Brazil probably to get worse before it gets better, thinking of FY16?

A second question on the Free Trade Zones. You said you need to see a stabilisation in depletions in order for Free Trade Zones to improve. Where does the actual final demand, or most of the final demand for your products sold in Free Trade Zones, where should these depletions actually improve?

And then a more general question on LatAm. You've grown double digit your sales essentially every year until FY13. You've been around flat in the past couple of years. Part of this is structural. A large portion is cyclical. What do you believe is a sustainable long-term growth rate for the region?

Alberto Gavazzi

Okay, Andrea, so let me answer these in order. So, Brazil outlook - that is a tough question, I mean how to predict Brazil's situation. Every time we look there is something new that happens and obviously as a Brazilian I'm very disappointed with this current status of my country.

In terms of the impact in the business, the dollar has strengthened through 3.20 and now it has gone back to 2.90, then yesterday back to 3.01, so it's fluctuating a lot for us to be able to determine what is the final impact on the business. We have, yes, planned price increases. We always do in any developing market to protect the margins on our products and we tend to take pricing according to devaluation, because we're leading the category and we want to protect the value of the category going forward. So, we have those planned increases in Brazil which combined with the current situation, I cannot say that I will see Brazil coming up with strong growth in the near future.

Yesterday I read an article that is suggesting eventually some silver lining at the end of this calendar year. But, you know, it's too early to predict. At this stage I would rather be conservative on Brazil's future and say that we will continue to protect our position in there, drive pricing to protect scotch value, and still trying to gain share in the current environment which, by the way, we have been able to do in scotch this fiscal year.

In terms of the Free Trade Zones, what I referenced is in order to have stabilisation of Free Trade Zones, what I need to see is currency stabilisation. So, to have depletions resuming I need to see currency more stable. What affects the Free Trade Zone trading ability more than the devaluation is fluctuation because with fluctuation nobody really knows [with] which dollar you are buying your goods and [with] which local currency you're going to be selling and nobody wants to be selling at local currency and then having a much bigger debt in dollar. So, people tend to hold back and sit for a while, while there is this fluctuation of currencies.

So, for depletions to improve we need to see that coming back. As I always said, in Latin America we've always had these fluctuations. It's not the first time. It's not going to be the last time. As soon as these resume we should see that business also resuming together with it.

In terms of LAC sales, yes, we had double digit sales in years in the past when we also had a much bigger GDP growth in the region. So, right now the GDP growth in the region is about 1.2% and we're being able to drive growth in domestic business of high single digits which are way ahead of market conditions growth. So, I would say that our ability to outperform the market remains equal. It's just market condition is not where it was a few years ago, as you certainly know.

In terms of predicting the future, you know, right now our plans continue to see robust growth on high single digit and that's what we expect to continue to be able to drive in the near future. So, there is nothing showing that this rate of high single digit growth is slowing down.

Andrea Pistacchi

Thanks. Can I just ask a quick follow-up on Brazil on the pricing there?

Alberto Gavazzi

Yes.

Andrea Pistacchi

So far, what sort of price increases have gone through and is the strategy there a series of price increases or do you tend to go with one greater price increase at a given time?

Alberto Gavazzi

Well, it will depend a lot on what is happening with the currency. This time we had a big hit at once. On a period of three months we have a 30% devaluation. So, we decided that we would catch up relatively fast. What we have done in Brazil is twofold. We have revisited our commercial policy and this is one of the reasons why we are seeing more of a flattish performance. We revisited our commercial policy that was allowing for parallel interstate. So, you had, let's say Rio de Janeiro which has a lower tax than Sao Paulo, so there was a lot of purchase in Rio de Janeiro and then product being sold in Sao Paulo. As a result of that, our revenue and mix also deteriorated and we decided to revisit that and equalise our pricing according to different state price tax rates. The result of that is that we got rid of let's say cheap sales. We didn't want to have cheap sales which was deteriorating our margin and that has impacted to some extent our top line growth in Brazil, hence that's one of the reasons of why we're seeing some flattish performance in the market.

We have taken a hit on NSV, but now we are selling at a much more quality pricing and with better margins than we were a few months before. We have a healthier operation that we can build upon. In that healthier operation which has already increased prices despite the devaluation, we're looking to taking prices to follow devaluation. We expect to put double digit price increases either at the end of this fiscal year or beginning of next fiscal year, but to happen relatively fast.

Andrea Pistacchi

Thanks.

Chris Pitcher - Redburn Partners

Thanks very much for taking the question. Could you give us more specific examples on how you're increasing visibility across the region? The group as a whole is talking about this increased focus of sell-out rather than sell-in. Can you give us some real world examples of how process or sales investments have changed to allow that?

Then secondly, on the destocking going on in the free trade zone I think you mentioned volumes would be down some 500,000 cases this year. Could you give us a feel for how much that is the destocking?

And in terms of just the visibility on that, why has it dragged on? I know you mentioned the industry currencies [technical difficulty] at the end of next year, but it does feel like Latin American destocking has dragged on longer than we had expected and can you give us reassurance that you've got ahead of the market now and with this reduction of three months, you are now comfortable that you're through it?

Alberto Gavazzi

Yes, hi, Chris. Let me start in reverse order. I would agree with you that destocking has dragged on too long and it's kind of disappointing that we find ourselves in this situation. But, again, I would like to separate those two.

On the domestic businesses we had a few months last fiscal year when we dealt with it and we're fine. If I could choose where I want to do well in this business, I want to do well in the domestics because that is where our consumers are, that is where we are building our brands and that's where we're showing the strength of our equity. So, for me, that is the core of the business.

Then we've got this big wholesaler on the back which is the Free Trade Zone and Border. While I would position last fiscal year as a big destocking, this year much more than the absolute level of stock that we have in place is significantly below what we had in the past. The issue is really our ability to drive trading again as I was explaining earlier.

I wish we could influence the currency fluctuation. We can't. It's very difficult to predict when this is going to stop. But I would really like you to look at this much more as adjusting to currency fluctuation and the current reality in that business than before.

Chris Pitcher

Just to follow-up to an earlier question because there was a question asked about where this stock ends up going when it goes into the Free Trade region. Are we just returning back to a more normal level of demand in Free Trade now that currencies have reset lower and by focusing on domestic businesses it sort of nets off? I mean you talked about looking for recovery in trading there. Perhaps we just had two years of abnormal demand in 2012 and 2013.

Alberto Gavazzi

No. Well, where do the stocks go in the Free Trade Zones? They go anywhere in Latin America. We can't predict where they go. Free Trade Zone people come and buy. They take it wherever they want.

In terms of the growth on those two channels, on domestic and Free Trade Zones, I would say I don't really see the growth on domestic being the cause for the situation on the Free Trade Zones. I really think they complement each other in many ways and the free zone tends to complement a route to consumer in places we can't achieve. Let's say in the Amazon, up in the north of Brazil, we tend to see some product ending up there because we can't reach. Our distribution doesn't get up to those places. So, you end up seeing the Free Trade Zone fulfilling that environment.

I really don't think that the situation on the Free Trade Zones is caused by the growth on domestics. I think they are independent.

So, in terms of the execution and focus on sell-out, yes, that is something that is clearly driving traction in domestic business in a much tougher environment than before. Before we had the wind in our favour a few years ago. But, basically, anything would stick when we were talking about scotch because there was such demand on scotch whisky that we really didn't need to be that efficient in terms of our out of stocks, of our demand planning conditions, in terms of our execution and the points of purchase, in terms of our incentive to distributors. What we have done there as a whole, in the whole of Diageo, and obviously this is the core to deliver our performance ambition, is transform this organisation from a sell-in organisation to a sell-out organisation and that's what we do in Latin America as well.

To give you specific examples, in Brazil, for instance, we have our distributor network that we're changing. At this time last year I was telling you we recruited six distributors. These distributors were actually ex-wholesalers. In Brazil you don't really have a very developed distributor network. We have to create our own distributors. So, these distributors were ex-wholesalers of which 40 of them didn't make our new standards. So, 20 of them did hit the standards of not only distributing our brands but executing them thoroughly at the point of purchase with measures such as share of space ahead of share of market, triple impact at the point of purchase, so, consumers go and they see the brand three times before they are able to buy the brand, implementing our promotions effectively in line with the above line execution.

So, we have a number of different KPIs that these distributors need to hit in order to make their incentives. We have changed our incentives from just a sell-out into "yes, you still need to continue to distribute our brands, but now you also need to do these other things for you to get your full incentive".

So, 20 of those distributors have said "yes, I'm capable of doing that, I will continue to do it", and the other 40 we had to change and we're continuously evolving that distributor network. Very unlikely that we will need 60 at the end. We knew that some of them wouldn't make it. But, we're still in a process of refining those and getting more from that.

The same could be said about Colombia where we have improved dramatically our execution, our visibility in the point of purchase, both the on-trade and off-trade. I alluded to Mexico as well as gaining leadership in the on-trade and that is clearly driven by us having very clear measures of how we consider winning in the on-trade. We want to have our products on the menu always placed ahead of competition. We want to have a strong visibility in the back bars. As consumers go in and they get closer to the bar, most of the brands they see are our brands. All of that is aiming at increasing impulse purchase, is aiming at driving consumption impulse for consumers and that's what we are trying to do with the execution.

So, there has been a lot going on on that, Chris. I wouldn't say that we're perfect yet. We still have some room to improve. But I'm very proud of the development we have this far in terms of service levels. In some of my markets they were 20%, 30% below what a global standard is. Now the vast majority of my markets have service levels in line with global standards of on time and in full delivery to customers. So, we're really tracking those in a lot of detail in every market, every single week.

Chris Pitcher

Thanks very much. Much appreciated your help.

Alberto Gavazzi

You're welcome.

Mitch Collett - Goldman Sachs

Hi, there. I wanted to come back to the Brazil pricing question. I know it's not easy to answer, but can you maybe just give us a sense of how much has a typical price gone up for imported products over the last year so we can understand how much there might be left to do? I know you said you might have double-digit price increases at the beginning of the next fiscal year.

Secondly, are there any other regions within LAC where you think you might have double-digit price increases to come on your imported product?

And thirdly, given that there are some pretty obvious price increases yet to happen, is there any chance that stock levels have actually been building ahead of the price increases you need to take? Thanks.

Alberto Gavazzi

Yes, Mitch, so let me answer those in reverse order. No, we do not expect a stock build up. We learned a lesson and we're controlling stocks everywhere very diligently. We do not want to have more than an x amount of stock per customer, per channel in Brazil and we will be controlling that very, very closely. So, no expectation of stock build up ahead of price increases is your first answer, either in Brazil or anywhere else. By the way, price increases are not going to be just in Brazil. We're putting price increases in Colombia, price increases in Mexico and in all of those places, and we're very, very clear with the local businesses, we want no stock build up. That has to be the guideline.

Then second, in terms of pricing, last year we have delivered double digit pricing already in imported products partially driven by this new commercial policy that I alluded to. Not a lot of it has been a mere response to devaluation, but we have already repositioned pricing in our brands. Despite that repositioning on pricing, we have been able to protect our share position in the market and this is the intention going forward. So, we do not want to see a lot of disruption in the business. We want to continue to see this category growing.

I worked in Brazil when the dollar was $4.50 to the Real, so much, much worse than we had today. When Lula was elected it went from $2.80 to $4.50 in no time. What we see generally is an adjustment of consumers to the new pricing and then they resume buying. This adjustment is just in a sense saying "is this temporary or is this here to [stay]?" As consumers get adjusted to the new prices, it's critical that we continue to invest behind our brands, then our learning is that consumers [get used] to the new pricing.

It is important that the whole category has to evolve, not just a few brands. So, everybody has to premiumise because otherwise what starts is a price war. But, the point is I am confident that once the price is established, trading will resume. The biggest concern I've got in Brazil is the consumer confidence and really the situation that the economy and political instability is driving in the market is affecting not only imported goods, as you know, but a number of different categories. So, consumer confidence resuming, we will see growth coming back into Brazil. If it doesn't resume, I would say we'll see more or less the same performance we've seen this far, but I don't anticipate an erosion on our scotch whisky business as a result of the new prices.

Mitch Collett

Just to make sure I've understood, you're saying that you've normalised the pricing between regions within Brazil.

Alberto Gavazzi

Correct.

Mitch Collett

But you haven't taken any pricing to offset the depreciation of the Real against the dollar or sterling and I think you said your aim was to protect margins within the market which would require you then to increase pricing so that it's flat in sterling terms. Have I thought about that the right way?

Alberto Gavazzi

Yes. So, let me just resume on that. So, we have taken pricing as a result of this new commercial policy which was sufficient to offset part of the devaluation. We are planning a new price increase at the end of this fiscal year or at the beginning of next fiscal year. We haven't decided exactly the final date in Brazil. It's very likely to be beginning of the next fiscal year, a new price increase of double digit. With the combination of those two we will offset any devaluation impact in terms of our margins. So, that is going to be brought to zero in terms of devaluation impact and from there on we will have to see what is going to happen with the currency to take any further decision. Making price increase after price increase is not good for trading because obviously people don't know what's going to happen next. Our intention is to make as few as possible [the number of] price increases to cope with the devaluation impact. So, unless there is another very big surprise, the price increases we're going to put through now at the beginning of the fiscal year should be lasting for a number of months into the next fiscal year.

Mitch Collett

Thank you.

Alberto Gavazzi

You're welcome, Mitch.

Well, I would like to thank everybody for taking your time to participate in our President's call with Latin America. I hope I have given you a little bit more insight in what's happening in the business and I hope that you have taken away with you that, again, it's a tale of two tales with the domestic businesses really driving growth ahead of the market and the Free Trade Zones and Border channels which, with Venezuela, have impacted our business. But they are no longer as significant as they were a few years ago in terms of the total LAC composition.

So, thank you very much and looking forward to speaking to you soon again.

End