DIAGEO AFRICA - CALL WITH THE PRESIDENTS

John O'Keeffe – President, Diageo Africa
March 16, 2017

John O'Keeffe:
Welcome, everyone, and thank you for joining me. Last year on this call I shared with you why I believed Africa was the most exciting growth region in the world, why the business I lead was in unique position to take advantage of the opportunity, and our strategy to access this opportunity.

The medium to long-term opportunity remains intact, despite the short-term volatility, with Africa's forecast to be the fastest growing total beverage alcohol region over the next five years, with the LPA population expected to grow by about 60 million, and increasing incomes.

In addition, per capita consumption stands at about a quarter of other regions, except for India, and consumers aspire to move to formal, safer drinks from a large informal sector, which today represents around 40 percent of alcohol consumption. These consumer fundamentals translate to a very positive growth for the industry, TBA volume is forecast to increase by around 20 percent over the next five years.

In the short term, we are seeing a divergence in growth across Africa. GDP growth has slowed down sharply in the last two years among oil exporters, of which Nigeria is the most relevant to Diageo's Africa business. In Nigeria, currency scarcity and devaluation are driving a high inflationary environment, making affordability even more important to consumers.

Our strategy in Africa is to grow our beers fast and our spirits faster. To deliver this, we are executing against the following priorities. Keeping our premium core brands vibrant while expanding participation across price tiers, strengthening our route to consumer and using it to accelerate access to the spirits opportunity, providing the products to consumers want via our strong innovation capability, driving costs out, and we are building local talent base to sustain this growth.

Today, I'll share with you my thoughts on our first half performance and the progress we have made over the past 12 months against our strategy through executing against our priorities. I will then give an update on each of our key markets.

In the first half, Africa performance improved with net sales growth of 4 percent, driven by spirits. Beer net sales were down 1 percent, while mainstream spirits grew 20 percent, and premium spirits grew 13 percent -- with double-digit growth in scotch. Beer performance was impacted by a 43 percent increase in excise duty in December 2015 on bottled beer in Kenya; our biggest beer market, and the comparison against strong double-digit growth in Guinness and Malta Guinness in Nigeria in the prior period.

This was partially offset by strong growth in our value brands, Satzenbrau in Nigeria and Senator in Kenya, and 7 percent net sales growth of beer in Africa regional markets with the relaunch of Meta in Ethiopia on the growth of Guinness. A tough half on beer, however, I do expect beer performance to improve in the second half as we complete cycling the two factors that impacted first half performance.

Let me now share the progress we've made against our strategy to grow our beers fast and our spirits faster by executing against our priorities.

Starting with beer; if you look beyond the first half challenges, beer is the key foundation for our region, and Diageo's strength in Africa is our beer business and its synergies with our spirits. Beer and Malta Guinness net sales represent about 60 percent of the business, and we have strong share positions, infrastructure, and leading brands in our beer markets.

We continue to drive our beer business by keeping Guinness, our flagship brand, including Malta Guinness vibrant; growing our local brands, Tusker, Meta and Serengeti, aggressively expanding our participation in the value segment, and leveraging innovation.

Guinness is the cornerstone of Diageo's Africa business, with Guinness Stout and Malta Guinness representing 45 percent of our beer business. The overall brand equity of Guinness remains strong as we focus on delivering a consistently high quality liquid at the right price, and engaging consumers through a strong marketing and trade activation platform. Our African breweries are consistently delivering high quality Guinness following a renewed effort to improve quality from grain to trade. In Nigeria, where volumes were impacted by an excessive price index to mainstream beer, we have taken limited price increases in the last three years, despite inflationary pressures. We continue to drive consumer engagement through the successful Made of Black campaign and on trade activation during the English Premier League football matches, encouraging consumers to choose Guinness as their first beer of the evening. Guinness gained share in the first half in Cameroon, and in Ghana the trend is improving with share gains in the three months ending December 2016. In Kenya, despite the large excise tax increase, Guinness is aspirational and resonating with consumers. We are also increasing investment in the second half in key Guinness markets to drive higher levels of consumer engagement and activation.

Malta Guinness is our non-alcoholic malt drink, which is almost as big as our second biggest African beer brand, Senator. We continue to drive mental availability through a robust through the line campaign across traditional and digital media, and improving physical availability. As we innovate to meet the consumer trend towards healthier options, we launched Malta Guinness Herbs lite; a low sugar line extension in Nigeria in the first half.

I will cover our key local brands in the market update later on in the call.

Now moving on to our participation in the value beer segment. Historically, our beer business has centered on premium beer. In recent years, we've seen consumers migrate to value beers in a number of countries. Nigeria is a good illustration of this, where over the last 2.5 years, the value beer segment has increased volume share from 26 percent to almost 50 percent. To meet consumer needs, we have focused on delivering compelling beer propositions to consumers at affordable price points, more than doubling the volume share of value beer to 34 percent of our beer business. We've done this with existing brands like Satzenbrau in Nigeria, which doubled net sales in the first half, and Senator in EABL [East Africa], which grew double-digit in the first half after more than doubling last year. We've also launched new value beers in Ngule, Uganda endorsed by the King of Uganda, which already has 3 percent share of beer category, and Azmera in Ethiopia; a lager made from the finest local grown ingredients. We are also expanding our presence in value malt segment in Nigeria with Dubic Malt. It has nearly doubled its share in the past year, and we're expanding it into the bottle format in the second half. The scale value beers provide is also critical to optimizing the capacity of breweries, and securing better input costs.

So we're making good progress on our strategy to expand our participation in the value segment.

We continue to innovate in the beer space with new beer and RTD offerings. In the first half, we launched Black Bell in Uganda; a rich and flavorful beer targeted at millennials, Tusker Premium Cider and Smirnoff Ice Electric Guarana and Ginseng in Kenya, and Tappers Palms in Ghana; a crisp sparkling drink with the refreshing taste of palm inspired by the iconic local palm wine drink.

Let me now tell you how we are progressing on unlocking the spirits opportunity, both in international premium spirits and mainstream spirits.

International premium spirits are out of reach for most Africans at the moment. However, they remain an important part of our growth agenda, as we participate across all price points. They are almost 17 percent of Africa's net sales now with Johnnie Walker by far the biggest brand, followed by J&B, Smirnoff and Captain Morgan. Net sales grew double digit in the first half, driven by Johnnie Walker Black Label in Africa regional markets and Nigeria.

Mainstream spirits is an exciting opportunity, with consumers increasingly including spirits in their repertoire and easily switching between beer and spirits -- with more than 40 percent of beer consumers having consumed spirits in the last four weeks. Affordability is a key consideration for the vast majority of consumers in the region, and so are safe quality products. Most mainstream spirits consumers in Africa earn less than $5,000 a year. And the price per serve of typical mainstream spirits is less than, or similar to, value beer or local spirits.

Diageo's presence in both beer and spirits in Africa makes it best placed to make good quality mainstream spirits that are affordable, accessible and aspirational. Our beer business gives us a unique position to drive mainstream spirits growth that. The results demonstrate it, over five years ending fiscal 16, we delivered more than double the growth rate of spirits in our markets with an established beer platform compared to those with a majority spirits business. And the operational synergies are significant.

Let me bring this to live few things example of Kenya. In Kenya the value and mainstream segments form 87 percent of TBA consumption; 99 percent of the on-trade and off-trade outlets sell both beer and spirits. These outlets are serviced by distributors, 100 percent of whom already sell our beer, and wholesalers, 80 percent whom already sell our beer. And they use the same warehouses and trucks to deliver our beer and spirits.

So you can see the significant overlap in route to consumer for beer and mainstream spirits. Similar synergies exist within our EABL business through a shared manufacturing footprint, warehousing, logistics, and procurement.

We have gone after this opportunity in a systematic and aggressive way through establishing a clear participation strategy, leveraging innovation, further strengthening our route to consumer, and a focus on costs.

Today, mainstream spirits represent around 14 percent of our net sales. Our participation strategy is to create a focused portfolio with fewer larger brands meeting distinct consumer needs. We are leveraging our existing big local brands, like Kenya Cane Rum in Kenya, Orijin Bitters in Nigeria and Ghana, and Waragi gin in Uganda. And our proven multi-market and global trademarks like [Smirnoff], McDowell's No. 1, and the primary scotches Black & White, and VAT 69.

We recently launched; 5cl Orijin Bitters sachet in Ghana and Nigeria, meeting the consumer need for small format, safe product, at affordable price points, Kenya Cane Coconut flavor to re-reenergize the Kenya Cane franchise, new packaging, and PET format of Uganda Waragi. And in Nigeria, we're looking to take Orijin into adjacent categories where herbal roots are important to consumers.

In Nigeria, we launched locally manufactured Smirnoff X1, McDowell's No. 1 and a new flavor of Gordon's Gin. And we're using primary scotch learnings from our Latin American business to establish Black and White as the bridge between lower mainstream whisky and standard scotch.

To strengthen our route to consumer, we have increased our presence in the wholesale channel in Nigeria and Ghana to be competitive with local spirits competitors, with Uganda and Tanzania to follow. We've also created selling tools and execution standards for our sales force based on the learnings from our large mainstream business in India.

And most importantly, mainstream spirits are margin accretive in our beer markets. We're producing locally with an asset light approach, and have recently added new capacity in Ghana, Nigeria and Cameroon. Rigorous cost tramlining and benchmarking ensures we don’t over engineer our products, and we support them with an appropriate level of marketing investment.

So lots of good work happening on mainstream spirits; across the region net sales grew 20 percent in the first half and I expect mainstream spirits to be a key growth driver with double-digit growth over the coming years.

OK. So I've covered beer, mainstream spirits and international premium spirits. Let me now talk about three priorities that I've not touched on, namely, how we are strengthening our route to consumer, driving our costs, and more importantly, our people.

We are strengthening our route to consumer by improving execution on four mandatory commercial standards. How we manage our major customers, achieving product assortment and activation standards, for 100 percent of outlets we call on, automated measurement of attainment of goals, and rewarding achievement of goals.

South Africa is a great example, where in the first half the number of outlets meeting minimum product assortment has doubled, and almost 90 percent outlets are now meeting minimum activation standards. This execution is measured through a digital image recognition tool that allows for a real-time measurement and reporting against the execution standards.

A key priority is driving costs out through our productivity program. This has been essential for us, given the pressure on organic operating margins with high local inflation and adverse mix from consumer shifting to value products. In the first half across Africa, we were able to mitigate most of the margin headwinds, resulting in a small organic margin decline.

This focus on productivity is evident across all of our markets. Let me bring this to light by sharing what we've done to drive out costs in Nigeria. In Nigeria, we are seeing significant input inflation both on imports due to the naira devaluation, and on locally sourced inputs, due to embedded exchange exposure and local inflation. We are also seeing adverse mix from the consumer shift to value. In a muted pricing environment, we've implemented a big agenda in supply to drive costs out, delivering improved organic gross margin, versus last year in the first half. We have rightsized our brewery workforce, as well as optimised spans of control and reduced layers, improved the efficiency of our breweries through a manufacturing excellence program, improving bottling efficiency by 10 percent, and reduced waste and energy and water usage. Delivered a double-digit reduction logistic costs by driving operational efficiencies, and leverage our procurement capabilities to secure supply of inputs in an escalating cost environment. We are also expanding our supplier base to allow us to secure the best prices.

Rightsizing the broader organization, zero based budgeting for indirect spends and marketing efficiencies from negotiating better media and point of sale costs, also delivered savings in Nigeria. In the first half, we also took some price increases, which partially offset the impact of inflation. We have now embedded net revenue management capabilities and tools in the business. This will allow us to better identify pricing opportunities and trade spend efficiency going forward.

We are now sourcing locally around 70 percent of third-party raw materials, and our medium term goal remains at 80 percent for Nigeria. And on packaging material, we're working with suppliers to reduce the amount of embedded exchange exposure.

Across Africa, we have also embedded a culture of capital discipline and an everyday focus on cash. Capex as a percentage of NSV has reduced from double-digit to close to 7 percent in F17 as we move from a period of beer capacity expansion to focused Capex spend in key markets to support delivery of our strategy, especially local production of mainstream spirits. Our consistent focus on cash has reduced average working capital as a percentage of NSV from high-single-digits, to mid-single-digits over the last couple of years. So as you can see, we've gone after costs and cash in a big way.

We're also guaranteeing our plans with the right people and capabilities. We're doing this to building a local talent base through a combination of developing our internal talent and external improvement.

So we're making good progress on our strategy to grow our beers fast and our spirits faster by broadening our portfolio and participating across a range of price points, and we're doing this through disciplined execution of our priorities.

Before we move to Q&A, let me share some thoughts by market, both in terms of performance and progress against the execution of the strategy.

Starting with East African Breweries, we are executing our strategy with value beer, mainstream spirits, and international premium spirits growing double-digit in the half. We are leveraging innovation to broaden the portfolio with the launch of Kenya Cane Coconut, Tusker Cider, and Smirnoff Ice Electric in Kenya, and Ngule and Black Bell beers in Uganda.

Guinness is in good brand health, and there's some exciting refresh work coming through on Tusker in the second half. We're also working to address excessive price increases taken by some retailers post the duty increase. While the bottled beer and our overall performance in Kenya will improve in the second half, the excise duty increase has put bottled beer out of the reach of many consumers, and it will likely take longer to get Guinness and Tusker back to consistent growth.

Moving over to Nigeria, where despite the challenging environment, we've been making good progress on our strategy. Both value beer and mainstream spirits doubled sales in the first half, driven by Satzenbrau, and launch of locally produced mainstream spirits, respectively. International premium spirits also grew double-digits, driven by Johnnie Walker. And I expect Guinness and Malta Guinness performance to improve in the second half. While we're seeing topline growth in Nigeria, there continues to be pressure on organic margins due to the continued consumer shift of value, high local inflation, and a muted pricing environment. I had shared earlier how we have gone after costs aggressively to mitigate this impact, and it will continue to be an area of focus for us.

If I now turn to Africa regional markets, Ethiopia had a strong first half with solid growth in Meta following the re-launch last year and, Malta and Johnnie Walker also grew double-digits. The growth in Cameroon was driven by the launch of Orijin ready to drink last year, Johnnie Walker growing double-digit, and Guinness. And in Ghana, Guinness grew double digits as a brand benefited from the 'First Beer On Us' campaign; Malta Guinness and ready-to-drink also grew double digit.

Finally, in South Africa where the market is facing tough economic conditions, we're starting to see the benefits of the new structure come through. Net sales grew 10 percent driven by growth in mainstream spirits led by Smirnoff 1818, and price increases taken over the past 12 months. Johnnie Walker benefited from significant focus in investment, as well as the launch of Johnnie Walker Green Label and an up weighted gifting activity on Johnnie Walker Blue Label.

Let me close by saying we have made good progress against our strategy to grow our beers fast and our spirits faster, despite facing short-term challenges in some markets. We have broadened our beer portfolio across price points, and are building a strong mainstream spirits business quickly while also growing our international premium spirits. This is underpinned by our strong innovation capabilities and an aggressive cost agenda.

All of this gives me the confidence to reiterate what I shared in the last call, that our Africa business in the medium term will grow organic net sales high-single digit, and deliver a modest improvement in organic operating margin. In the near term, we expect to see continued challenges in Nigeria, but as I look at the second half, I expect our organic net sales and operating margin performance to improve on the first half.

Thank you, and now would like to open the session up for any questions that you may have.

Simon Hales:
A couple of questions, please. Firstly, you just referenced at the end your medium term confidence in delivering the high-single-digit organic growth rate from the region. How should we think about that splitting down between growth in the spirits versus the beer business, do you think, over that medium term horizon?

Secondly, you flagged the cost cutting measures you've taken, particularly in Nigeria, to try and shore up the difficulties you've been facing in that region. What learnings you've been able to take from what you've done there in Nigeria and apply perhaps to some of the other markets in terms of efficiencies?

And finally, and maybe just linked to that last question, in terms of the margin outlook for the second half and the full year this year, should we expect organic margins in aggregate across Africa to be positive in the second half?

John O'Keeffe:
Great, OK Simon, thank you for that. So let me take those questions in turn. Our medium-term guidance is unchanged; I expect Africa to deliver high single digit organic net sales growth as we execute our strategy to grow our beers fast and spirits faster. And a key within that of course is broadening our portfolio and participating across a range of price points.

Now within that, I would expect beer to be growing low to mid-single digits, and spirits growing double-digit. In the near term, I'd expect to see continued challenges in Nigeria.

In terms of the productivity agenda that we've been pursuing in Nigeria and the learnings applied to other markets; yes, I mean, the first thing I'd say is that we are pursuing the productivity agenda right across Africa, and not just in Nigeria. And it's really, I guess just to kind of delve in a bit more detail in this, it really has become critical, given the pressure on organic operating margins with high local inflation and adverse mix coming from consumers shift to value. As I mentioned in H1, across Africa we were able to mitigate most of the margin headwinds, resulting in a small organic [operating margin] decline. Specifically if I get into some of the details, across supply, we've been able to improve brewery efficiencies through a manufacturing excellence program -- not just in Nigeria, but right across Africa.

We aggressively rightsized our workforce to Nigeria, but again, we did that across all of Africa, depending on the how efficient we felt a particular business was. And regional pan Africa operational efficiencies in logistics, leveraging our procurement capabilities to secure supply of inputs in an escalating cost environment. Also across Africa, and not just Nigeria, we've been pursuing zero-based budgeting for indirect and marketing efficiencies for negotiating better media and point of sale costs.

And we are taking some price to partially offset the impact of inflation, but again, that's quite muted. So really, I think -- and I think probably the thing we've learned the most is how to get after the LRM [local sourcing of third party raw materials] agenda, which in Nigeria is now up at 70 percent versus a few years ago where it was at 40 percent. And my goal remains to get that to 80 percent. And so we take a lot of learnings in what it takes to shift the needle in our local raw materials agenda – out of Nigeria, across into the other markets.

I think your last question, Simon, was on -- in term of the second half and expectations. I would expect H2 organic NSV [growth] to improve on H1 as beer performance improves in Kenya and Nigeria. Organic operating margin performance will also improve, driven by firstly in Nigeria, as we see full productivity savings coming through. Secondly we'll incur lower productivity costs versus the same period a year ago, and finally, we'll also get some pricing yield coming through.

Edward Mundy:

Hi John. Can I ask a wider question around total beverage alcohol? I think you mentioned on your opening remarks that where you do have beer, your rate of spirits growth is significantly ahead of that of where you don't have beer. At what stage do you feel you've got critical mass within spirits?

John O'Keeffe:
I think, yes, it's first of all, there's kind of two parts of your question. Again, how beer is helping spirits. Interestingly, we are seeing increasing incidence of beer drinkers drinking spirits, so increasingly we're seeing TBA spirit drinkers.

I think we already are gaining critical mass in spirits. I mean, it's already 30 percent of our business, with mainstream spirits being around 15 [percent] of that, being about half of that 30 percent, and international premium spirits and reserve being the other half. So, already, a third of our business is in spirits -- and that's -- begins to become quite even across the patch.

And as I mentioned, I would anticipate our spirits part of our business growing double-digit going forward. So I think we already are beginning to achieve mass, and I would expect that to accelerate each year that goes by as we grow spirits faster than beer.

Edward Mundy:
Just as a follow-up, your medium-term targets of high single digit revenue [growth] -- are you confident you were able to achieve that by fiscal 2018 onwards?

John O'Keeffe:
I think the unknown entity is really Nigeria where it's still very volatile, and so the pace at which we can deliver on that medium-term guidance will be very much dependent on what happens in Nigeria over the next 12 months.

I anticipate Nigeria to remain quite bumpy; the macroeconomic environment is not yet getting better, and that economy is still in recession. So I think that's the one caveat I would add, and as that works through the cycle, then I think we'd start delivering that medium-term outlook that I just stated.

Edward Mundy:
Just one final question. Are there any other potential regulatory hot spots across the African region that are keeping you awake at night from the tax increases?

John O'Keeffe:

Yes, I acknowledge that many governments across Africa are under a lot of financial pressure, particularly oil producing and big commodity export economies. And so, there is a heightened tax risk, a heightened regulatory risk that we are proactively monitoring.

As you can imagine across Africa, we are in regular and open discussion with all the government stakeholders on a range of subjects. Where appropriate, we provide input and data -- reflecting possible impacts of changes in duty, impacts on the industry, impacts on the government revenue stream, but also impacts on the consumer in that country and the farming community. And we have seen those impacts play out in Kenya, where excessive duty rises on beer have had quite a big impact across a wide range of stakeholders.

So, ultimately, we are seeking a sustainable and predictable tax environment. But right now, given the pressures, I think it's fair to say that it is going to remain a little bit more unpredictable than usual in Africa in the next 12 to 18 months.

Sanjeet Aujla:

Hi, John. Three questions, please. Firstly, can you just allude to any change in competitive behavior with new owners coming into Africa in recent months? Secondly, on the mainstream spirits side, I think a couple of years ago, SAB were talking about building out their mainstream spirits business into new markets, such as out of Tanzania into Nigeria perhaps. Have the new owners gone ahead with some of those plans?

And thirdly on the premium spirits side, many competitors have come in recent years that are trying to build scale there. How are you dealing with that and can you just allude to the market share dynamics on the premium spirits side? Thanks.

John O'Keeffe:

OK. So first of all on the competitive dynamics, the first thing I'll say is SAB has always been a strong competitor, and I expect ABI to be the same. We have a clear strategy and we're focused on executing it brilliantly while keeping an eye on the competitive environment.

We are the only scale TBA player on the continent, and we believe that can be a source of real competitive advantage. I'll let you ask the question specifically on ABIs intentions, to ABI rather than me answering it. But right now we feel that mainstream spirits is relatively uncontested, and it’s more about taking share from big local producers.

I think the third question was around premium spirits competitor environment. Are we seeing that intensify, I think was the question. Is that correct?

Sanjeet Aujla:
Yes, actually -- you've seen some competitors come in and trying build scale there. How are you dealing with that and are you comfortable you are gaining share in your market?

John O’Keeffe:
Yes. Look, I'm feeling very good about our performance of our premium spirits. We grew double-digit in the half; I'd expect that to continue. We continue to grow our reserve business – double it every two years [organic growth of about 70% from F14 to F16], and notwithstanding the deteriorating kind of economic environment, we see our reserve business holding up relatively well [flat organic net sales in first half F17].

And so, we remain quite a large spirits player across the continent, and what we're now doing is actually building out a portfolio beyond the strong brands of Johnnie Walker, Smirnoff, Captain Morgan -- but actually, a broader international premium spirits portfolio to meet kind of an expanding, growing demand from consumers. And again, I'm seeing increasingly a greater interest in spirits in general across many markets in Africa.

And as I mentioned earlier, over 40 percent of beer drinkers consumed spirits in the last four weeks, and I'm encouraged to see that spirits penetration is on the whole improving across the continent.

Chris Pitcher:
A quick question -- I've four questions on Nigeria. You mentioned that you are upto 70 percent of local costs of raw material sourced locally. Can you gives us a feel for what the total percentage of your cost of goods is actually imported, including intercompany stuff like Guinness concentrate and the like?

And then in terms of your outlook for modest margin growth for the region, what should we expect with regard to Nigeria, local expectations the Guinness in Nigeria for quite a significant recovery in operating profit over the next two to three years? Is that in line with your thinking?

Can you sort of square the circle on that one? Thank you.

John O'Keeffe:
Yes. So, let me take the second question first. I think that we are seeing a recovery in margin [organic operating margin] in Nigeria. However, it's a very high inflation environment; double digit of around 18 percent and 19 percent, and pricing remains relatively muted, hence the criticality of the productivity agenda that I just alluded to.

We have got some pricing away over the last nine months, which is helping with margins. So, I would expect Nigeria to play its fair share contribution moving forward to the overall operating margin expansion across Africa.

Chris Pitcher:
While we're on Guinness in Nigeria -- in terms of the minority stake in the business, there was a while back you were potentially looking to increase your share of the business, but far as I'm aware, nothing came with of that. What we should think with regard to capital allocation to Nigeria?

John O'Keeffe:
Yes. On that question, there was originally a tender offer -- but the macroeconomic environment radically changed 12 months after announcing that, and since then Diageo -- we have focused on supporting Guinness Nigeria to ensure it is operating seamlessly. Right now, there is a rights issue being undertaken to enable Guinness Nigeria to optimize its capital structure by deleveraging its balance sheet thereby reducing its finance costs. The Guinness Nigeria board has got approval to raise up to NGN 40 billion, and that is now moving through the process.

So -- but I would continue to focus our capital investments more specifically in Nigeria on expanding our mainstream spirits footprint, and we have laid down capacity there. To me what is now quite a nice portfolio of mainstream spirits brands, including McDowell's No. 1, which is a significant brand in Nigeria, Orijin Bitters, another significant brand, and more recently introducing Smirnoff X1 and Gordon's Meranga. So we now have got quite significant [mainstream spirits] portfolio from where we were 12 months ago to capitalize on that opportunity within Nigeria.

Chris Pitcher:

And given your stake, is it fair to assume you will participate in the rights issue?

John O'Keeffe:

Absolutely. We hope that all the shareholders will participate. I think the proposed rights Issue provides an excellent platform for both ourselves but other shareholders to provide critical support to Guinness Nigeria, and we are very committed to part taking in that and ensuring that the right Issue is going to be a success.

Chris Pitcher:

If I could just get that imported COGS number.

John O'Keeffe:

Yes. So, our raw materials are about 70 percent local, approximately. Our packaging is approximately 100 percent local, but there is an ongoing issue around embedded FX. So just because one is acquiring raw materials locally, doesn't mean you're immune from FX, because the component parts that are used in the production of those local manufacturing processes. And I think the question was finished goods is, yes, IPS is around 5 percent [7% of Nigeria F16 net sales] of the business.

Tripp Blum:

Hi. I was just interested to hear a little bit about some of the differences between trends in spirits versus beer. I know that you've referenced the trend that's been happening for a while, which is in Nigeria, you've seen beer trade down continuing. But I'd just be interested in sort of the trends in beer versus spirits in the big markets where you have both. So for example, if spirits were premiumising and beer were trading down, any trends like that either in terms of categories or in terms of price points, which direction consumers are going? Just some general trends like that, where you could compare the two, thanks.

John O'Keeffe:

Thank you. So again, across a number of market studied, we are seeing more drinkers including spirits in the repertoire. And just to give you a couple of stats on that, I guess. Ghana, 47 percent of beer drinkers now also consume spirits versus around 40 percent five years ago. In Kenya 41 percent of beer drinkers now drink spirits; that would have been 37 percent a few years ago. And Cameroon is over 42 percent against the figure of 24 percent two [four] years ago.

So what we're seeing is consumers increasing in the repertoire to much more significant degree spirits, and the interaction between the two even on the same occasion, is now more obvious. And I think what we're seeing is consumers getting more adventurous. I think we're also seeing industry players, like ourselves, innovating more in spirits than what would have been traditionally the path and that of course is driving a greater consumer participation within the category.

In terms of trends in comparing the two, I think we're seeing down trading across both categories as consumers are under duress and are on the hunt for value. And I think we're seeing obviously in the kind of very premium end of spirits, reserve like, yes, less impacted than the premium end of beer, because that consumer, I think, is just more resilient in the higher -- in the high-end bars of the big cities and urban areas across Africa. So these will be the kind of trends that I'm observing right now.

Tristan van Strien:
And three questions if I may. Just on the first one, you've launched some of your brands in sachets, and over the years in Africa like in place like Angola and Burkina Faso, we have events with governments actually banning this pack. So what are you doing to kind of prevent that coming up as a regulatory risk as you've launched this pack in particular?

And then my second question, on your launch in Ngule in Uganda and Azmera in Ethiopia, are you getting any tax benefit here, and are you maintain the same types of margins as your mainstream brands? And then the third question; you talk about beer helping spirits. I guess the reverse of that, due to spirits help beer or considering the better margins on spirits, does that actually matter? Thanks.

John O'Keeffe:
OK. On the first question of sachets, I'm cognizant that sachets kind of being quite a controversial pack type. Frankly, I'm packaging agnostic, as to what packaging is available and legally allowed in a country; we will participate in that to be successful. And the reality is to participate in mainstream spirits, sachet is a go-to format in many countries.

We are seeing a number of countries ban that particular format, and obviously we'll be fully compliant with that. The interesting thing is we know that consumption just switches into other formats, usually PET, which we already have available in the market. So, we don't really see it as a disruption to our business. And actually in many cases, lower cost local operators find it more difficult to compete when the sachet format is no longer available.

In terms of your question on Ngule and Azmera, we are not getting excise tax benefit specifically on both of those [Note: The excise structures laid out by the respective governments apply to all beer suppliers, and they apply to Ngule and Azmera in Uganda and Ethiopia, respectively. In Uganda locally produced beer using local raw materials falls in a lower excise tax bracket, which is the case for Ngule]; however, they are playing a role in offering an affordable brand to consumers, and critically they play a role in making our breweries very efficient, which is critically important to recover that fixed cost overhead from a brewing perspective. And so, the margins vary depending what channel of our format you are talking about, but on the whole those margins, while dilutive, are acceptable from my perspective.

The third question, I think, does spirit help beer, conversely? I think from my perspective, we are dealing increasingly in Africa with the TBA consumer, we are certainly have had a TBA retailer for a number of years, and we've had TBA distributors where our distributors are not only carrying beer and spirits, they are carrying them on the same physical truck. And so I think when we as a supplier can go to every element of the chain and offer the total portfolio that can only be a good thing. So I think the totality of offering TBA that is our competitive advantage, and therefore, to that end, I do think not only is beer good for sprits, but spirits is good for beer. And it allows our sales representatives in each of the channels to really offer a competition beating portfolio as they walk in the door to make their sales.

Tristan van Strien:

Thanks, John. Just a follow-up on the second one. A few years ago you launched Ruut, which is cassava beer in Ghana. So I was just wondering what's happened to that brand, or is that still going at the moment and find a role like it does, I guess, for the Ngule in Uganda and Azmera in Ethiopia?

John O'Keeffe:

Yes. So it's a very timely question. After a very strong start with Ruut, we did struggle; we struggled because of the infrastructure that was acquired from suppliers, particularly in the processing of the cassava in order to deliver Ruut on a sustained basis. And so what we have learned since then and what we're bringing to on more recent launches in the last 24 months is making sure the right eco structure is around our value beer brands in terms of farming,

farming communities, but also the processing of that agricultural raw materials so that we can then convert that in the brewing process. So, we have taken a lot of learnings from some of the challenges we had with Ruut from Ghana across the rest of Africa. Thank you. I am going to just move to the last question, please.

Andrea Pistacchi:
Hi, John. I have three questions, please. First one on the competitive environment in beer in Kenya, you've got – of course, a dominant market share there. Bit of competition has been coming in, Keroche, a few other tiny players. Is this getting a bit more intense now?

The second on the pricing comments you made about Nigeria, you said you've been taking quite muted price increases. Is this a reflection that just because competition, the market leader hasn't really moved in a meaningful way? Or is it more your thoughts about the consumer probably not being able to the support more significant price increases? And the third question on mainstream spirits and the opportunity you have there across the continent, when you think of the geographic footprint, you have with beer, the markets you're in and the markets you want in – are there more markets where it would make sense to have a direct presence, that is for your mainstream spirits business, but is it possible without having the beer operations in those markets?

John O'Keeffe:
Yes, great thanks, Andrea. So first of all, the competitive intensity in Kenya, I feel, is the same as well it has been, it is competitive. I have encouraged to see that we've grown our share in beer from a very high level this fiscal to and even high level. And as we have more systematically gotten after mainstream spirits, I am also encouraged by our share growth within spirits.

That said, for me, as I look at our business in Kenya, while we have a very large share, I'd like to remind people that the penetration of alcohol is only 40 percent; so six out of 10 consumers in Kenya do not drink formal alcohol today for either religious reasons, lifestyle reasons, or usually affordability reasons. And so for me, the opportunity in Kenya is very much about increasing the size of the pie and getting after the illicit sector, which we recently commissioned a study and it confirmed that was around 50 percent. So that is the reason why we're very excited by Senator and its growth, is its ability to encourage consumers to trade up from illicit into the formal alcohol market where they can buy our brand.

Turning to your question on pricing dynamics in Nigeria. I think it's twofold. I think first of all, the competitive environment is intense with the three brewers there. Point number one. And point number two though, probably more salient point, is the consumer is under an enormous duress with that 18 percent and 19 percent inflation on the back of the naira devaluation, and we are seeing disposable income drop off. And for me it's not just about competing with other alcohol players, but actually about competing with share of wallet and you get into competing with mobile phone operators and so forth in Nigeria as that consumer duress is maintained. So, that's one of the main reasons why I think you are seeing a bit of muted pricing environment in Nigeria.

The final question is, are there any other markets, we can expand presence in Africa, especially you mentioned spirits? Yes, I think the exciting thing about mainstream spirits is you can go after in a more asset light fashion. I also do feel that we can penetrate new markets; we've recently done a joint venture in Madagascar as an example of that, in the last six months, which was on the basis of a mainstream spirits play, a JV with a local spirits distributor in Madagascar.

So that is one of a number of examples that I expect to see going forward of the idea of going into new markets and broadening our participation beyond the current kind of beer market as you see today. The last thing I'd say is that I think spirits is easier to avail of the economic trading zones that exist across Africa and our ability to logistically move spirits from one country to the next without incurring punitive transport costs is also greater than it is with beer or malt. So, I think that is another reason why -- I think you're right to say that on mainstream spirits. I think we do have, I think, a greater room to maneuver in terms of new market entry.

Thank you very much. What I'll do now is I will bring the session to a close. I'd like to thank you for taking the time to join. In closing, let me just say, Africa represents an exciting opportunity. The progress we're making against our strategy to grow our beers fast and our spirits faster gives me the confidence we will deliver against this opportunity. Thanks again. I'll close the call now. Goodbye.