Brunch time Call with the Presidents

Latin America & Caribbean – 7th June 2017

Presenter: Alberto Gavazzi

Good morning or good afternoon to you, depending on where you are today, and welcome to this year's regional president's call for Latin America & Caribbean, or "LAC" how we call it internally. As you may well know, I am now also responsible for Diageo's Global Travel business, however today I'm going to focus on Diageo's business in the LAC region. My plan is to spend about 20 minutes on some remarks and then I'll open up the call to take your questions.

Today I want to structure this call in four sections:

- I will start with a reminder of the opportunity we see in LAC, and why we are well placed to access it.
- Then, I will share an update on how we are executing against our strategy to capture the LAC opportunity.
- Third, I will talk about our progress against two of Diageo's global priorities:
    - Route to consumer and
    - Our Productivity agenda.
- Finally, I will wrap up with my views on the outlook for the region.

Let's get started with the opportunity for Diageo in LAC. We expect Total Beverage Alcohol category volume in the region to grow at a CAGR of around 2% over the next few years. This is supported by positive demographic and socio-economic trends. Current estimates suggest that through to 2020 we will see an additional seven million Legal Purchasing Age consumers come into the category each year, and within this group, the emerging middle class will continue to expand, supporting premiumisation trends.

Spirits penetration continues to be relatively low when compared to other parts of the world, and hence we believe there is significant headroom for growth. Beer accounts for over 80% of total beverage alcohol volume, and per capita consumption of international style spirits is about half of what is in the US. Therefore, I expect continued growth within the international spirits category.

Within this context, our business has a strong position in LAC. We are the leaders in international premium spirits, with our brands holding top positions across most markets and categories in the region, led by scotch, where we have nearly 70% value share. This is mostly due to the strength of our premium-and-above brands like Johnnie Walker, Buchanan's and Old Parr. However, more recently, we have grown share further through increased focus on primary scotch brands such as Black & White, White Horse and VAT 69. I will take you through some more detail on our progress on these brands in a moment.

In summary, we believe the opportunity is clear and we are well positioned in the region. So, what steps are we taking to capture this opportunity in LAC? As you may recall from previous calls, our strategy for LAC is based around three core pillars:

- First, we will continue to strengthen our leading position in Scotch in all markets, not only by winning in premium, standard and primary, but also by driving total category growth.

- Second, we will accelerate our diversification into other spirits categories, by making careful category and price segment participation choices, by leveraging Diageo's great portfolio and stepping up Innovation.
- And third, we will create more opportunity for consumers to choose spirits over beer and wine more frequently than they do today, which we expect will increase spirits' share of total beverage alcohol over the longer term.

In this call, although I will comment on each pillar, I'm going to focus on the first one in particular.

Last month, at our capital market day, you heard how Diageo has outperformed the competition in scotch globally, gaining 2.3 percentage points of value share over the last 5 years. LAC was a key contributor to that.

During the past five years, the scotch category has grown by 6% in terms of value across the region, and, over that time, our business has taken 4 percentage points of value share, despite the volatility we've seen in the market.

Part of this success has been driven by a more structured approach to positioning our brands, our price points, and packaging sizes to access opportunities in a volatile economic environment, combined with a step up in route to consumer across the region.

Let me share some examples from our markets, and start with Brazil, where we clearly continue to experience a tough economic environment. While there have been encouraging signs, with employment levels improving in the last month, recent Nielsen data still shows a declining scenario for consumer goods across a number of categories.

Given the recessionary environment, we have focused on delivering offerings at different price points across scotch, and this has driven strong performance in primary scotch in particular. Latest readings show that we have just taken the leadership position in primary scotch from our largest competitor in the segment, and this has led to total scotch volume share gain in Brazil of 3.5 percentage points. To put this into context, we have now about doubled the size of Black & White in the market over the past two years, reaching around 600k cases. Overall, I believe we have been managing the business well through the downturn, and continue to aim to emerge stronger.

Moving on to Mexico, but still in primary, you may remember Ivan highlighting Mexico's success on Black & White at the end of F16, when we celebrated rapid growth to about 400k cases. Well, I can tell you that the brand continues to go from strength to strength. A combination of great commercial execution, and the highly effective step we took to remind people of Black & White's heritage as a member of the Buchanan's family, has not only led to continued growth, but also enabled us to sustain a price premium of around 30% above our closest competitor in the segment. We expect the brand to get to nearly 600k cases by the end of this financial year. Another great feature of our success here is that we are not seeing direct cannibalization of other more premium Diageo brands, but instead we are recruiting new consumers and fueling category growth.

Before I move on from primary, I'd also like to highlight early success we are having with the launch of Bell's in Mexico, as our second primary scotch. We launched in October 2016, and it has been the most successful new brand launch in our history in Mexico. We expect the brand to exceed 40k cases by the end of the year.

If we stay in Mexico, but switch gears to our more premium brands, both total Johnnie Walker and Buchanan's delivered double digit growth in the first half. On Buchanan's in particular, our recent relaunch of the brand with superb new packaging, and our increased focus on specific occasions like Father's Day, have truly transformed the brand's performance.

This broad-based, strong performance in Mexico has led us to record market share results in both off and on trade. Our value share of scotch is up about one percentage point and approaching 70%, which further demonstrates our ability to continue to strengthen our position in the category.

Finally, let me touch on Andean, which includes Colombia and Venezuela. I am not going to spend a lot of time on Venezuela, as it is now small for us and not material to the overall performance of the region. However, through our local brands our operations in Venezuela are now self-sustainable, and allow us to be there for when the market recovers.

In Andean it is Colombia where we continue to deliver strong results. In H1, scotch net sales grew 31%, and we saw good performance in our premium brands, Buchanan's, Johnnie Walker, and Old Parr. Our continued work on route to consumer, with the rigorous implementation of our commercial standards, has been key to this growth in F17. We now have great visibility of sell-out and execution data at our distributor's customer level, which allows us to evaluate the most effective places to invest, and where interventions are required.

Looking ahead in Colombia, we expect that the recently implemented tax changes will drive premium brand's price points upwards, and so expect growth here will slow to some extent. On the other hand, we believe it will create significant opportunity for mainstream spirits, including primary scotch, where tax changes should improve affordability in this segment.

Let me now give you an update on our second strategic pillar and on how we are further expanding our participation in the spirits category beyond scotch. Here, I would like to first share how we are doing this in mainstream spirits through innovation under our new Smirnoff X1 platform.

We have already launched Smirnoff X1 in Brazil and Mexico with encouraging initial results, and we have plans to further expand this platform to other markets.

In Brazil, Smirnoff X1 was launched through a local version of ready-to-drink cocktails with bold fruit flavors, and disruptive Tetra Pak packaging, which is revolutionary for the segment. In its first four months on shelf it reached nearly 5% value share of vodka in the modern trade, and sell out is well above target across all channels. The success of this launch was again driven by having clear commercial standards implemented. Weighted distribution reached 68% in the modern trade, which is a great example of our increased implementation speed for innovation.

In Mexico, we have launched Smirnoff X1 Spicy Tamarind at the San Marcos Fair, which is attended by approximately 9 million people over 2 weeks. This is an affordable mid-strength vodka liqueur with a locally-rooted flavor, designed to be consumed in shots, with the intention to recruit from standard and upper mainstream tequila. Early results have exceeded our expectations for the first month.

We have also plans to get cachaça back in growth, by focusing on innovation and by investing behind the more premium variants of Ypioca. We have launched 2 new flavored variants: Ypioca Honey & Lime, and Ypioca Fogo Santo, with good results. However, more importantly, Ypioca Ouro, the aged gold variant of our cachaça, is 18% above last year in volume, reaching 1 million cases. It is driving differentiation from the more popular silver variants, and also helping the brand grow outside of its stronghold home state of Ceará.

In Tequila we continue to drive double digit growth of Don Julio. Diageo is now the second largest tequila player by value in Mexico. Recently we have announced our plans to expand our capacity to support both the growth of the brand in and outside of Mexico, as well as our local bottling agenda for other brands.

Finally, gin is gaining momentum in many of our markets. We are seeing real success in Mexico and Brazil, with Tanqueray in double digit growth, and becoming an engine for a stronger cocktail culture, which leads me on to talk about our third pillar: accelerating growth of total spirits within total beverage alcohol.

Based on our experience of long term trends in other markets, over time we expect to see a shift into International Premium Spirits driven by the combination of their aspirational role and increasing disposable incomes.

A great example of how we are driving this is through our efforts to create a stronger cocktail culture across the region. We are executing this through our Cocktail Week initiative, which is run by the reserve team. Top and premium on-trade accounts are invited to participate and, for one week, cocktails sell for a fixed price across bars. Activations include special cocktail menus, special events, and a focus on a differentiated consumer experience. Cocktail week runs twice a year in Mexico, and not only drives incremental sales but, more importantly, also delivers a trial and brand building opportunity for our portfolio. We have now expanded into other markets in the region.

We are also excited to be hosting the 2017 Diageo Reserve World Class Bartender competition global final in Mexico City later this year. This is great news for Mexico and for LAC, and further supports our cocktail culture initiative.

So, I hope that gives you some color on how we are progressing on the execution of our strategy. Let me now update you on two of our global priorities and key enablers of this progress: our work on route to consumer and productivity.

The most significant changes made to our business in the last couple of years that are driving performance today is how we have strengthened our route to consumer, and the work we have done to implement our commercial standards program. Although we have made a lot of progress here, we continue to work on improving our route to consumer across all of our markets. I mentioned a few example examples in Colombia and Brazil earlier, but let me expand further.

During F17 alone, across LAC, the number of outlets with minimum activation standards has increased from 38% to 53%, and the number of outlets with minimum product assortment standards is up from 24% to 31%. These metrics have been incorporated into our salesforce incentive programs, as well as in most distributor trade terms. Mexico is the first market in Diageo where we can measure the business impact of specific execution standards, which increases the effectiveness of our investments. Also, Brazil is the first market where we are using Digital Image Recognition to objectively measure outlet execution, while reducing the duration of sales visits by approximately 50%. We expect to roll-out to Mexico, Colombia and Argentina in F18.

Finally on route to consumer, you may remember that last year I told you we had just signed a new distribution agreement in Argentina. After just one year, we are seeing improvements in the performance of our brands, and fully embedding our commercial standards of execution from the start. A key highlight for F17 is Smirnoff Vodka, which we expect will reach around 450k cases this year. The brand is now three times bigger than it was before the change in route to consumer. Data shows the brand is recruiting from mainstream spirits as a result of local bottling, increased distribution and stronger communications.

The second global priority that I want to highlight is productivity. At our capital market day, Kathy shared an update on how we are planning to achieve our goal to deliver £500 million of productivity savings over the F17 to F19 period. In LAC, we have detailed plans to contribute to that goal for each work stream. Let me give you some examples of how we are deploying this agenda with pace across the region.

In marketing effectiveness, this year we will deliver over £5m savings in media spend across LAC. This is the result of stronger engagement with our agencies across the region to commit and deliver media price reductions and optimization plans, as well as direct negotiation with important local media networks. Productivity will be enhanced during F18 through further consolidation of our media operations. We are also in the process of embedding Catalyst as a tool to drive more effective choices in our A&P investments. So far, we have started to use Catalyst in some markets to inform investment decisions during the F18 planning cycle.

We continue to review our supply chain to drive more efficiency. As an example in logistics, through the implementation of E-sourcing/E-auction for freight services in Brazil, it was possible to deliver 20% reduction in rates. Through this initiative, Brazil reduced dependency on a single supplier and started developing six new freight supplier relationships that are strong in specific regions. Further network optimization projects were delivered in the Caribbean, Dominican Republic and Peru.

On organizational effectiveness in LAC, over the last few years, we have built an established shared service center in Bogota, which markets are progressively leveraging to standardize and simplify their processes. And finally since last year all markets in the region have been using ZBB planning tools to develop our budgets for indirect costs, with good results. Across LAC, we have reduced our facilities and real estate costs by 7% as a result of office space rationalization and re-negotiations. Legal and staff-related costs are also down by 13% and 11% respectively.

I hope this gives you a good insight into our performance and the actions we are taking to drive sustainable growth.

Looking ahead to the close of F17, I expect LAC performance to continue the momentum we saw in the first half.

We continue to face uncertainty in a number of our markets, as an example I do not expect Brazil to get any better in the short term. However we are building a degree of resilience in our markets, and we are gaining market share across the region. Therefore, I continue to have confidence that we can deliver sustainable mid-single digit growth in the medium term.

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

The opportunity in LAC remains attractive, and our strengthening leadership position in scotch gives us the scale to continue to build out into other categories, recruit new consumers and penetrate new occasions.

We have adjusted our execution to effectively navigate the current environment, and expanded our focus on both the top and bottom ends of the portfolio. We continue to strengthen our Route to Consumer and embed productivity into the business. We now have a stronger business than we have ever had, and we are better able to cope with the inherent volatility in the region.

I continue to be excited about the long term prospects of spirits and of our business in the region, and I am confident that we have strong fundamentals in place to drive sustainable growth.

Now, we have time for questions, operator please go ahead.

Q&A

Olivier Nicolai: Good morning, Alberto. Just three questions from our side. Regarding your guidance of mid-single digits growth in the midterm, could we already see this performance for full year '17? Second question is on Mexico and Colombia. What are the drivers beyond the strong growth in scotch? And just then more specifically about Colombia, there was a bit of an issue in terms of tax structure between scotch and aguardiente. Is there still any tax discrimination between domestic and imported spirits? Thanks a lot.

Alberto Gavazzi: OK. The first question on what's driving the strong growth in scotch is basically two things across, I would say, more markets than just Mexico and Colombia, overall Latin America. The first of what I alluded to is in regards to the primary segment, which we started developing about two years ago. I think I remember telling you that we would be investing further on this segment to unlock growth to recruit consumers into the category.

So the role that primary is playing for us is bringing new consumers in that category. And because we're positioned at a premium price point to competition, we are also using this as of vehicle of a trade up from more lower priced primary brands into our more premium priced offerings to consumers. And now we have achieved leadership in Brazil already, in Mexico, in Colombia and strong growth in Chile and in Peru as well and some of Central American and Caribbean markets. So we're going to continue to push that strongly.

And the second piece is our premium brands, where we have delivered double-digit growth, also, in many of our markets, mainly driven by Buchanan's. Buchanan's is really driving strong growth on the back of the packaging relaunch we did two years ago as well as strong advertising, both focused on general momentum, specifically driven to drive performance during specific occasions where we want to be growing the brand, like Father's Day or Christmas, for instance. So this is what's driving that performance in scotch.

In regards to Colombia, the mainstream agenda is a big opportunity for us. Because of the tax changes system in Colombia, it has opened a new door for us, where we believe we can be more competitive with our Smirnoff and primary offerings. We are at very early days of that journey, so I'll hold on to comment our success or not on that front, and in the next call next year, but I'm very confident that given the success we had in other countries, we will be able to recruit from the local business in Colombia as well as we have been doing in other places.

Olivier Nicolai: Thank you very much.

Fernando Ferreira: Thank you. Alberto, I have three questions as well. First one, when we look at the data, Latin America is one of the only regions where we haven't seen spirits taking share from the beer, right, in the last couple of years. I wanted to get your sense of why do think that is? Is that because local spirits have been losing share? Or it's more of a culture thing around beer? And if you have some thoughts around that.

Second point, when we look at Diageo's strategy, it seems to have adapted in other regions, like Africa and India, for Diageo to have a bigger presence in local and mainstream spirits, right, to recruit new consumers, although your portfolio in LatAm still seems to be very tilted towards the premium and affordable premium brands, right? So I wanted to understand if you see opportunities to have a bigger presence in that category.

And then lastly, if you can discuss and then just briefly share your thoughts on the mezcal category produced in Mexico?

Alberto Gavazzi: Yes. OK. So let's start with spirits versus beer. As I mentioned in my opening, I see this as a big opportunity. Beer has an overwhelmingly strong presence in LAC. It's about 80 percent of the volume sold. Beer is growing indeed above one percentage point over spirits every year for the past seven, eight years, and this is mainly driven by local spirits, so their source of growth is local spirits, as it is our source as well.

If you compare the most premium spirit versus beer, we have been able on a compounded annual growth rate to be growing faster than what beer has posted over the last year. And I strongly believe that this year will continue to be the same case for us. So I think it's a bit our role, as leaders of the premium segments in the region, to continue to be able to drive that performance ahead of beer, but I think it's a big pool as an opportunity to recruit for us going forward.

Mainstream will help on that journey, answering your second question. Primary has been a really big step in that direction, where we have had early success in the period of two years and achieved leadership on that segment, which is substantial in its size within the total scotch business. But we are also deploying Smirnoff X1, as I told you before. We started in Brazil, and we started in Mexico already, but we have plans to roll out the platform across all the region.

So X1 is a more mainstream-oriented proposition for Smirnoff. It is more price – it's lower in price positioning, and it is very tailored to the local taste of the market. So it's something that should be very appealing to local consumers. Every place is going to have its own development for Smirnoff X1.

So in Mexico, and I'm speaking to you from Mexico, we're following up the launch of Smirnoff Spicy Tamarind. The early success is very strong and it appeals to a flavor that is very common to the Mexican palate, and we're counting on that route to help us get into the primary business.

The last question on mezcal. As you know, we are partnering with Unión on mezcal, which is doing very well for us. We are well ahead of our business case in the expansion of the brand in Mexico. So I was just in the off-trade and on-trade yesterday visiting the brand growth, and we reached already the number one position in the off-trade in a very short period of time and number three position in the on-trade as well. So we're very happy with the performance of Unión and our partnership, although the category is still very small relative to other place that we have in the region.

Fernando Ferreira: Great. Thanks a lot. And if you needed more capacity in mezcal, is that an issue or not really, in terms of growth?

Alberto Gavazzi: For the time being, we want to gradually build the brand strongly as opposed to a massive rollout. In all fairness, we could be selling more if we wanted. But the truth is, we want to be building this brand strongly and properly. So for the time being, the capacity we've got is suiting our needs. And in case we will need further, we already have plans on how to achieve that.

Sanjeet Aujla: Hi, Alberto. Thanks for the presentation. Three questions please. Firstly, can you just give us a bit of a flavor on the current pricing environment you're seeing within scotch? And secondly, just on the medium-term target to grow mid-single digit, can you just give us a sense of how that breaks down between volume and price/mix? And thirdly, why isn't your medium-term aspiration higher than mid-single-digit? Prior to the crisis, LatAm was growing double-digit pretty consistently, and (does) targets really in line with the group. So can you give us a sense of why those can't be higher?

Alberto Gavazzi: OK. Thanks for the questions. So the first one on pricing, that was a question some of you posed to me two years ago. In the midst of a strong devaluation that we were experiencing, what would be the future of scotch when we also continue to drive scotch growth with all the price that we needed to do to recover our margins, if you like, and obviously, the inflation in the markets.

So two years later down the road, I am very happy with where we are in the progress on this front. We have been able to position ourselves ahead of inflation on many markets, actually in all markets in Latin America in terms of pricing. And we have had a balanced view on how would we recover from a market-to-market perspective. So let me give you an idea.

On Colombia, we felt there was momentum to go faster on the journey of recovering the devaluation impact. Colombia was one of the markets with biggest devaluation we had. And we've put more than one price increase, smaller price increases throughout the year but more than one, and in Colombia within 18 months after devaluation, we had already covered our margins.

In Brazil, where combined with the devaluation, we had a massive tax increase. We decided to go slower, not to stall the category growth, which was one of our, obviously, bigger concerns. In Brazil, we managed to pass on all the tax impact on to consumers. We're in the process of covering up with the devaluation impact in the market.

So we took it – we played it by year on every market, really making sure that we were aiming at maintaining category momentum, which I'm pleased to say that we have been able, driven by the results you have seen right now as opposed to just recover at once and then eventually lose our capacity to continue to recruit and build the category.

In terms of the guidance, we have, in terms of price, between 2 percent and 4 percent depending on the market, and volume 2 percent to 4 percent as well. So I'd say it's a good balance between volume and pricing. It is something that we have purposely tried to do. It's key to category momentum, while taking price increase. I strongly believe that we – our brands are strong when they're able to do both pricing and volume growth ahead of our competition, and that's where we're positioning ourselves to continue to do on a sustainable basis.

Then in terms of the guidance going forward, there is a lot of uncertainty still in the market. At the end of H1, we posted a good double digit growth. I believe that we will replicate that, as I said, into the second half of the fiscal year. But Brazil remains very uncertain with a very strong political turmoil. If you remember, I am from Brazil, and I am concerned with the situation of my country and the paralysis that could lead into.

And Colombia, for instance, had a tax increase as well, as you are very well aware of, which will have a direct impact on our strong source of growth, which is the deluxe business, the premium business, as well as opening more opportunities for the primary category.

And in Mexico, we saw a blimp as soon as the election in the U.S. happened with all the threat around NAFTA and closing of the border. That blimp has now gone away, but we have learned that Mexico could also be volatile depending on what our upper neighbor decides to do in terms of external affairs, politics. So I would say it's a confident view about our growth in a very volatile environment.

Sanjeet Aujla: Very good, thanks.

Alberto Gavazzi: Sure.

Chris Pitcher: Thank you. Two questions for me you. Alberto, could you give us a bit more detail on the Brazil market? I know you're saying you're not expecting recovery anytime soon because of the uncertainty around politics, et cetera. But you do have an easier comparative in the second half because of the phasing of shipments last year around the excise tax increase. And can you give us a bit more color on the shape of the Brazilian business now between cachaça, primary scotch and your reserve brands, get a feel for where the growth is and where they are. And they might – that was quite a long first question, sorry.

And my second question, I know you say you're not going to talk about Venezuela, but even with 10s and 12 million pounds worth of sales given the sort of price increases that I imagine are having to be put in the country, that's still potentially adding 1 percentage point to group – regional organic revenue growth, unless of course, you can move the hyperinflation accounting and taking it out completely. Could you just confirm that, please?

Alberto Gavazzi: Yes. So let me start with the question on Brazil. Brazil, we're delivering about mid-single-digit growth this year [*Note: When giving this guidance Alberto meant the market PUB, which is made of Paraguay, Uruguay and Brazil rather than only Brazil],* which in the current environment I consider to be a strong performance. We're gaining share in scotch despite our strong position, and we're entering a new segment with primary. We're almost doubling our presence over the last year-and-a-half or so in that segment. So we really had to look for growth in other places so we could drive business performance, if you like.

It has been a tough couple of years in Brazil. If you look at the Nielsen basket of goods, about 80 percent of those basket of goods are still falling versus the previous year. There was an early sign of recovery with unemployment improving, consumer confidence improving. It lasted one month until this political scandal hit the fan again. And now there's a lot of uncertainty in investors and business people are holding their investments in the market. So the future is not very clear, obviously, in terms of what could happen.

As I said, relative to competition, I think we're doing well and I believe we're growing faster than competition. Our cachaça business, we manage to protect our share in Ceara. As you know, we have about 90 percent – 95 percent share in Ceara, so very strong position, and continue to expand the brand strongly outside of the state of Ceara and to the rest of Brazil. We recently decided to focus on the gold version of cachaça to premiumize the category – help us go into the journey of premiumizing that category.

And to my delight, only just after few months of investment on this new strategy, we are seeing results. That segment is growing 18 percent versus last year. We should be reaching 1 million cases of gold cachaça, which would put us as the number one gold cachaça in the market already, Ypióca, and our goal is to drive that more aged segment and premiumize consumer, which I think is what we're really good at and know how to do well, just premiumize consumers into better offerings, and that strategy is doing well for us right now.

So again, for the future, next year, I would see Brazil also maintaining, more or less, the mid-single-digit *[Note: When giving this guidance Alberto meant the market PUB, which is made of Paraguay, Uruguay and Brazil rather than only Brazil],.* And the reserve base that we've got in Brazil is driving double-digit growth for us and helping, obviously, on the performance of the overall brand – of the country.

Venezuela, as I said, is about – it's not material for us, it's about 8 million, and it has no material impact on group or even LAC because of the exchange rates we're practicing right now. So there is no hyperinflation impact, nor in Venezuela or in Argentina, for us because in Argentina, we sell in dollars into our partners in

Argentina. So in our numbers, there's absolutely no impact on hyperinflation or adjustments for that. *[Note for clarity this statement is true at organic operating profit level, an hyperinflation accounting adjustment [if required] is recorded in other finance charges at group level]*

Chris Pitcher: OK. And with the new currency system, have you been able to access dollars better? I know it's only has been a couple of days the auctions have been taking place? But is it still difficult?

Alberto Gavazzi: Yes. What we've been doing in Venezuela, you know we're leaders in rums with Cacique and Pampero, and we continue to sell those brands in the rums categories. The rum category has occupied a little bit of the position that scotch had because of the lack and the scarcity of scotch in the local market. And there's a new law where there's a percentage that we can import from our exports.

We export – we're the biggest exporters of rum from Venezuela, so we can use a percentage of that to – about 80 percent of it to import scotch. So that's what we've been doing, is using the money that we generate from local rums to pay for the local business, who are not sending capital or cash to Venezuela at all from abroad, so that the business is self-sustainable in a way.

So we believe it's a healthy situation for the time being for us, and it would enable us in case the environment changes to rapidly grow in the market because we – with this strategy, we're protecting our route to consumer with our distributor partners in the market, which is clearly our strong gain, as well as protect over 200 people that we have working for us in the market.

Chris Pitcher: Thank you very much, very clear.

Cole Hathorn: Good afternoon. Could you just give a bit of an example on how you think about price laddering in your market? So for example, how primary versus premium is positioned on the price point?

Alberto Gavazzi: Yes. That is actually one of my favorite subjects because I think this is one of the reasons of our growth is really the strength of our portfolio and the ability that we've got to occupy different consumer price points.

So if you would consider Johnnie Walker Red Label, let's say, at 100 points, right, we would have Johnnie Walker Black, so the deluxe category Buchanan's, Old Parr, all sitting around twice as much as that, but within ranges.

So depending on the market, you would have Old Parr below Johnnie Walker Black to protect it against ankle biters, if you like, and you would have Buchanan's above and depending on the market, it would be the other way around. But clearly, the flagship is Johnnie Walker Black, and that's the franchise that we try to push ahead and continue to grow strongly, right, so that's our hero brand, if you like, in the market.

Then above that, you would have the reserve brands, which would go anywhere from double the price of those premium offerings. So it would be up to 400 percent – to 500 percent over Red Label. But in between that, you have Gold Reverse, Black Label and then Johnnie Walker Blue, which would be our [ultra] premium variant.

Then below Johnnie Walker Red Label, you would have primary, Black & White or some of other offerings of primaries, which could be VAT 69, it could be White Horse, depending on the market. Black & White will be the most consistent across Latin America, which would be at about 80 percent of the price point of Red Label. And then the other offerings I mentioned like VAT 69 would grow up to 60 percent of the price of Red Label. So we would be covering a wide range of price positionings, and by serving, reaching an interesting price points to consumers.

The thing that we're doing as well is offering lower sizes of products. So we're starting to develop formats in the region and offering, for instance, 200 mL as opposed to the 750 mL or a liter bottle that we normally offer, and that reduces dramatically the out of pocket for consumers and they're able to enjoy their preferred brand, even if they have a lower disposable income.

So we're in the starting process of that journey. Early signs are very encouraging. We have some of the markets in Latin America like Guatemala, for instance, where 40 percent of the rum category at mainstream level is consumed in format sizes, small sizes. So that could be a significant opportunity to increase our expansion even further into middle class with these offerings on smaller formats. So I'm excited about to see how that's going to come about as well.

Cole Hathorn: And then just finally, do you have any numbers you can give us on what your market share is in the primary segment, particularly in scotch in Latin America?

Alberto Gavazzi: Yes. So we're market leaders now in Brazil, in Colombia and Mexico and Chile. Let me just get you the market share. So in Mexico, we're around 40 percent market share. In Brazil, more or less the same. And in Colombia, we have more market share because we're the only players right now in that segment. So we're just getting started. The category is still small, but we're getting started. So in Colombia, we basically have the whole category to ourselves.

So I would say it's around 40 percent market share, which positions us clearly as the leader, and we're the fastest-growing brands in this segment as well. So this year is the year that we achieved leadership and the brands continue to be driving the strong performance as we're finishing the fiscal and going to the next fiscal year.

(Cole Hawthorne): Thanks very much.

Alberto Gavazzi: Sure.

Andrea Pistacchi: Hi, Alberto. Thank you. I have three questions please. The first one, maybe following up on your market share questions on primary scotch. How large is the primary segment in value terms within your scotch business in LatAm today?

And then the second question is on margins. FX devaluation was something that occurred in LatAm mainly and significantly in your FY '16. Now this year, fiscal '17 and next year, with less FX pressures and you putting through price increases at or above inflation now as you're saying, should this translate into good margin expansion?

And my third question is on the overlap or competition with premium beer because ABI and Heineken in Brazil, for instance, have been very focused on building the premium segment. ABI presumably intends to do similar in Colombia, Peru, the new SAB markets. To what extent do you see this competing with your business?

Alberto Gavazzi: OK. Andrea, let me start with the margin expansion one. So on margin expansion, we deliver about 60 basis points in the first half, as you know, and I expect to continue that journey throughout the second half of the fiscal. And going forward, we – driven by productivity and everything else that we're doing on that agenda, I believe that we can continue to see margin expansion in our region. So I'm confident that we can continue to pursue that.

In terms of the premium beer, we haven't seen any impact in our business. Premium beer is a small – a relatively small size of the total beer operation. And it is actually premiumizing from their own business. It's not taking away from spirits, at least not in the premium on-trade outlets and off-trade that we are present. We have not experienced – that is something that I personally also have been following through very closely because it could happen, but it seems that the occasion that it's hitting is complementary to ours, and is just growing as a result of a tradeoff from their lower marks.

In terms of the primary scotch, on how large it is, it is a significant piece of our business and is driving a significant growth. Let me just check – why don't I forward you the number on the size of the category on the major markets and as well how much it is for each one of the – on a percentage basis, how much it represents for the scotch business. But what I can advance, it is substantial already.

Andrea Pistacchi: OK. Yes, that will be great.

Alberto Gavazzi: Yes, OK.

Andrea Pistacchi: Thank you.

Alberto Gavazzi: You're welcome, Andrea. (Sophie), any further questions?

Mitchell Collett: Can I just ask about profitability, which in the past has been somewhat volatile? I think it was up 300 basis points in the first half against the relatively easy comparator. And I think some of the comments you made about growing affordability and not taking full pricing for input costs – sorry not input costs, FX moves might suggest that margin progress from here might be muted. Could you perhaps gives us some context from what you expect for margins for the full year this year and then beyond?

Alberto Gavazzi: Yes. We had 60 basis points in the first half in terms of our margin expansion. That said, I expect this to continue during the second half, so around thereabouts in terms of the closure for the fiscal year. Going forward, I believe in our ability to continue to expand our margin on a similar basis. *[Note: please refer for clarity to the answer given in a previous question where Alberto said "going forward I believe that we can continue to see margin expansion in our region" as the comment "similar basis" could be misleading].* We will continue to be putting pricing. We believe, or I personally, believe on the delivery of growth by a combination of volume and pricing. And we have to be very careful not to stall the category as we're putting pricing.

In a number of our markets, we have recovered margins in pounds. And in other markets, we're close to do so. So during the next fiscal year, we would see most of our markets, if not all of our markets, having recovered fully our margin in pounds and having been able to sustain a category growth over the period of the crisis.

Just to give an example, years ago, when we had another big crisis in Brazil, for instance, about 10 years ago, we decided to go up once for the price increase. It took us eight years to recover the growth of the category after that one price increase that we have put into because we have really scared consumers away. And now we have earned our pricing, if you like, as we went through. And in the prices that we put through, we had to recover devaluations of 60 percent. So we're talking about substantial price increases, even in markets that we haven't recovered. We're talking about 20 percent price increase in any given market. So we have been putting a lot of pricing too in the system as well.

Mitchell Collett: Is it possible to get a bit more color on what's driving margins up? I know in the release, you talked about low marketing spend, but are there other factors that are offsetting the adverse mix dynamics and transactional FX headwinds you face?

Alberto Gavazzi: None of the transactional FX. It is mostly driven by the OE agenda that we have delivered. We have delivered some substantial savings on OE. Our A&P efficiencies have contributed to that as well. As I alluded, we have over $5 million efficiencies on A&P as well. Our productivity agenda is helping us fuel some of that. And obviously, our pricing and volume and our expansion as well.

So there isn't one particular thing that is driving it. It's a combination of our initiatives and agendas that are driving that expansion on margins. And as I said, I continue to see opportunity for that to continue to happen in the future.

Mitchell Collett: OK, thanks.

Alberto Gavazzi: Thank you. Great. So with that, I'm going to close the session. I thank you all for the question and your time. As I mentioned, this is a region with an attractive growth opportunity. We have the scale and clear strategy, and we're executing to capture these opportunities. I hope some of the examples that I've shared today with you give you some insights and credibility into that as well. And for this year, as I said, I expect LAC performance to continue the momentum we saw in the first half. In the medium term, I have confidence that we can deliver consistent mid-single-digit growth.

If you do have any further questions, please don't hesitate to contact Investor Relations team. I'm sure they will be happy in answering all of your questions. And I look forward to speaking to you all in the next conference call, if we don't see each other before. So thank you all very much.

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