Brunch time Call with the Presidents – LAC – 16 May 2018

Alberto Gavazzi

Good morning and afternoon everyone and welcome to this year's Latin America and Caribbean call. Let me start the call by saying that it will follow the format you are now familiar with. You will have received a few slides earlier today which I will refer to during the call.

I will briefly remind you about the opportunity we have in the region and the strategy we have in place to deliver the opportunity. I will then talk about how we are executing our strategy using specific examples from our markets.

I will also touch on two global priorities that are key enablers to deliver our strategy: route to consumer and productivity. At the end of the call I will leave plenty of time for questions.

This continues to be a region with attractive opportunities, as you can see on slides 2 and 3, and the strong fundamentals that underpin them have not changed since the last time I spoke to you:

- TBA volume in the region excluding Venezuela is expected to grow around 2% CAGR over the period 2017 to 2021, with scotch, the largest spirits category, expected to grow nearly twice as fast
- Legal purchasing age population continues to grow faster than total population and we expect that about 7 million new legal purchasing age consumers will come to the market each year in the medium term
- Continued expansion of the middle class and rising income will continue to support premiumisation trends
- And finally spirits penetration is low compared to other parts of the world which creates opportunity for growth

Within this context Diageo is well positioned to capture this growth. Within international spirits scotch is the largest category by value in the region and, as you can see on slide 4, Diageo has a leadership position in all key markets. This gives us scale and the opportunity not only to continue to drive scotch category growth but also to expand into other categories.

Our strategy is consistent and has not changed as it focuses on three pillars:

- Continue to strengthen our leading position in scotch and drive category growth
- Accelerate our diversification into other spirits categories
- And create more opportunity for consumers to choose spirits over beer and wine

While this region has an attractive opportunity, it does come with volatility. However the changes we have made over the last few years have significantly improved our ability to deal with this volatility:

1) We have strengthened our route to consumer in key markets and embedded a focus on sell-out.
2) We have delayered the organization and embedded a culture of performance accountability across all our markets.
3) We can now access better quality data from multiple sources that we use to gather insights to drive performance.
4) We continued to strengthen our portfolio. We expanded our participation in primary scotch and we acquired Don Julio which allowed us to enter the attractive tequila category in Mexico,

we also disposed of non-core businesses such as our beer operations in Jamaica and our wine business in Argentina.

We are now a more consumer centric, agile and performance focused organization that is better positioned to navigate through the volatility across the region and this has resulted in improved consistent performance over the last 18 months, with net sales up 9% in F17 and 7% in the first half of this fiscal year.

In the first half, the performance we delivered was solid, despite volatility in specific markets. PUB, Mexico and PEBAC delivered a strong performance. However the tax changes in Colombia, which, while good for our business in the medium to long term, did have an impact in H1. We also saw the negative effect of the hurricanes in some of our markets in the Caribbean and demand in the export channels continued to be weak. In the second half I expect these trends to broadly continue.

As I look at the macroeconomic environment for the region I am cautiously optimistic about the recovery I see. According to Euromonitor, GDP growth is expected to accelerate to 2.4% in 2018, nearly 1 percentage point faster than in 2017, with Brazil expected to be the key driver of this acceleration. In Mexico, consumer confidence seems fragile post the earthquake, with some uncertainty coming from the outcome of the presidential elections as well as the NAFTA negotiations. The next 12 months will also bring general elections in Brazil and Colombia and we will have to keep a close eye on how they could impact consumer confidence.

Let me now give you now some examples on how we are executing our strategy to continue to deliver consistent performance. Starting with scotch.

Scotch is our largest category accounting for 2/3 of our business and nearly a quarter of the scotch net sales in Diageo. At nearly 70% value share across the region we have scale in all key markets, largely driven by our premium and above brands: Johnnie Walker, Old Parr and Buchanan's. In fact 8 out of 10 bottles of premium plus whiskey sold in LAC are Diageo's. Over the last few years we have consistently driven category growth. According to IWSR and as highlighted on slide 5, in the last 10 years Diageo's absolute growth in retail value in scotch was more than three times that of our closest competitor. These are impressive numbers but I am not complacent, and our strategy to continue to drive category growth is consistent with the one you have heard from John Kennedy at our last capital market day:

- Continue to recruit and re-recruit consumers with scale brands.
- Use primary scotch to both recruit new consumers in the category and retain those that might be forced to trade down
- Drive vibrancy in the category through innovation
- And finally we have an untapped opportunity to introduce our single malts in the region.

Starting with our scale brands I would like to focus on Johnnie Walker today, our biggest brand, accounting for half of our scotch business. As you can see on slide 6, our strategy for Johnnie Walker is again consistent with what you have seen in our global communications: telling inspiring stories of personal progress, scaling liquid on lips, winning in the gifting occasion and activating against Blue Label. The strategy is working and after 2 years of net sales decline, Johnnie Walker was back in growth last year and delivered another solid performance in H1 this year with net sales up 4%.

Let me give you some examples on how we are activating against these pillars.

This is a very diverse region, made of markets at different stages of social and economic development. We use the “Keep Walking” campaigns to tell inspiring stories of personal achievement to connect Johnnie Walker with local consumers, and we do that by using local consumer insights. We have done this in many markets including Mexico, Colombia and Brazil. In the past we spoke about some of these successful campaigns so let me give you an example of what we did in a smaller market where Johnnie Walker was underperforming.

The Dominican Republic is one of the largest islands in the Caribbean. In the last couple of years Johnnie Walker was suffering from negative depletions and lower penetration, but most concerning was the fact the brand moved from the number 1 spirit in the country to number 3 in terms of brand awareness. Consumers wanted brands that connect with the local culture, while Johnnie Walker was seen as part of a somehow distant international elite. That’s when the team started to work on the “Keep Walking Dominicana” campaign. The local consumer insight was that living in a small island and always looking up to the United States, Dominicans felt that they had limited options for their future and few chances of achieving their ambitions. So we partnered with David Ortiz, a former baseball player, ten time All-Star and three times World Series champion with the Boston Red Sox, to tell his story to inspire personal progress in Dominicans by demonstrating that they can always achieve their dreams if they trust themselves. I encourage you to have a look at the video by clicking the link on slide 7. The campaign was launched in June and had an enormous success. Not only was Johnnie Walker back in growth but its brand equity scores strengthened and it moved back to the country’s number 1 spirit brand in terms of awareness in the country.

Putting liquid on lips is our second pillar. The insight is that consumers who try the serve are more likely to purchase it in the future. We do this by creating experiences that drive trial at specific events and occasions, and by focusing on the on trade. In Colombia we used a Johnnie Walker truck to visit the most popular nightlife areas in key cities inviting consumers to participate in an interactive game with the possibility to win a Johnnie & Ginger voucher to be redeemed in surrounding on trade venues. Formula 1 events are also an opportunity for us to activate at scale. During the race in Mexico this year over 200k people were sampled through 4 Johnnie Walker rooms, 22 Johnnie Walker bars and other bespoke events. We also reinforced Johnnie Walker Black execution through the “striding man” presence which resulted in being the highest trending hashtag on Twitter over the F1 week end.

Gifting is also a clear area of focus in the region and we are increasing our investment around the biggest festivities, such as Father’s day and Christmas. Johnnie Walker Blue Label is also a key beneficiary of our gifting activations. This year we have increased our activations using pop up stores in the most exclusive malls in Brazil, Chile and Mexico giving consumers the option to personalize their Blue Label bottle with an engraved or calligraphic message.

Overall net sales of Johnnie Walker Blue Label were up double digit across our markets in the first half.

Old Parr and Buchanan’s are the other two scale brands. In the first half Old Parr net sales declined primarily due to tax increases in Colombia, which drove up prices, and performance of Buchanan’s slowed down with net sales flat, largely due to price increases we took in Mexico and weak demand in the export channels. On both brands we will be launching new campaigns and activation plans in their biggest markets: Mexico for Buchanan’s and Old Parr in Colombia with the aim of strengthening brand equity and reinforcing the quality cues of both brands.

Moving on to primary scotch, I am extremely proud of what we achieved in this space. Two years ago I told you about our decision to accelerate the investment behind primary scotch with the ambition of becoming the number one: as you can see on slide 8 we did it. This move gives us the ability to effectively use our portfolio across all price points, better positioning us to meet consumers' needs as they respond to changes in the external environment.

Black & White is the brand that we have activated consistently across our key markets, with outstanding results as we leveraged its association with the House of Buchanan's. Over the last 3 years it has brought over a million cases of scotch into the market and it is now the number 1 brand in this segment in Mexico, Brazil and Colombia.

In Colombia the new tax regime created an opportunity to expand the penetration of standard and primary scotch as it levelled the playing field with local spirits. Once the news of the tax changes emerged, the team immediately put a plan together to get all the necessary legal and commercial plans in place to be able to activate Black & White at scale. In F17 the brand more than doubled in value from a low base and in the first half it grew 5 times. A great example of our agility to quickly respond to changes in the external environment

Innovation in scotch in the last two years in LAC was focused largely on the primary segment. We now have an exciting pipeline of new projects in the deluxe and super deluxe segments. In Mexico for example we have recently launched Buchanan's Select, a 15 years old limited edition blend of single malts that has had extremely positive feedback from our customers. And there is more to come, so watch this space. Finally single malts represents an untapped opportunity in the region. We see increased interest in this category from millennials in markets like Brazil and Mexico, and we will do more to introduce our world class portfolio to these consumers.

In summary our scotch business across LAC continues to strengthen. Underlying performance remains strong across the region and we are gaining share in all of our key markets.

Now I'd like to move on to the second pillar of our strategy: diversification outside of scotch

Over the last few years we have expanded our spirits portfolio beyond scotch and, as you can see on slide 9, net sales from these categories were up 25% in H1 in our markets, with all categories in growth. Tequila was the biggest contributor with Don Julio in Mexico growing three times faster than the category. Since the acquisition, we took it from the number 3 tequila brand by value in Mexico to number 1. We are now using innovation to further premiumize consumers into the Don Julio trademark. This year we launched Don Julio Dos Barricas. The concept of this limited time offer is to create a link between the two most loved spirits brands in Mexico: Don Julio and Buchanan's, by ageing Don Julio reposado in Buchanan's barrels. Results have been very encouraging with the innovation being 90% sold out within 4 months of the launch.

Vodka is our second largest category and for many consumers in the region it still represents the most affordable way to trade up into international spirits. In the first half net sales were up 16% with all our brands in growth. Smirnoff, our largest vodka brand, grew net sales double digit, largely driven by Smirnoff Red. We used growth drivers that adapt to the local consumer environment in different markets. In Brazil we used new formats to increase accessibility in a time where consumer disposable income is under pressure. In Mexico we used innovation to bring new vibrancy to the category: the launch of Smirnoff X1 spicy tamarind was aimed at recruiting new consumers from the upper mainstream category by providing an authentic Mexican spicy flavour. Early results have again been encouraging with 74% of consumers that purchased it saying they would buy it again. In Argentina Smirnoff is leading and developing the vodka category by recruiting consumers from local spirits as the brand benefitted from a scale communication platform, innovation and leveraging the change in the route to consumer following the disposal of our wine business.

In other categories, Ypióca, our cachaça brand, continued to deliver a good performance in Brazil with net sales up 6% in H1 driven by new packaging and a new communication platform that reinforced its brand credentials.

Rum net sales grew strong double digit driven by Cacique in Venezuela and double digit growth of Captain Morgan and Zacapa in Mexico where we gained share in the category.

Finally let me say a few words on gin, a category that is gaining traction in many markets, although from a very small base, and that is quite popular with millennials. Here we are leading the category growth with Tanqueray a brand that in the last half trebled in size in Brazil and doubled in size in Mexico. The growth of gin in these key markets is an example of how consumer interest in cocktails and new categories is growing, a trend we are actively investing behind and that forms the third pillar of our strategy.

This year we continued to invest behind our Cocktail Week platform in multiple markets. In a nutshell, Cocktail Week strengthens our partnership with the on-trade, improving on-trade distribution and assortment of our Reserve Brands, and allows consumers to experiment with cocktails across multiple spirits categories that may not be in their traditional repertoires. This year Cocktail Week has expanded to markets like Peru, the Dominican Republic, and Costa Rica. And in markets where it was already launched, we have done it at scale. As an example this year in Mexico we recruited more high end bars into the platform, and had over 300 bartenders and 15,000 consumers highly engaged with our Reserve Brands. We are clear that developing a stronger cocktail culture will be a key growth driver in the midterm and will continue to invest behind this trend.

Let me now touch on two enablers of our strategy: route to consumer and productivity

Strengthening and optimizing our Route to Consumer has been a clear priority in LAC as we improved our reach and sales execution. In the first half of F18 we have continued to make good progress: our average call-on universe for H1 F18 has increased by 25% vs the same period in F17. Similarly, the number of outlets where we reach minimum assortment and activation standards, have increased by 42% and 69% respectively. This is the result of ruthless focus on capabilities, technology and more robust partnerships. Across the region we have also fully rolled-out our refreshed global set of commercial scorecards. This is driving better visibility of the most critical KPIs.

We continue to expand our focus and use of technology and data analytics, and in key markets have been able to deploy tools for collection and analysis of sell-out and activation data. Last year, I also mentioned that we were launching Digital Image Recognition technology in Brazil to facilitate data capture at the point of sale and optimize sales call duration. As a result we can now audit performance in 15k outlets, up from 4k last year, and our on trade team has doubled their call universe with the same number of sales people. We continue to explore further opportunities as we expand our portfolio offerings and focus on increasing penetration of spirits and our brands.

Productivity is the other topic I wanted to touch on. Delivering efficiencies across the business to reinvest in growth is an important enabler of our strategy. Last year organic operating margin was up 111bps and in the half margin expanded another 97bps. We are expanding margin while continuing to invest behind our brands, in fact marketing spend grew ahead of net sales in the first half. Let me update you on the progress we are making on just some of the work streams, starting with NRM.

Like everywhere else in Diageo we are building our muscle in this area. This year we put a greater focus on formats and trade spend optimization. Smaller whisky formats were launched in Brazil last year, and this year they were complemented by larger formats in Smirnoff and Johnnie Walker Red Label with the aim to provide a specific accessibility solution for cash and carry and hypermarkets. New smaller formats in scotch were also launched in Mexico, Colombia and CCA. We are also conducting a deep review of our trade spend across our key markets. For example in Brazil, we have analysed the profitability of 12k combinations of product/customer and have started to identify value accretive ways to improve mix. Similar work is ongoing across all the other markets.

We continue to drive efficiencies in our marketing spend as our procurement programme continues to deliver savings in our input costs. In fact in the first half we delivered over £3million of procurement efficiencies. The Catalyst system has now been broadly deployed across LAC giving us the ability to use econometric modelling tools to help our marketing teams to channel investment in activities that deliver the best returns. While we are still in learning mode we have started to see the benefits. In Mexico for example, our advertising spend on Johnnie Walker was rebalanced between TV and Out of home channels throughout the year but specifically around Christmas. This drove a 25% increase in spend effectiveness.

On indirect costs, the continued deployment of ZBB tools and technology are delivering efficiencies. For example we are leveraging web-based conferencing technologies to reduce the need for travel, and I expect it to deliver almost £1m of savings this year. Our organization design also keeps evolving following our journey towards a flatter and more efficient structure. In the last year we have removed one layer across the region and nearly doubled our average span of controls. All in all, our total overheads costs were down 3% in the half.

Productivity is now engrained in the fabric of the organization and part of how we do business.

Before opening to questions let me summarize.

1) This is a region that continues to have attractive opportunities which Diageo is well positioned to capture
2) We have a clear strategy that is working, and we are gaining share in all of our key markets
3) The changes we have made to the organization means that our business is more agile and better positioned to deal with changes in the external environment.
4) Our work on productivity enables us to drive out cost to reinvest in growth and expand our organic operating margins.

A lot has been done, but there is more we can do. This makes me confident that over the medium term we can deliver organic net sales growth of between mid-single digit and high single digit and at the same time continue to expand our organic operating margins.

Operator you can now open the line for questions

Operator: Thank you. If you would like to ask a question, you may signal by pressing star one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, star one to signal for a question.

We'll take our first question from Edward Mundy with Jefferies.

Edward Mundy: Hi Alberto, hi everyone. Three questions, please. The first is your primary Scotch business as reported of the overall Scotch portfolio, how big is it? The second one is I think you mentioned that in the second half you expect the trends from the first half to broadly continue. Is that both at revenue and EBIT? And the third question is on tequila. You mentioned some very good growth for Don Julio and your tequila portfolio. I was wondering whether you could comment on the supply chain and levels of inventory and possibly input cost volatility for your tequila portfolio, both in reference to Don Julio and Casamigos.

Alberto Gavazzi: Great. Thank you, Edward. I will start with trend. So yes, as I said in my opening remarks, we expect the trends to continue in H2 in the same format as we have in H1, both on net sales and on margins as well.

Tequila Don Julio is performing very well for us, as I stated, and our supply capacity is enough to continue us to enable to grow. We are aware of what's happening in the market but there's nothing at this stage that would impact our capacity to continue to grow. And primary scotch, we're looking at the percentage here. It's about – Black & White is about 8%, so let's say primary scotch would be about 10% to 12% of our total scotch business.

Edward Mundy: Very good. Thank you. But if I could possibly just come back – and I appreciate you didn't sell, you know, any Casamigos in Mexico, but were you able to comment at all on supply chain for that given that, you know, it does come from one of your regions?

Alberto Gavazzi: So, sorry, supply chain for…

Edward Mundy: Casamigos – well, tequila and Casamigos, on – given what we're hearing in the industry.

Alberto Gavazzi: Yes, like, Casamigos is not sold in Mexico and, as I said, we have sufficient capacity to fuel our ambition for growth in our portfolio.

Edward Mundy: Very good. Thank you.

Operator: We'll take our next question from Fernando Ferreira, Bank of America.

Fernando Ferreira: Hi. Thanks for the question. I have two questions, Alberto. First one, when we think about the long term potential in the region, given your high market shares, I'm sure you're more worried about growing the pie instead of gaining further share, right? So, can you please talk about the penetration of international spirits relative to the locals spirits, right, like the Cachaça and aguardiente, and what's the potential that you see there? And then second question, can you comment and elaborate a little bit more on how do you see the recovery path in Brazil? I mean, would you say that the worst is behind and any signs of real consumer recovery? Thank you.

Alberto Gavazzi: Okay, Fernando I can tell, with your similar accent to mine, that you're from Brazil, so I'll start with that question. To me, I'm cautiously optimistic about Brazil. We see that business is detaching somehow from what's happening in the political system, and our operation is doing well. We are back and gaining share. We're back in growing our flagship brands. And we continue to see this trend progress into the near future. So, as I said, I'm confident we can continue to expand our penetration in the market and grow our business down there. In terms of the growth of international spirits, we're about 3% to 4% of total TBA.

So, we're a very small fraction of the opportunity in Latin America and we have huge room to improve. Our goal is to improve, not only against local spirits, which clearly is an opportunity, but also against beer. And, hence, the third pillar of the strategy that talks about creating a cocktail culture which we know, from more mature markets that – like the US, drives consumer preference versus other alcoholic beverage categories. So, we have been investing, especially behind the reserve brands, in growing that proposition and clearly, enabling consumers to experiment with way more than what they would use, just a few years ago, which was just only scotch whisky, rum, tequila, Cachaça, depending on the market that you were in. Now, they're able to experiment with bourbon. They're able to experiment with gins and with much broader propositions and cocktails than we ever had before. And we feel that that is driving our growth and enabling us to grow, albeit, at a small pace, still, versus the other categories. So, there is plenty of opportunity, as I said, to continue to expand on that front and that's our goal.

Operator: We'll take our next question from Laurence Whyatt with Societe Generale.

Laurence Whyatt: Hi. Thanks very much for the question. First one is on your pricing. We understand there's been quite a lot of volatility in currencies in Latin American leading to inflation in a number of regions. Are there any countries in which you're not being able to take price in order to cover inflation? And, secondly, following on from Ed's question about tequila, I realize that you don't sell any Casamigos in Mexico at the moment. Would there be an opportunity to sell that sort of brand in Mexico, and especially given line extension with Mezcal? And then also, your recently acquired a Mezcal brand, is there any opportunity for that brand in Mexico? Thank you.

Alberto Gavazzi: Okay, so the first is price inflation. We are very ambitious in terms of our pricing agenda and we try to take price at least to cover deflation in every market. What might change is the speed in which we do that. So, sometimes we have to cope, even with devaluation, which is much bigger than inflation, depending on the market. So, what we do, is we look at our portfolio, we see which brands of a given market are able to take price increase right away and which part of the portfolio is not. And then we phase that out into more an extended period of time. But our plan is always to catch up with inflation and devaluation. At this stage, if you look back over the years, where we had a lot of volatility, there wouldn't be any market in specific where we haven't been able to match inflation. So, we're happy how our pricing agenda has progressed in this front. Oh, and Casamigos, which is your second question, we have no plans for Casamigos at this stage in Mexico. We haven't been asked to look at, as you know, and we have announced we're concentrated in the US at this stage. So, there is no thoughts about expansion. And, you know, once we reach that stage, we'll see what the opportunities could be in Mexico. And we're very excited about Pierde Almas, it is the leading super premium brand in Mexico. It's positioned in a different price point and more premium than Union which would work with us well. So, we're satisfied that this is a portfolio that can start putting Diageo footprint into, although a very small base compared to tequila and other categories that we're in today.

Laurence Whyatt: Excellent. Thank you very much.

Operator: As a reminder, Star 1 if you would like to ask a question. And we'll go next to Robert Ottenstein with Evercore.

Robert Ottenstein: Great. Thank you very much. I was wondering if you could touch on two areas. One, vodka and Smirnoff, what do you see the opportunity there? How big can that get? What's your strategy? And then second question, if you could touch on, you know, the ready to drink category. You know, you guys have some great products with, you know, the Smirnoff, Spike's sparkling seltzer in the US. Wondering if that's a product that you may be able to take to Latin America at some point.

Alberto Gavazzi: Okay, so thanks for the questions. On Smirnoff, we're very excited with the performance of the brand. In fact, I'm talking to you from Mexico where we're doing a market visit and, in this market itself, we have taken Smirnoff back from Cuervo alongside Don Julio, the Don Julio purchase – pardon me. And we're very happy with the performance of Smirnoff. We recently launched an innovation named X1 which is positioned at the same price point as Smirnoff 21 in the market and is flavored out of a local flavor, spicy tamarind. And innovation is going extremely well and, as I said, about 76% of consumers who bought the brand say they would buy it again. So, innovation is one of the ways we're growing Smirnoff in the market. The second one would be format, and we're expanding – we had Smirnoff only in one format before, either it was 750 or one liter, depending on the market you are in. Now, we expanded Smirnoff to different formats.

For instance, in Brazil, we introduced 600 ML which has been one of the driving growth drivers for us in the market as it positions Smirnoff at a more competitive price versus local, cheap vodka. So, you're still able to buy yourself a nice bottle of Smirnoff with the out-of-pocket of a cheaper vodka. And for us, in terms of NRM, it's a positive change from a consumer mix, from a brand mix. So, format is a second way in which we're growing the brand. And the third one would be by investing behind the mother brand itself, Smirnoff 21, which has been growing in all the markets I've been talking about, and especially in Argentina where we changed our route to consumer.

And with our new partner, have been able to develop Smirnoff to recruit from the local spirits market by producing it locally and positioning it at a price point where it is competitive in the local market and, therefore, is gaining a lot of market share in that environment. So, there are many different ways in which we're investing behind Smirnoff. It is an important platform for us as we diversify from scotch. It's the first step up from consumers from local spirits into international spirits. It's well-positioned in terms of price for us to be able to do that. So, it is an attractive proposition for us in the region. In terms of RTD, I would say we selectively play in the market where we see opportunities. So, I'll give an example. In Costa Rica, it would be one – a core element of the Smirnoff platform where we have about 2% market share of the beer market.. Other markets, we have more of an opportunistic participation just to complement the Smirnoff portfolio and aiming to enable consumers to choose Smirnoff on different occasions than they would be able to if Smirnoff was non-existent.

It's not a core platform for growth for us for the time being. It's more a complement and what we want to do is really focus on the growth of 21.

Robert Ottenstein: Great. And, you know, I don't know, five years out, ten years out, where do you see vodka as a percentage of your total portfolio?

Alberto Gavazzi: That's the million dollar question. So, vodka is very dependent on a few markets. You know, as international as it might be, it is niche in many markets, including Mexico. So, you would have a large vodka category in Brazil, relatively in Argentina, a little bit in Costa Rica and not much more beyond that. So, what we're trying to do is really establish the category in many places that we go to. And our job, at this stage, is to expand the category and grow the category together with the other international players, as well. So, we hope other people will also invest behind the brand. So, today, I'd say it's about 14% of our business. We expect it to be way more significant into the future. But I don't have a precise target.

Robert Ottenstein: And do you need to have the cocktail culture to get it much larger?

Alberto Gavazzi: Not necessarily. The strategy for Smirnoff has been also to use a cocktail culture. But we also use local drinks and habits to expand it. For instance, Smirnoff in Brazil has grown on the back of caipirinha. So, we pack it with a so-called caipiroska. And we sell that brand in that way. In Mexico, it's the Paloma. And we invest behind Mexico Paloma which is the local drink with tequila, so all consumers have to do is substitute tequila for vodka. So, we try to make it easy for consumers to replace their usual spirit with Smirnoff when they choose, so, it doesn't need to be a very elaborate cocktail culture in order for Smirnoff to succeed.

Operator: We'll take our next question from Chris Pitcher with Redburn.

Chris Pitcher: Good afternoon. Thank you. A couple of questions, please. Firstly on your sort of route to market across the region, could you talk a little bit more how your domestic business has continued to take share and how important what you call free trade or border zone and free trade is? You're now really sort of dependent on in-market companies rather than sort of pan regional wholesalers and what that means for sell-in versus sell-out visibility. And then secondly, on Ypioca in Brazil, can you give us an update for how big that is as a part of the Brazilian business?

And in the first half, that would look to be a price readjustment or, you know, some quite significant price mix negative, what the pricing environments and mix outlook for Ypioca is from here. Thanks.

Alberto Gavazzi: Sorry, Chris, just to clarify the second question – what specifically in Brazil would you like me to elaborate? Is it pricing only?

Chris Pitcher: Firstly, how big is Ypioca? In the first half you had quite big negative price mix on the brand, and whether you've still got the same sort of premium aspirations for Ypioca or whether it's, you know, you price adjust it down to increase penetration or that sort of thing.

Alberto Gavazzi: Okay. Okay, so thanks for the questions. RTM is a critical growth driver for us in the region. If I have to choose the one thing that we are really confident that we have transformed and will continue to transform going forward, that would be it. And that is enabling us to execute much better at the point of purchase, both in the on-trade and in the off-trade. And as a result, as you said, we're increasing share and building some distance between our competitors, some distance because of our capacity to execute. So, just to give you a few examples – portfolio assortment, we never measured that before. And we're measuring that very diligently now. So, which brands are we carrying, along with the brands that sell themselves more easily, like, Smirnoff and Johnnie Walker? You know, is the salesforce really activating all the brands all the time consistently? And that is especially important for our reserves business because we have a number of different propositions that are incredibly profitable, and if not distributed, they don't have a chance to grow into the future. So, a portfolio assortment is a tool for today and is a very strong tool for us for building something for tomorrow. Distribution is another one where we are expanding distribution into more customers year after year. But more importantly, within these customers, we're choosing a set of customers where we want to activate on and that's where we see the biggest difference and impact, when we're able to execute our brands in the points of purchase. So, whether we operate directly or we operate through partners, we are operating through partners that have that ability of activity our brands at a point of purchase. We operate in an impulse category. We can never forget that, right? So, 50% of the decision-making is made at the point of purchase. And if we're able to look up well and show up nicely at the point of purchase and link with the message that we're giving consumers, the chances that we're going to get a bottle off the shelf is much greater. And that's our belief and that's what we've been pushing forward to get. And that culminates with a lot of analysis on data analytics which we're now able to do and before we were not, that tells us exactly what and when our brands are using the best results ahead of season, in which types of customers. Through data collection and digital image recognition, we're able to identify when competitors are acting on a specific store and then react to that specific store in the supermarket chain without having to react to the whole chain as we had before. So, we can be far more surgical and precise into any response we want to – and agile – into any response we want to give onto competitors. So, (Chris), there's a lot to be done on this front still, right. We have a lot of opportunities here and by no means, we're all done. But I'm very pleased with how we have transformed – is the word I would use – the way we go to market versus a few years ago.

In Brazil, Ypioca, as I said, I'm satisfied with the growth of Ypioca – about 6%. Ypioca is a core brand in Brazil for us, as you know. It's an acquisition we made a few years ago and we want to see that brand expanding, and growing its presence and distribution, which we have been doing successfully, and not driven by price. But we also want to premiumize the category. And one of the things that we have been doing is invest behind Ypioca Gold, right? We have Ypioca White and Ypioca Gold in a number of different propositions. Ypioca Gold has been the area where we have been trying to differentiate ourselves from the rest of the market by saying it's the best cachaca in the market. We were the number five gold Cachaça in the market. And we're now number one as a result of that effort. And we have a double digit growth on gold ahead of the white, so we're premiumizing our offerings in Ypioca in a way. So, our goal is to continue to do that and to continue to expand the brand in the market while we continue to premiumize the brand in Brazil as well.

Chris Pitcher: My issue is in H1, the volume grew considerably ahead of organic sales, so are you saying that in H1, it was a negative mix affect that caused that revenue per case to fall? I'm just trying to understand the development of the brand.

Alberto Gavazzi: Yes, I have to check that. My assumption, (Chris) – and we'll get back to you on that – my assumption is that it's state mix more than anything else. So, eventually we had a state that, you know, has different pricing exporting to other states. So, we need to check what happened there, but it's not something on price that we act upon in terms of a brand proposition.

Operator: We'll take our next question from Sanjeet Aujla with Credit Suisse.

Sanjeet Aujla: Hi, Alberto. Two questions, please. Are there any structural reasons as to why your business can't back to the 30% margins it was achieving between fiscal '10 and '13 when you think about the long term trajectory? And secondly, can you just characterize the competitive environment in scotch at the moment across your major markets?

Alberto Gavazzi: Okay, I'll start with the second question. Scotch is always a competitive environment. And for us to maintain our level of share it's very, very tough, right, because we have a very strong presence in the market. And what we want is not only to continue to grow that share but to expand the category. So, we see ourselves as leaders of that category with the role of expanding this category versus other categories in the region. And that's – it's important because it is the most profitable category across, right? So, the more we're able to expand, the better it is for spirits, overall. We have an active competition across all levels of prices. A couple of years ago, we were losing the battle on primaries as I shared with you back then. And we have since developed a couple of our positions on that front and I'm very, very happy that we're now leading that segment, as well, especially in the key markets. And, you know, competition has not made it easy on us to lead. But, I guess, through our route to consumer, our market activation, we were able to prevail. So, I actually think it's important to have a competitive environment, an environment where we're all investing to grow the category ahead of other categories. And I hope it continues to be that way. I hope it continues to be very competitive. So, structural reasons – we continue to expand margin, as I stated before, and you know, our goal is to continue to expand, you know, into the future. One of the factors that affected us is the loss of Venezuela. Venezuela has been a profitable market for Diageo in the past and it has completely disappeared from the radar in period of two years. So, you know, other than that, we continue to appreciate and do everything we can to expand our operating margin and we'll continue to going forward.

Operator: We'll take our next question from Jamie Norman with Societe General.

Jamie Norman: Good afternoon, Alberto. A couple of questions, if I may, on Mexico. You mentioned that it had been slightly a lower demand partly due to earthquake, partly the impending elections. Forgive my ignorance, but just enlighten us a bit on the character and the nature of the populist guy who is leading the polls. If he was elected, would that be a mild threat to business or something more serious? Second, perhaps related to that, is the impact of a NAFTA agreement, you know, put another way, to what extent are the uncertainties running that perhaps put a damper on demand in Mexico? Thanks.

Alberto Gavazzi: Right. Good questions and tough questions to give a right answer, right, because they're very open. So, with NAFTA, it is difficult to say where it's going to land, and I – whether it's positive or negative. We in Diageo we favor free trade agreements and the ability to trade freely – obviously we export a lot of our brands, sold in more than 180 countries. So, for us, whatever open trade agreement we emerge with is a positive one. There might be some opportunities to evolve the current NAFTA and we would welcome that. But we're prepared to deal with whatever might happen as a result. It is creating uncertainty at the moment in the Mexican market. And that uncertainty, alongside with the election, is impacting consumer confidence. So, we're seeing some of the Nielsen basket categories suffering a little bit as a result of that. That could be temporary and we hope it is temporary and things resume. But at this stage, it's difficult to predict. In regards to the election, again, it's difficult to predict what will – what could happen. The views we get from the outside on people we speak with is that whatever happens there's not going to be a massive disruption in the market.

And remember, Latin America always comes with volatility. I have never – I've worked on this market for most of my life and I never remember a year where we didn't have some sort of volatility somewhere. You know, again, I repeat, the good thing is that we have now a portfolio and we have the capabilities embedded that give us a little bit more immunity to go through that volatility than what we had before. So, at this stage, I'd say we just have to watch what's going to come out but we're prepared.

Operator: That concludes our question and answer session today. At this time, I'd like to turn the call back to Mr. Gavazzi for any additional or closing remarks.

Alberto Gavazzi: Thank you, Katie, and listen everyone, thank you for your time. I hope the call was useful for you to have a better understanding on why the business I lead is now more agile and better positioned to deal with the changes in the external environment. The region's attractive and brings a lot of growth opportunities that Diageo is well-positioned to deliver. We have a clear strategy that is working and we have delivered improved consistent performance over the last 18 months. A lot has been done, but there is more we can do. And that gives us confidence in the medium term that this business can deliver organic net sales growth of between mid-single digits and high single digits and expand our organic operating margins. If you have any other further questions, do not hesitate to call the IR team. We'll be happy to answer them and I look forward to speaking to you on the next call if I don't have a chance before. Have a good day, everybody. Thank you.

Operator: That concludes today's call. We appreciate your participation.