DIAGEO CAGNY 2023 Transcript
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(Janet): And now saving the best for last, please join me in welcoming Diageo back to CAGNY and thanking them for generously sponsoring tonight's dinner. Diageo is a leader in the structurally attractive total beverage alcohol industry and has an advantage portfolio and geographic footprint. Diageo's strong culture fosters agility, creativity, and experiences, which also drive opportunities for premiumization and stronger margins.

With us on stage are Ivan Menezes, who has been CEO of Diageo for almost ten years and has been instrumental in pivoting this company towards a higher growth higher margin company, and Lavanya Chandrashekar, who was appointed CFO about 18-months ago. Thank you.

((VIDEO))

((END VIDEO))

Ivan Menezes: Thank you, (Janet). And it's great to be here. We're coming to CAGNY after a long time. Thank you for joining the session. It's my first at CAGNY. Here's our forward-looking statement. Now, for those of you who don't know Diageo, we're a global leader in beverage alcohol. We have over 200 brands operating in 180 countries.

Our purpose is celebrating life every day everywhere. And it goes hand in hand with our performance ambition, which you see on the screen, to be one of the best performing, most trusted and respected consumer products companies in the world.

Now I believe three things at Diageo are apart. First, we are consumer and brand obsessed. We put our consumers at the heart of what we do.

Second, we are committed to having a positive impact on society. And third, we're restless, and we operate with agility and urgency to deliver consistent quality growth.

Today our business is 36% bigger than pre-COVID. That's a four-year organic net sales CAGR of 8%. And we've delivered a strong start to fiscal '23. In the half we just completed net sales was up 9% with growth across all regions, volume grew 2%.

Even though we took price operating profit was up 10%, and we expanded organic margins by nine basis points. We had $800 million of free cash flow, and we've continued our track record of increasing dividend every year for the past two decades. But we're not complacent, we are restless and determined to go after more opportunities.

Now, here's why we're confident in our ability to deliver quality, sustainable growth. Our industry total beverage alcohol, TBA, is very attractive. And within TBA we have the best assets plus an advantaged portfolio and geographic footprint.

Our obsession with being close to consumers and customers while doing business the right way, is a key competitive advantage. We're investing in our brands while driving efficiencies to fuel the investment. And we've delivered strong performance consistently in every period.

Diageo has a long runway for exciting growth ahead. TBA represents our overall consumer opportunity, and we're focused on increasing our share. We're the leading international spirits player by retail sales value.

Two years ago we set out our 2030 TBA share ambition when we held about a 4% share. Now I'm thrilled. We are already almost a third of the way to achieving it. But we're only at about 4.6% value share of global TBA. As I say to our people in the company, we're still - we're only a startup. We have tons of headroom to go after.

Now I think Diageo operates in the best consumer goods segment. TBA is incredibly attractive. Over the past decade, TBA the market worldwide, grew at a 4% compound annual growth rate. Spirits grew materially faster at a 7% compound annual growth rate. Spirits is premiumizing as consumers around the world drink better. This is Diageo's sweet spot. We've shaped our portfolio and positioned ourselves to go after this growth.

Let's turn to the US, which I call our most exciting developing market, here's why. First, the number of LDA plus drinkers in America, continues to grow consistently at 1% a year. Second, spirits continues to gain share of TBA. Since 2019 spirits has taken almost five points of TBA share. And this is driven by longstanding secular trends, taste, preferences, demographics, and cultural relevance. The cocktail culture continues to thrive.

Third, premiumization continues. And it is resilient because of the affordability of our category and the infrequent purchase cycles. I love this stat. In 2021 about a quarter of Americans bought a bottle of spirits over $50 a bottle.

One year later, in 2022, it's 33%, 1/3 of Americans, are buying spirits over $50 a bottle. Now, if you look at the last two decades, the US spirits industry has shown remarkable resilience. Volume and value growth both have grown every year, including during the Great Financial Crisis. I was here with our business in North America then.

And we only have a 7% value share of US TBA, a lot of headroom for growth. We've shaped our portfolio to participate in faster growing categories. And we continue to invest strongly in this key market. We are confident in continuing the sustained growth of our North American business.

Our strong performance in the first half of fiscal '23 demonstrates our advantage portfolio and broad geographic footprint in action. We grew organic net sales in all five regions in the first half of fiscal '23, despite lapping strong double-digit growth.

Over the past four years, Diageo has delivered a net sales CAGR of 8% with a 3% volume CAGR with strong growth in every region. You see it here on the map. North America, a CAGR of 8%, Europe, 7%, APAC, 7%, Africa, 8%, and wonderful Latin America, 15%. Now the strength of our business is not just in our footprint.

We're also in the fastest growing categories and price tiers. The top end of our portfolio, premium plus, is 57% of our business. It's been growing, and it contributed to 65% of our growth.

And we've been steadily premiumizing our business across every region in the world. Scotch, tequila, international whiskey, and gin are the fastest growing spirits categories. And we have an advantage portfolio in these strategic categories. And I'm delighted with the growth of our brands. Again, in the last four years, our scotch business is nearly 40% bigger, our tequila business is more than four times as large, and Guinness is almost 20% bigger.

We also participate in a portfolio of terrific Cognac and champion brands through our 34% ownership in Moet Hennessy. And we are the only international spirits player to participate in the highly attractive and premiumizing Chinese white spirits category.

Now, let me tell you about our exciting positions in scotch and tequila. Scotch is the largest premium international spirits category. We're the global leader with almost a 40 share in the scotch whiskey market, over 1.8 times our nearest competitor.

We have grown our scotch business at a 9% CAGR in the last four years. Growth is exciting, both in the developed markets and the emerging worlds. Scotch is hot. It's highly aspirational. It's cool. It's recruiting the next generation of consumers around the world.

And we are shaping the vibrancy and driving the growth of the category. Eight years ago we could see consumer interest building in the high end of the tequila market. So we went about and acquired Don Julio in 2015 and Casamigos in 2017.

We applied our brand building expertise, commercial excellence, and supply chain advantage to accelerate the performance of these brands. As a result today, we are the market leader in tequila, in the US, and globally. Now in spite of this exciting growth in the US, tequila is only in half the households or has half the household penetration of vodka and North American whiskey. And the category continues to show strong consumer momentum.

So it still has a long runway for strong growth in the US, but we are also very excited about the global opportunities for tequila. And we will invest in growing Don Julio and Casamigos globally, starting fiscal 2024. And now before I hand over to Lavanya, I hope you enjoy this clip, which brings to life the magic we bring to the scotch and tequila categories with our brands. Could we play the video?

((VIDEO))

((END VIDEO))

Lavanya Chandrashekar: As Ivan mentioned, we play in an extremely attractive category, and we have an advantage footprint. And we use this along with our operational excellence, to be able to deliver exceptional results. As you will see on this chart, Diageo has over the five-year period, fiscal '17 to '22, exceeded every other CPG peer group company in top line growth. I'm extremely proud of the work that we have done to achieve this. And it is our capabilities in digital, in supply chain, in brand building, in innovation, and our people that enables us to make this happen.

It is this performance history that gives us the confidence in our ability to continue to grow this business in a profitable manner, for the long term, and drive shareholder return. So there are two things that underpin this - the first is our growth algorithm, and the second is our consistent approach to capital allocation.

So let's move on to our growth algorithm. It's actually really simple. We drive top line growth because we have a fantastic portfolio of brands, and we have an advantage footprint. We drive revenue growth through price and mix improvements.

Our culture of everyday efficiency, helps us deliver productivity. And we take all of this, and we reinvest it back into our brands, through sustained investment. And that enables us to be able to further accelerate the growth of our top line and our share results.

Since this is at the heart of the thesis of investing in Diageo, let's walk through this one step further. So let's start with top line growth. One of the key enablers of our superior ability to deliver the top line growth that you saw two slides ago, is our deep consumer understanding, our brand building, and our innovation.

It is this deep consumer understanding that enables our innovation team to create magic, magic that allows us to bring more consumers into our brand portfolio. But rather than listen to innovation from the CFO, why don't we go and listen to it from the people who actually make this happen, Mark Sandys, our Global Head of Innovation.

((VIDEO))

((END VIDEO))

Lavanya Chandrashekar: Diageo has over the years, built out a really strong capability in revenue growth management. We are extremely strategic and surgical in how we take pricing action. And we do this in a very data based manner, using the investments that we have made in digital and technology, and data analytics over the years, to be able to take the right pricing decision by market, at a brand level.

In a category where pack sizes are mostly regulated, another big level for us to grow price mix is premiumization. And we do this as you saw in the video before, through innovation and through how we allocate our A&P spend. Ivan talked a lot about the great progress we have made in premiumization, but to give you a very tangible example, in the period fiscal '17 to '22, Johnnie Walker Blue Label, which is at the top end of our Johnnie Walker portfolio, grew net sales at a 14% compounded annual growth rate. At the same time, Johnnie Walker Red Label grew at 4%. So the growth of Johnnie Walker Blue Label was more than four times faster than Johnnie Walker Red Label.

As you can see from the chart on the left, we have driven price mix growth ahead of our peer group on a consistent basis. And as you can see from the chart on the right, our delivery of price mix has accelerated over the recent past. And this has been driven by the strong growth that we have delivered on our super premium brands and by the increased pricing that we've been able to gain in the recent years vs what we have historically done. This is a strong capability that is present across Diageo, across all of our markets in the developed and in the emerging markets.

Let's move from price to productivity. At Diageo we do not think about productivity as a program. Everyday efficiency is a mindset, and that's built into the culture of the company. And it is this culture that has enabled us to deliver 400 million pounds - on average 400 million pounds of productivity a year for the last several years.

In November 2021 in our last capital markets day, I set out a goal for us to deliver 1.2 billion pounds of productivity in the three fiscals, '22, '23, and

'24. We're at the halfway mark. And we have delivered 600 million pounds of productivity. And we are off to a really strong start in fiscal '23. In the first half of the year, we've delivered about 220 million pounds of productivity.

The most significant part of our productivity savings comes from COGS. And this is where our supply chain colleagues use the scale of Diageo and the breadth of our business to build strategic relationships with suppliers that enable us to deliver regular cost savings.

We also deliver cost savings from the work that we do on sustainability. When we improve energy efficiency of our operations, when we reduce the water usage of our operations, when we remove carton boxes from our products, we are also delivering COG savings. In the area of marketing, we go after waste in every spend type, from agency spend, to being more choiceful in how we use point of sale material, reusing it, as well as in gaining efficiencies on media. We also deliver cost savings on overheads.

We completed our productivity program from fiscal '17 to '19. But even after that we have been extremely careful about how we have managed our headcount. From fiscal '19 to fiscal '23, we have actually gone down headcount by 1-1/2%, while we have grown our business by 36%.

The thing that really distinguishes us from our peer group is the fact that we consistently up weight investment in marketing behind our brands. In the last five years we have increased marketing investment in our brands by nearly 1 billion pounds. Our reinvestment rate has gone up from 14.9% to 17.6%.

That's an increase of 270 basis points during this time period. We do not have a target reinvestment rate, but we are extremely disciplined and data-based in making decisions around marketing investment. Going back to fiscal '17, we started to invest in a suite of tools and capabilities to enable us to improve our marketing efficiency - tools, such as catalyst and sensor, which we have talked about in the past. And these tools enable us to use the data and technology at our disposal to ensure we make the best investment choices by brand, by market.

This ensures that we are continuously investing in the highest growth opportunities that deliver the highest returns. And it works. Our marketing investments help us to gain market share. As we shared in our interim results, we are holding or gaining market share in 75% of our net sales value. And this is not a capability that we only have in our developed markets like in the US or in Great Britain. This is equally a capability that we put into use across all of our emerging markets as well.

So let's now, you know, let me introduce you to (Patty), who's from our Latin America team. And she will bring to life the magic of our brand building and our digital capabilities.

((VIDEO))

((END VIDEO))

Lavanya Chandrashekar: We have a consistent track record of delivering operating profit ahead of net sales growth. At Diageo promises made are promises kept. In the three fiscal years prior to the pandemic, fiscals '17, '18 and '19, we increased our operating profit ahead of our net sales growth. And we have continued to do so as we have emerged from COVID. The two periods in between, the second half of fiscal '20 and the first half of fiscal '21, our business was significantly impacted by a once in a 100-year pandemic, with the on trade being closed with travel restrictions and a slowdown of global travel.

That really impacted our business in those two periods. But coming out of that, despite supply chain disruptions and significantly stepped up inflation, we have continued to increase our operating profit ahead of net sales growth. And we have done this by using all of those strategic levers that you see on the page over there. In the last 2-1/2 years, price and productivity from supply operations, has more than offset COGS inflation. We have grown our business at a volume CAGR of 3%, and that has enabled us to get operating leverage through the P&L.

And we have driven premiumization, and premiumization drives margin improvement because premium products tend to have better margins. And this is what is at the heart of our medium term guidance as well. Having gone through the growth algorithm, let's now turn to our capital allocation, where we use a very consistent and disciplined approach.

Our first priority on capital allocation is investing in the organic growth of our business. Second, we invest in acquiring strategic brands that strengthen our exposure to fast-growing categories. Third, we have a progressive dividend policy. As Ivan said, we have increased dividend every year for over the last 20 years, including in fiscal '20, when the business was significantly impacted by COVID. And fourth, where we have excess cash, we return it to shareholders. We have stayed invested in this business in marketing, in capex and in maturing stock, as well as making regular bolt-on acquisitions, despite the challenges of the last several years. Let me walk you through some of these.

We run this company for the long term, like true owners. A true testament of this is the steady increase in investment that we have made in maturing stock, which currently sits at a little over 5 billion. This is our liquid gold. This is what provides Diageo its strongest mode. And this has increased by over 1 billion pounds in the last five years.

In fiscal '22, our production volumes were up 9% over fiscal '19. That is the equivalent of us producing approximately 400 million more bottles and filling it and shipping it with our most delicious liquids. We did this because we have consistently invested in this business in capex.

This is what - our confidence in our business and the potential that it has, along with our share ambition has led us to decide to increase our capex investment to be between 1 billion and 1.2 billion from fiscal '23 to '25. This will help us to be able to invest in adding capacity in strategic categories such as scotch, tequila, Baijiu, US whiskey, Canadian whisky, and beer. In addition to adding capacity, our capex investments also enable us to invest in delivering against our sustainability objectives. We use capex to build our digital capabilities, which will ensure that we retain the competitive advantage that we have in this space.

We invest capital in consumer experience centers, such as Johnnie Walker Princes Street, which enable us to build a deep and lasting relationship with consumers. And most recently, we announced a supply agility program, which is designed to ensure that our supply chain remains a competitive advantage for us in the long term.

The supply agility program will enable us to increase the resilience of our supply operations while reducing our carbon footprint and increasing the efficiency and reducing costs, as well as increasing cash flow. Let's take a look at a short video that brings to life our supply chain capabilities.

((VIDEO))

((END VIDEO))

Lavanya Chandrashekar: Beyond investing in organic growth, we are also active and disciplined in managing our portfolio. We use our deep consumer insights to identify opportunities to expand our portfolio into attractive new segments.

Since fiscal '17, we have invested $2.2 billion in acquisitions, ten of which are in fast-growing super premium price segments. During the same period, proceeds from divestitures, which are mostly brands that either did not really fit within our portfolio, and mostly played in slow-growing segments, have netted us £1.2 billion.

Recent divestitures include our move of our Guinness business in Cameroon, to an asset light model, the divestiture of Archers, and the disposal and franchising of a portfolio of popular brands in India. We not only make smart acquisitions, but we also have a strong track record of turning these acquisitions into blockbuster brands, an example of which, is Casamigos. So what does this all do, the growth algorithm and our capital allocation strategy? It creates value to you, our shareholders.

In the last five years we have increased our return on invested capital by 300 basis points to 16.8%. Now let me hand it back to Ivan, to take you through how this translates into a steady increase in shareholder returns.

Ivan Menezes: Thank you, Lavanya. Okay, as you can see here, we've delivered significant value for our shareholders, increased dividend every year for 20 years, consistently returned excess cash to shareholders. We just completed our £4.5 billion return of capital program earlier this month. And we've just started a £.5 billion buyback last week and expect to complete it by June, the end of this fiscal year. Now here's Diageo's competitive edge. It's our people and culture. All 28,000 colleagues are driven by our purpose and our performance ambition.

They have an ownership, passion to build brands the right way for the long term. And they are restless to execute better every day. We enjoy 82% employee engagement. And 90% of our employees are proud to work for Diageo, a very high benchmark. Our culture and performance track record enables us to recruit, develop, and retain talent in a fiercely competitive market. I am very proud of and grateful to my 28,000 colleagues across Diageo.

Now, we aim to create a more inclusive and sustainable world. This is not new to Diageo. We're very proud of what we've achieved from 2010 to 2020. And we've now set ambitious industry-leading targets as part of our Society 2030 ESG action plan. We champion responsible drinking, including our commitment to reach 1 billion people with dedicated, responsible drinking messaging by 2030. We are well on our way to our ambition to achieve 50% representation of women in leadership and 45% of leaders from ethnically diverse backgrounds.

Diageo's attractiveness as an employer enables us to hire, grow, and retain the best and most diverse talent. We aim to become net carbon zero in our direct operations by 2030. And we aim for a 50% absolute reduction in our Scope 3 carbon emissions also, by 2030. We aim to use - in every drink we make, to use 30% less water. We intend to replenish more water than we use, in water-stressed areas. Diageo is well-recognized externally for our leadership on inclusion and sustainability.

Now, given what Lavanya and I have covered, I hope you see why we are confident that we're well-positioned to deliver our medium term guidance, which is consistent organic net sales growth in the range of 5% to 7%, and sustainable organic operating profit growth in the range of 6% to 9% for fiscal '23 to '25.

So in closing, here are the key takeaways - I'm excited about Diageo's future because TBA is an attractive industry, and within that, spirits is super attractive. We have an advantage portfolio of fantastic brands. We have an unrivaled geographic footprint with only a 4.6 share of TBA.

We have a long runway for growth. We are investing behind the growth opportunities. Our focus on driving quality sustainable growth, delivering everyday efficiency, and reinvesting smartly, is working. We have a strong track record in ESG delivery, and we've delivered consistent high-quality, strong performance. And finally, we are excited about our strategy and confident in our ability to deliver sustainable long term growth and shareholder value. I believe the best is yet to come.

So now, before we go to Q&A, I have to show you at least one of my favorite ads. This is on Guinness, which was - which broke recently after the pandemic and lockdowns. By the way if you haven't tried this, Guinness 0.0, absolutely delicious. You can't tell the difference. So I hope those of you who come to our party tonight, you're going to have fabulous cocktails and dinner tonight, but try this as well. Could we show the ad please?

((VIDEO))

((END VIDEO))

Ivan Menezes: Thank you. And let's open it up for Q&A.

(Janet): Wait for the microphone, (Robert).

(Robert): Thank you, Ivan. I'm sorry, Sir Ivan. And congratulations on the knighthood.

Ivan Menezes: Thank you. Thank you.

(Robert): So when I - I think I first saw Diageo at CAGNY, it was Paul Walsh probably around 2010. And he made very clear an objective to grow in emerging markets. And lo and behold that happened. A number of deals, transactions, more recently I think, you know, five, six, seven years ago, you set out a very clear objective to grow market share in the US, which you clearly have delivered on and done extremely well.

So looking out longer term now, you know, next five years or so, what are the key challenges that you see? What are you kind of tasking the firm to do to accomplish so that you can continue, you know, the long history of growth? Thank you.

Ivan Menezes: Thank you. Yes, I would say, at its heart the success and value creation of this company comes from staying extremely close to the consumer, spotting trends faster than anyone else, and moving and executing against them faster.

So as I think I indicated (Robert), the - that's plenty of attractive, profitable growth right across our geographic footprint. I mean you look at Latin America, which has had stunning growth, but it's also improved its margins significantly in the last four years. So as a management team and with our general managers, we just had them all together, we always talk about double down on your external focus, really be the best at understanding consumers.

We've got the wherewithal to invest, and our magic of brand building and innovation, the digital capabilities we built. So I say Diageo's success and lack of success, will depend very much on that factor, in my mind. And this to me, is what we've been building in the company over the last six, seven years, the talent, the capabilities, the tools, the analytics, to really make us at the leading edge of this.

Now beyond that, of course, we have to ensure we deliver on our Society 2030 commitments. We have to ensure we're a great player in the communities we operate right across the world. But we see, I mean we did, as you said, in 2010, the emerging markets was the big move. Right now we're seeing really exciting growth in the developed world. You know, in the last six months everyone talks about the doom and gloom in Europe. We grew our business 10% in Europe in the first half of this fiscal.

And we see the strength to spirits gaining share of TBA, and premium brands doing well as very sustained. So the main differentiator is going to be the consumer centricity, and execution against opportunities and threats that we see with the consumer. And I think Diageo is well-positioned to navigate the world we're in to keep outperforming and growing market share.

(Janet): Next, (Simon)?

(Simon): Can I just drill down a little bit more into the whole confidence in pricing on a go-forward basis? I mean I think as growth rates begin to normalize around the world after a period of outsized growth, if you look at someone like the US, I think historically a lot of your certainly above average growth, was coming to volume and mix.

Going forward, how do we think about the build of growth in a market like the US, or maybe other developed markets? How's it going to split volume mix and price? It seems that you're much more confident perhaps than you were, and maybe as an industry than you were, in your ability to take headline price.

Lavanya Chandrashekar: So on pricing, we are extremely surgical in the pricing action that we take. I mean pricing is not the only lever that we have to either grow brand equity or to offset inflation. It's one of multiple levers that we have. And our objective is to drive balanced growth, balanced growth between volume growth, between taking price, but also driving premiumization. And it is the combination of all of these that really enable us to be able to build brands that are sustainably strong for the long term, while also achieving on our medium-term guidance objectives.

So, you know, strong brands can take more price. And as we invest more A&P behind our business, we enable our brands to be able to take more price and still provide the right value equation to our consumers.

Ivan Menezes: I think just to add, I mean volume growth is critical. It means more consumers enjoying your brands. And we take a very firm view that the health of our business is in expanding the consumer franchise. So getting volume price and mix and balance is really important and if it gets out of kilter we very much focus on getting it back into balance. Now it doesn't work everywhere in the world, but that is our intent. And I'd say by and large, in most places around the world, across our categories, we're able to deliver it.

(Janet): And with that, we're going to move next door to the - for the rest of the breakout. I'm really excited to try this Liquid Gold. So thank you again, Diageo, for sponsoring tonight's dinner.

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