Diageo PLC
2013 Interim Results

AM Analysts Presentation – 31 January 2013
Q&A Session

Simon Hales - Barclays Capital

Just a couple of quick questions if I can, Paul. Firstly, just on Europe, I think back at the Europe dinner you hosted back in October, I think at that stage Andrew was indicating, or hoping, that for the full-year 2013, that you'd be able to deliver probably flat sales and profit in Europe. I just wondered where your thinking is against that now, given it probably was a slightly tougher Q2 performance in Southern Europe for you.

And then, just related to that, in terms of the destocking we saw in Spain towards the end of the first half, was that all completed in the first half? Or is that going to be an ongoing drag into H2?

And then, just secondly, around Deirdre's comments on the pension, the £400m pension contribution, I wonder if you could just talk in a little bit more detail about the impact that will have. You indicated that will be slightly positive for earnings and I'm just trying to reconcile that in my mind.

And, related to that, just remind us how you're planning to account for the IAS 19 pension changes and how and when they're going to come in and hit your numbers. Thank you.

Paul Walsh - CEO

Let me just give a perspective on Europe and then maybe Andrew can give you the specifics around destocking, etc.

There's no question that we aspire to get aggregate Europe to a flat trading position and we believe that we can do that.

However, clearly, in this set of numbers, we've not achieved it, largely because of weak performance in Southern Europe. We all know the situation there. Consumers are just continuing to reduce their spend on many categories; ours included.

That said, our goal to get aggregate Europe flat remains intact.

Andrew, issues around destocking and your observations on Q2?

Andrew Morgan - President, New Businesses

Yes, Simon, you're right; that was the aspiration going forward. I think we talked about the next financial year in terms of getting back into growth at that dinner. So yes, this half has been sales off 2% total Europe. I think the underlying position is a bit better because we’ve got some one-off factors in Western Europe in the first half, which I'll touch on in a minute.

But, as Paul says, it's still very polarised, so up 15% in Russia, up 14% in Turkey, up 16% in Germany, up 15% in Benelux, but Southern Europe still very, very, weak and Spain particularly soft because there was more destocking there and the continued weakness on the consumer side.

The place that has deteriorated significantly is France, where consumer trends are worse. But then, also, we've lapped the stock build-up in the prior year that came ahead of the tax increase. So there's a sort of double hit there. But it's not only the one-off, France, as a market for us, has deteriorated significantly as well.

So the one-offs, then, that reverse out in the second half is that France lapping of the stock up. There is some destocking in Spain. I think there'll be further destocking in the second half, but not as much.

And then we also had a very poor Bordeaux En Primeur business. Not core part of our business, but it actually hit the numbers quite badly because it was very marked in the wine business in last summer. So that was a big year-on-year impact versus prior year.

So H2 will definitely be better and I would go so far as to say H2, we will grow both sales and profit in total Europe. How far that gets back towards flat in total, it's tough to call at this point. But I would say it will be better than the minus 2% that you're seeing in the first half as a result of really not having those one-off factors that we saw in the first half.

So not an underlying improvement in Western Europe, but a better performance in the second half.

Paul Walsh

I think it's testament to the strength of Diageo that we can absorb such a shock out of Southern Europe and still deliver what I believe are a very good set of numbers.

Deirdre, pension?

Deirdre Mahlan - CFO

On the IAS 19 piece, that is going to be effective in 2014. That would have been F14, of course. F'13 would be restated when that's implemented. We expect the impact for 2013 to be £40m to £45m higher charge.

2014 is a bit more difficult to predict because it does depend on the deficit at the time. Based upon current values, we'd expect it to be around £30m.

With respect to your current question on our additional contribution that we're making to the UK pension scheme, that improves EPS because it will have a slight reduction on the finance charge element of our pension charge. That's why you will get a slight EPS benefit.

Paul Walsh

Is that clear, Simon?

Simon Hales

Yes. That does it. Thank you.

Ian Shackleton - Nomura

A few questions just round the US. You've always had a very good performance, but there have been a few comments from some of your competitors about some weakening over the holiday season. I'd love to have your view on that.

Secondly, the 2% to 3% of pricing that you talked about, is that the sort of level of pricing you're aspiring to do every year from here on?

And the third question, obviously beer and ready-to-drink was a drag factor in H1. Do you see that becoming less of a drag as we go into H2 and fiscal 2014?

Paul Walsh

Let me take some of those questions in reverse order.

A lot of the performance on beer was held back as a consequence of Nigeria, and we are confident that we will see a level of improvement in the second half in that regard. So, we do expect to see an improving trend on the beer business.

Regarding pricing, first of all, our brands are healthy, our innovations are strong, and we are determined that with the improved global economy, that we will get into the rhythm of price. And 2% to 3% is a reasonable benchmark to use.

Clearly, it will vary year to year. It may vary market by market on local brands. Obviously, for global brands we need to have consistency. But we think that this is very achievable and should be our long-term goal.

Regarding the US, I actually think the US is performing very well. There may have been some modest slowdown in December. I do not see that as interrupting what has been a steadily improving trend. But let's ask Larry to comment specifically because he's living it every day. Larry?

Larry Schwartz - President, North America

We felt a little bit of an interruption in December because of the Hurricane Sandy, the Sandy Hook shooting, and the fiscal cliff, but we don't see this as a new trend.

So the numbers that we saw in NABCA and IRI weren't apple to apple, so that wasn't really a good indication. But I guess the best part of the indication is that January is looking pretty good, so we think it was just a minor blip.

I think in this country people look at their 401ks and housing. Those are in pretty good shape, so the January numbers are looking fairly good, so we just think it was a minor interruption in December.

Paul Walsh

We're very pleased with how our US business is positioned, how our brands are performing. I think the US is going to be fine.

Trevor Stirling - Sanford Bernstein

Two questions from my side. The first one may be for Deirdre. I notice that you took a £40m exceptionals on restructuring the global supply chain. Could you just give us a little bit of colour of what the initiatives are that lie behind that restructuring?

And the second thing, maybe you'd give us a slight update on USL. We note that you're in discussions with the Indian regulator. Is there anything there that could slow down, or put at risk, your ability to consolidate USL, fully consolidate it, into your accounts?

Paul Walsh

Before I hand over to Deirdre to talk about the restructuring charge, let me comment on USL.

It is before the regulators. It is very difficult for us to make any comments beyond that, other than to say that we understand the process and we are very respectful of the process that operates in that jurisdiction. But, equally, we're confident that we will prevail in this transaction. Deirdre?

Deirdre Mahlan

On the restructuring charge, these charges that came through, there was actually £4m in the half and we expect the second half to be £38m, which is really where the £40m comes from. These charges relate to previously announced activities, almost entirely in Irish brewing.

It's just the nature of the accounting is that we have to take them as certain activities take place, which is why you're seeing those charges come through now.

Trevor Stirling

Thank you very much, Deirdre.

Philip Morrisey - Berenberg

You've highlighted this morning positive operating leverage to overheads, most notably in emerging markets. And I wondered if this is something that we should expect to be sustained going forward, and even after the United Spirits deal starts contributing to the organic growth numbers.

And then secondly, in the United States obviously you've highlighted the 2% to 3% price increases on strategic brands. And I wondered if competitors were generally following those increases, and whether there was any risk as we go forward of their being pulled back. Thanks very much.

Paul Walsh

Generally speaking, on price increases we have seen people follow in the majority of markets, so we're encouraged by that.

Regarding the overhead leverage, we have said for some time that, as we not only get scale but we now get good percentage growth on an established attractive base, whilst we will increase overheads, the sales rate of increase will be faster and, therefore, you'll continue to see appropriate leverage through the P&L.

The other thing I would say, there is a lot of focus on price. Let's not forget that we are continuing to premiumise, and the mix aspect has been a little bit subdued in these numbers, by and large down to our performance in Korea where volumes and the sales revenue growth was down.

But premiumisation remains a very important plank of our strategy. It has delivered in this half and, in fact, again you have seen our ultra-premium brands grow at 18%. And, as you know, this is now a substantial piece of our business and it's growing 18%. So I do believe that we can get price, and we will continue to get premiumisation of our brands.

Melissa Earlam - UBS

A couple of questions please. In your prepared presentation you commented that you were looking to address tequila in the US organically. Is that going to be a sizeable launch that could impact marketing spend over the next 12 months or is that going to be absorbed in your overall guidance of flat A&P to sales in North America that you've indicated previously?

And then secondly, you've increased your dividend growth guidance to 9% for the interim dividend. How should we be thinking about use of balance sheet going forward obviously since the Cuervo discussions have ended? Are you looking to modestly increase your rate of dividend growth going forward, and would you consider a share buyback even resuming? Or are you looking to be on a continued basis opportunistic and, therefore, keeping balance sheet powder dry, so to speak? Thanks.

Paul Walsh

First of all regarding tequila, it is inappropriate to go into too much detail here. But, clearly, an organic play into this category is de facto our preferred approach. And I would draw your attention to what we have done with Ciroc, where this was a slow but very successful build. You didn't see a huge splash of marketing spend that eroded EPS or anything like that. It was absorbed.

Equally, if we see the opportunity to do something that's in the interests of our shareholders by making such an investment, we will do so. But we have no plans for that. I also don't rule out the possibility of making small inorganic plays in this category.

But it's very clear that the deal that was available to us was not in the interests of our shareholders, and, as you know, we are extremely disciplined in that regard.

What I would also say is that the removal of this brand from our portfolio is accretive to our growth rates, accretive to our margins and accretive to our management attention on our own brands.

Regarding dividend growth, we grew our operating profit 9%., we have attractive dividend cover and, therefore, it's appropriate to increase the dividend by 9%, which is the third time we've increased the rate of dividend increase since we issued the medium-term guidance.

We don't envisage a move back to buybacks. We believe that we can continue to have a strong balance sheet, continue to generate a lot of cash and move when we see opportunity and it would be unwise to say more than that.

Melissa Earlam - UBS

Great. Thank you very much.

Ann Gurkin - Davenport

Two questions, if I might. One is the industry has talked a lot about building out capacity, and if I could just get an update on how you think demand is tracking versus that projected capacity growth. Any changes in expectations there?

And then second on Russia. Russia, being one of your faster growing markets, if Russia decides to enact a smoking ban in many public places, how do you envision that impacting consumption? And right now what are you incorporating for growth in Russia in the second half of calendar '13?

Paul Walsh

I think, Ann, when you talk about industry I assume you mean the scotch whisky industry.

Ann Gurkin

Correct.

Paul Walsh

As you know, we have continued to invest both in maturing spirits and in distillation capacity over the last six years, and we are in good shape.

Now, if there is the cloud of Southern Europe regarding Scotch whisky consumption in Spain and Greece, the silver lining to that cloud is that that was relatively young scotch that we can hold on to longer, and sell in other markets as 12 year old rather than three, four, five year old. So that has also helped our situation.

So when you combine our purchase of distillate, our increased capacity in distillation and the fact that we've got a falloff in demand in Southern Europe, you put all that together, we're in pretty good shape.

In the numbers we've reported you saw 10% growth in scotch. We're very pleased with that. You saw 14% increase in Johnnie Walker. And the traction that we are now getting with our marketing programmes and our ability to trade consumers up is very, very clear and very exciting. So we're feeling very strong about scotch. Our capacity is in good shape and the future of scotch is incredibly bright.

Andrew, regarding Russia and smoking.

Andrew Morgan - President, New Businesses

A good segue. The future of scotch in Russia is very bright as well, so our business is in great shape; up 15%. Don't see any reasons for that to change significantly.

We're doing particularly well in accessing the middle class consumer ever more every year. So we're getting a bigger and bigger consumer base with our scotch brands, but also with other categories. And we're looking at ways to access that middle-class consumer in different ways in Russia. I'm very excited about that.

In terms of regulation in Russia and the smoking ban, there has been quite a lot of changes in regulation, but mostly addressing beer. So beer, as you may know, used to be classified as a soft drink. That has been finally addressed. It's now treated like alcohol, as is spirits, and most of the changes in regulation in Russia have been around beer, not around spirits, which is where our business is centred.

If there is a smoking ban, the important thing to know is that a very small percentage of the spirits volume in Russia is in the on-trade. It's 85%-plus off-trade business, so the smoking ban is not going to have any significant initial impact on volumes. And I'm sure the Russians will find ways to deal with that in other ways anyway, knowing their entrepreneurial capabilities.

Ann Gurkin

That sounds great. Thank you so much.

Andrea Pistacchi - Citigroup

I have a couple of questions, please. One is on your cost savings. In this period you delivered benefits from procurement, production efficiencies and overhead savings, and you're flagging that, going forward, the incremental overheads savings, there will be less of that. So I was wondering, the other two drivers of the cost savings, how should we think of the incremental benefits going forward, please?

The second question is on Ciroc. We saw a bit of a slowdown in this half period, I think in the US. I think 14% sales growth. Is this a reflection of just anniversarying the Peach selling or are there any other factors, maybe one-off shipment issues, here? And is this the sort of growth rate we should expect going forward for the brand, given its much larger base now in the US?

Paul Walsh

Let me handle Ciroc, and then maybe Deirdre can talk to some of the cost savings.

Ciroc grew globally 17%. It is the law of numbers that the bigger it gets, the more muted that growth rate is going to be. We did, indeed, find in this period that we were lapping the Peach launch in the US. Ciroc is in great shape. There are many markets where it's only just getting going, and we are very excited about its prospects. But, as the brand gets bigger and takes more and more share, as it is doing, the growth rate will be inevitably more subdued. That doesn't worry me at all.

Deirdre will talk about cost savings. One of the things that I would also point to regarding cost savings is the work that actually Larry and the team, assisted by Andy Fennell here, have been doing to actually drive more of our marketing investment into above-the-line activities, making sure that below the line we are really hawkish on value, that we're procuring POS at the best price possible and that's having a very beneficial impact on the mix of our spend.

But Deirdre, overheads.

Deirdre Mahlan

On cost savings generally, first I would just say again that we're committed to efficient growth, which means that every year you can expect that we will be looking to drive efficiencies through our cost base, and that's the supply chain or our overhead base. And certainly, these results demonstrated that, and we'll continue it.

It is true that the operating model changes that we made, those savings, the incremental element of those savings are going to be completed largely in fiscal '13.

However, we continue to look to drive efficiencies through priority-based budgeting, through staying focused on procurement savings, and we will still see some additional savings coming through on the brewing restructuring that I referred to earlier. If it is complete it will be in the order of about £10m next year. But we will continue to be looking to drive efficiencies through our manufacturing base, so that's the piece relating to the restructuring charges, but you can expect us to continue to look to that.

You'll have noticed in the presentation that we said that our input costs were up 4% and that we were able to offset about half of that through efficiencies in procurement and on manufacturing operations.

Andrea Pistacchi

Thanks.

Eddy Hargreaves - Canaccord Genuity

Just coming back to the beer performance, I take on board, Paul, your comments about Nigeria probably improving in H2. But looking at the developed markets, if I'm right, in full-year 2012 fiscal it was up 1%. It's down 3% in the just reported half. I understand that some of that is lapping the launch of Guinness Black Lager, but it would appear that GB/Ireland has deteriorated somewhat fairly fast in the half. Can you give some outlook on US and GB/Ireland beer for the remainder of this year, please?

And then, secondly, just a question on Venezuela. You mentioned some advance purchases in that market. I wondered if you could say how material or otherwise that was and are you yourselves planning for devaluation in that market in the current half year?

Paul Walsh

First of all, by way of context on beer, Eddy, we actually grew 1%. That is below our trajectory and it is a position we intend to improve upon.

We have consistently been able to offset softness in UK and Ireland by over-performance, very strong performance in Africa. For reasons we've explained, particularly around Nigeria, that was not doable, but we do expect to pick up the pace in the second half and certainly improve our aggregate performance of beer.

Specifically on the UK and Ireland, let me ask John Kennedy to offer some perspectives on beer performance there and our expectations for the second half.

John Kennedy - President, Western Europe

We saw Guinness down 2% for the half. We're certainly seeing a continued weakness in the Irish market and the GB on-trade, which we would expect to continue.

However, if you actually look at what we're doing with the brand, we feel very positive about the plans going forward. We're launching a major new campaign. That tested very well across both countries. Have a major initiative on rolling out a new fount in thousands of pubs across both countries. So we'd expect the market to continue to be subdued. However, we think Guinness, the brand itself, should perform well in that market over the next six months.

Paul Walsh

So we expect pretty much of the same in the underlying beer trends, but we expect to outperform that in Europe. And certainly we will pick up the pace in Africa.

What I would also say about Africa is we often forget just how strongly our spirits business is performing in Africa. A few years ago we reclaimed distribution. That's now going through our own teams and performing extremely well.

Regarding Venezuela, Randy, do you wish to comment? Did you hear the question?

Randy Millian - President, Latin America and Caribbean

I did, thanks, Paul and Eddy. Venezuela we're tracking closely. We've got an experienced team that's gone through it. Obviously, we have to look at the currency control and the devaluation.

First, coming back to the Christmas period, this pre-buying was done by consumers who were stocking up, but January continued strong. So how much effect is there going to be in the second half? We do think the second half is going to have lower growth. It's hard to estimate what that is at this stage, but they continue to buy.

Now, as far as the devaluation is concerned, they usually devalue in February. But, as you're tracking it and we're tracking it, there is questions of who is really in charge and running things, so whether that decision will be made in February. But I do think in the next six months there will be an official devaluation.

But I just would remind you that what we do is we translate at the currency rate at which we purchase scotch. So if we do that in the second half, we will find what that currency rate is and do it at that stage -- but we do see a devaluation in the second half.

Eddy Hargreaves

Okay. Thank you.

Chris Wickham - Oriel Securities

Just a couple of things. I was wondering perhaps if you could talk a bit more about just the working capital increase and what working capital pressures you come under as you shift the balance of your business more in towards those high growth markets and whether they're just much more working capital heavy.

And then the second one, I was wondering if you could talk a bit more, similar to the Ciroc question, about Captain Morgan. Obviously there are a number of markets, we've just seen Captain Morgan putting in some very good numbers. Clearly there's some white space there. But I was wondering perhaps if you could talk a bit more about the sustainability of the growth in Captain Morgan.

Paul Walsh

Yes, Captain Morgan grew 7% in NSV in the first half. We've got some fabulous new executions at the market level innovation; Captain Morgan Black. So we're pretty excited about that. And, indeed, we're excited about the prospect of continuing to broaden our footprint in rum. So rum is hot. Zacapa performed incredibly well. Expect more innovations in this space. We do believe that it's sustainable.

Regarding working capital, before I ask Deirdre to comment on the impact of serving more markets that are farther away from the production base of Scotland, the biggest issue that we have faced is building our maturing inventory. We've been at this for five, six years. It is serving us well. It is giving us very strong margin. It is a very strong barrier to entry. So all of the economics point to continuing to build maturing stocks.

The one area where we have been quite ruthless is around credit. In an uncertain world it is most unwise to extend credit and provide credit to customers when you have doubts about the sustainability in their marketplace. So we have been very, very aggressive on credit control.

On inventory, Deirdre, do you wish to comment?

Deirdre Mahlan

Just in general, I would say our working capital increases, if you exclude the maturing stock that Paul referenced, is broadly in line with the growth of the business.

It is fair to say that, as you get into some more of the higher growth markets that have infrastructures that are not as developed and therefore the supply chain is longer, it does involve, in particular as the growth ramps up, it does tend to involve more working capital on the margin.

However, we have been successful and we expect to continue to be looking for opportunity to drive efficiencies at the same time, either through our developed market or through those same markets as we improve the execution against the supply chain.

So there is some increase, but it's not material.

Chris Wickham

Thank you very much.

Chris Pitcher - Redburn Partners

Paul, you've referenced Nigeria picking up again, or improving in the second half for beer. Could you give us a bit more clarity on what gives you that confidence? Is it capacity coming on stream? Is it the new management team in place?

And on Korea, Deirdre this morning made the comment that you expect some improvement because competitors have taken up price. Is that an improvement in your market share because the scotch market does seem to have deteriorated into the end of the year? I wonder if you can give us a feel for where you see scotch declines currently in that market.

And then finally, I may have missed it but have you given us a figure for actual Spanish net sales declines? And, if possible, could you just aggregate what was the stocking impact? Thanks.

Paul Walsh

I'll ask Nick to speak to Nigeria and maybe, Andrew, you can cover the Spanish detail. Maybe John Kennedy can do that.

The only area where we have seen scotch under pressure is really Korea. You saw a contraction in the category performance and we did underperform the category. We led with a price increase. There was a delay in others following. They have now followed. We've adjusted some of our promotional spend. And I expect us to recover our share in the second half. But I do not fundamentally expect the scotch category in Korea to get into growth. I think it's going to continue to see some erosion.

Other than that, scotch around the world is very, very strong. I'm delighted that it's performing well in North America and you're actually seeing a bit of a renaissance here in the UK. And also, scotch, the higher priced scotches are doing particularly well and we've had notable success in that regard. So that would be my observation on scotch, Chris.

Chris Pitcher - Redburn Partners

If I could just interject there? You've mentioned it's doing well on the sales side, but the world's biggest scotch market France, I know it's relatively small for you, but is that still holding up despite everything you were saying in the earlier commentary?

Paul Walsh

As you said, scotch in France for us is relatively small. And, as you heard from Andrew earlier, we are seeing pressure in that marketplace beyond simply the year-on-year impact of buying against the duty increase. But it's small from our perspective.

Nigeria, Nick?

Nick Blazquez - President, Africa

One of the factors that lay behind the slowdown in the market was the Nigerian government's decision to remove some of the subsidy that had been given to fuel. Now that occurred last year, and that was a significant reduction in subsidy and it consumed a lot of disposable income. So it had an adverse impact on the beer market, along with some other factors.

The Government has announced that they're not going to further remove that subsidy. Therefore, we are coming now to lap that period, so we can expect the market and the consumers to have some more disposable income to spend on products such as the beer category.

So the beer market we have seen over the last six months to be down, in our estimate, by about 4% to 5%, we expect that decline not to occur going forward and to see some recovery of that market.

Within that, we, as you say, have put a new management team in there. Seni Adetu is the new Chief Executive, and that is bringing a lot of energy to that business.

And, if I look at our relative market performance over the last 12 months, six months, three months and one month, I'm seeing a continuing relative improved performance versus our competition and I expect that to continue.

One of the things that's also going on in the Nigerian market is we're seeing some polarization into premium and into value, and both the mainstream value brands of Star, our competition, and Harp, ourselves, have come under some pressure from the lower priced products.

We've got a very active innovation programme. We've recently launched a product called Dubic, slightly lower priced, and that is doing well and that is gaining share and we expect that to continue as we roll that out.

And, finally, Paul mentioned our spirits performance. We've got a superb beer platform and, having taken over the distribution in-house, we are seeing very strong and continued growth in spirits. We grew volumes by some 60-odd-% and value by some 80% in Nigeria. We expect this to continue going forward and spirits, whilst today a relatively small part of that business, will improve and make an increasingly positive contribution to our overall performance in Nigeria, as we truly do leverage our beer platform into spirits.

So it's challenging in Nigeria right now. Looking forward I expect beer to improve, our relative competition to improve and to leverage that platform into spirits.

Chris Pitcher

Thanks. Very clear.

James Edwardes Jones - RBC Capital Markets

A couple of questions please. Can you explain why your overheads in Western Europe didn't decline, given the cost focus in that market?

And secondly, in your free cash flow guidance for a £400m reduction in free cash flow this year over last, does that include the additional pension contribution of £400m? So, in other words, would it be flat if it wasn't for that?

Paul Walsh

John can handle the overhead, but also pick up on the question we didn't answer from Chris's question regarding Spain. And then Deirdre can answer the free cash flow one.

John Kennedy

So, on the Spanish question, you saw the numbers for Southern Europe. We were down 19% for the half. We're a little bit worse in Spain; down 23%. If you actually split that out between destocking and consumer trends, it's about half and half. Particularly in the on-trade, we've got 12%, 13% declines coming through, and then the rest of it is coming from taking stock out.

If you looked at the second half, consumer confidence is still very weak, so we'd expect a similar trend. There will be some destocking as well, but less impact than in the half-year numbers.

On the overheads question for Western Europe, and essentially overheads are flat year on year. The percentage as a percent of NSV has gone up slightly because of the top line decline.

We're just cycling through a major restructuring where we put a new operating model in place, which took out significant overheads. And, actually, it's made us a much more efficient, lean business. And right now our focus is on making that model work; and we'd expect essentially to keep our overheads flat.

James Edwardes Jones

Flat in absolute terms, rather than percentage terms?

John Kennedy

Yes, exactly.

Deirdre Mahlan

I would just say on the overhead, before I move on to the cash flow problem, that yes, it's true, because, ultimately, these are highly profitable markets, and they need to be staffed with the right kind of staff to deliver performance.

If there is an extended period of under-performance, of course we would have to look at what the appropriate adjustments are to make, but John is right, in the near term we expect it to be, in absolute terms, flat.

On cash flow, yes, absolutely, it's flat, excluding the impact of the pension contribution, so when you ex in the impact, it's down £400m.

James Edwardes Jones

Thank you very much.

Mitch Collett - Goldman Sachs

Just returning to the US, if I can. To some extent this might be caused by the rounding, but looking at the Q1 and Q2 performance it does look like a bit of a slowdown, which, given some of your comments, maybe isn't surprising. But I notice that the spirits performance has remained relatively strong in the half, and is consistent with the performance in F'12. Perhaps if you could give some context as to how spirits performed between the two quarters. I know you said in the statement that DGUSA was a bit weak. Have you got some weakness in pre-mixed cocktails and RTDs as well?

And then secondly, on Korea, perhaps if you could quantify how much of the 19% decline was market and how much was market share?

And, finally, on Spain, you've said there'll probably be a bit less destocking in the second half. Could you maybe quantify how much more destocking there is to do in total? Will the second half be the last time we should expect destocking to affect the performance of that business? Thanks.

Paul Walsh

I think, first of all, in the US, you may have seen about a 1 point difference between Q1/Q2. Talked on some of the disruptive elements; the hurricane, the fiscal cliff debate and the fact that we are lapping Ciroc Peach launch. Equally, you've heard from Larry that Q3 is off to a very good start. So I'm not concerned about the difference between Q1/Q2 in the US. The US is in very good shape.

Regarding Korea, I think the category was down about 13 points, and we were down 21 points or something like that, directionally. So you can calculate the difference between the two.

As I said, we expect to certainly improve and pull back some of our share erosion in the second half, but I do not fundamentally expect the category to improve its trajectory.

Regarding destocking, hard to call. And the reality is stock levels are a function of future demand. And, therefore, you set your stock based on how you think your future sales are going to be. If we felt, or if our distributors felt, that they were seeing stabilisation, then you'd see an end to the destocking. If they do not see that, then they will continue to wind down their inventories. So it's very, very hard to call. But, certainly as we move through this, the ability to see material further destocking is limited.

And I come back to the point, that despite the travails of Southern Europe, Diageo still has the diversity and resilience and presence in high growth markets to more than offset the problems that we're having there.

And also, Southern Europe, to put into context, is now less than 5% of our total sales. If we'd have had this discussion five years ago, it would have been closer to 10%.

Mitch Collett

Understood, but just to come back to US, I accept the difference in performance is relatively small. Is the difference more marked in certain channels? Is there more of a change in performance in the on-trade versus the off, or is it pretty much the same for both?

Paul Walsh

No, pretty much the same. But, as I said, it's very much a function of Ciroc, some disruptive elements in the market place. But we're talking about 1 point.

Mitch Collett

Yes. I understand. Okay, thank you very much.

Dirk Van Vlaanderen - Jefferies

Just some questions on Asia. Firstly, Australia seemed to be quite a good result in the half. I was wondering what your outlook was there? Should we expect similar level of growth in the second half in Australia?

And then secondly, just coming back to China, the 16% growth there, I was wondering if you talk maybe about the phasing of that growth. Was that fairly evenly spread through the half?

And then also maybe your thoughts on your market share positions within scotch in China over the half. Thanks.

Paul Walsh

I'll ask Gilbert to comment on Australia, China and, specifically, scotch in China.

Gilbert Ghostine - President, Asia Pacific

Let me start with China. We are very excited about the opportunity in Scotch in China, and we have been outperforming the category. The Scotch whisky category in China has grown over 2012 by low single digits, and we have grown by 14%.

But the exciting story about Scotch whisky in China is in Super Deluxe. The Super Deluxe Scotch whisky category in China is growing at 15%, 16%, and we grew in the first half our Super Deluxe Scotch whisky brands in China by 58%. And this is for us 2.5 years of Super Deluxe Scotch whisky growth in China north of 40%. So, excited about Scotch in China. We are gaining market share. We keep gaining market share. But the growth story in China and the excitement is coming from Super Deluxe Scotch.

Talking about second half, I am confident about our strategy in China and I can see this existing momentum continuing into H2.

Now your question about Australia, in Australia, as you know, we have a turnaround in our performance in Australia. Our Spirits portfolio is doing very well. Spirits is up for us 3% in Australia, where RTD were down 1% and the exciting story also in Australia is behind super deluxe and Johnnie Walker.

Super premium brands, in the first half for us in Australia, were up 43%, and this is on top of growing our super premium business in Australia last year by over 60%. And all of this is not only led by Johnnie Walker and Johnnie Walker Platinum, Double Black and Johnnie Walker Blue Label, but also a very exciting opportunity with Ketel One and Ciroc.

Dirk Van Vlaanderen

Thank you.

Luke Cummings - Campton Capital Management

Regarding your growth strategy, is it more focused on geographic expansion or improving your brand/product mix?

And what is your strategy regarding your routes to market in new markets?

Paul Walsh

First of all, we will continue to build our presence in the new high growth markets. You can see in this set of numbers that 42% of our NSV comes from such markets. In actual fact, if you pro forma the acquisitions that we're making, that 42% moves closer to 50%.

So we are significantly ahead of our stated goal to have half our revenues coming from these new markets by 2015 and we expect that momentum to build. And it's a law of compounding percentages. The higher the growth on a bigger base, the more accretive it is to Diageo. So we will continue that strategy.

We're very committed, by way of acquisition, to buy both strong local brands that we can further premiumise and utilise their existing established distribution infrastructure to put our global brands through. The best example of that is what has been done in Turkey. Not only have we bought a very successful business with a very successful brand that has leadership in the local category of raki, it has a distribution system that has allowed us to move our scotch market share in Turkey from 20% to over 50% in about a year of ownership. That is the template for how we will operate in these markets.

So, the prime thrust is further penetration in the new high growth markets. But, equally, we will continue to develop our business in the US primarily through innovation and growing existing brands. The US is a formidable innovation machine, that has performed incredible well and we expect that to continue.

You heard from Nick about how the beer platform in Africa is serving our spirits franchises very well. That will continue too.

Equally, there are growth opportunities in Europe. The fact that our aggregate performance in Europe was sales down 2%, despite the travails of Southern Europe, is a testimony to how we are mining those opportunities elsewhere within the Continent. And that will continue too.

So there's no one silver bullet here. It's a number of tailored strategies, but underpinning it all is further penetration in high growth markets.

Luke Cummings

Okay, thank you.

Nicolas Ceron - Societe Generale

I have two questions. First one, could you confirm that your M&A policy will still be focused on emerging markets going forward?

And, secondly, on North America, you seem very confident about the organic growth for H2. Do you think you can achieve the same growth rate in H2 versus H1 despite a much tougher comp and if yes, why? Thank you.

Paul Walsh

First of all, I don't want to be pinned down on M&A to any one particular market. We have said that our focus will be disproportionately on the new high growth markets. But, equally, if opportunities present themselves, as long as the return criteria is satisfied and as long as the growth profile is accretive to the Diageo growth, we will look at it.

But I think the very nature of what we're trying to achieve very much steers us towards the new high-growth markets, but we don't rule anything out.

Regarding North America, I do believe that the trend will continue. Larry can speak to that in a moment.

What I would say about the second half, though, is we know that in Q3 we had very strong sales performance and, therefore, I expect most of the improvement to come in Q4 and we're comfortable with that.

Larry, do you want to talk about why you're confident?

Larry Schwartz - President, North America

I think overall business remains strong as we continue to deliver NSV growth while taking industry-leading price. Most of our price is in, so we will continue that. We came through the holidays leading in price and we still think the industry is going to grow about 4.5% and we'll continue to outpace the industry with our healthy portfolio.

We're spending more above the line. We have some hot brands, as you can see by some of the results in the first half. We believe that will continue. So we think the trend for the North American business will continue in the second half as it did in the first half.

Nicolas Ceron - Societe Generale

Okay, thanks.

Jamie Isenwater - Deutsche Bank Research

A couple of questions for Deirdre, actually. I think, Deirdre, you mentioned zero-based budgeting. You didn't use those words exactly, but I wondered if you could talk a little bit about how long that's been in place, what sort of progress you're making on that side of things in terms of costs?

And I also think I'm right in saying that the results have been announced about a week earlier than they were last year so I was just wondering whether there have been any systems changes or whether actually you just accelerated the whole process? Thanks.

Paul Walsh

Over to you, Deirdre.

Deirdre Mahlan

You're right, I didn't say zero-based budgeting. I said priority-based budgeting. And that is something that we put in place a couple of years ago, which is really just focusing the business on those things that are delivering against our strategy so that the things at the bottom can be dropped off and contained and/or reinvested behind the brands. And so that's part of the efficient growth programme that we've put in place and you should expect that to continue.

On the fast close, thank you for recognising that. My team will be very pleased to know it.

We did, in fact, make a decision to move forward our reporting. We did drive some efficiencies through the automate, but they were not major systems changes. It is mostly about streamlining our processes to ensure that we can get reported early. And so well done to the entire team, and thanks for mentioning it.

Jamie Isenwater

Great. Thank you very much.

Operator

We will now return to the speakers for a final comment. Please go ahead, sir.

Paul Walsh

Good questions. Hopefully you liked the format of our presentation today that allowed some digestion of the facts before we actually orchestrated this session.

This is a business that I think has performed well and is very well placed to continue to perform well. Thanks for your support and I look forward to meeting some of you over the next week. Thanks.

[End]