DIAGEO INTERIM RESULTS CONFERENCE CALL WITH MANAGEMENT

Ivan Menezes -- Chief Executive Officer of Diageo, and Kathryn Mikells – Chief Financial Officer of Diageo

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Ivan Menezes:

Hello everyone, and welcome to the call. We've got a good set of results to talk about this morning. Hopefully, you've had a chance to look at the press release and our presentation.

Just on top line, we're delivering our strategy, continuing our performance momentum, and progressing on the three priority focus areas we set for fiscal 2017; scotch, the US, and India.

Net sales growth has improved. We had good volume growth and mix, our productivity programs are on track, and cash delivery remains strong.

So with that, Kathy and I are here to take your questions, so let's open the line up for questions. Operator, over to you.

Sanjeet Aujla:

Three on my side, please. Firstly, can you just give us the exact US depletion numbers, just to see where you are versus the broader market? And can you just tell us if you expect the gap there to fully close in the second half still?

Secondly on scotch, strong growth in Johnnie Walker, but primary scotch, which is a big initiative, only grew 4 percent. What's the weakness there and what's going to improve the performance?

And thirdly, your margins. Would you be able to give us some numbers behind the productivity savings and the momentum you're seeing there, please? Thanks.

Ivan Menezes:

Sure. Good morning, Sanjeet. I'll take the first couple and ask Kathy to talk about the margins. On depletions, the US depletions value is running ahead of shipments and it's around 4 percent, slightly over 4 percent.

This also reflects momentum off the F16 run rate. So underlying depletions, I'm pleased with. And, in fact, if you look at it at a brand level, we have much more consistency and broad based performance coming through in the quality of depletions that's coming through.

Your second question on primary scotch, we are actually very positive on the primary scotch development. There are a few technical factors in some markets which are holding back in the first half but otherwise when you -- I'm very positive.

So, I wouldn't read too much into that 4 percent. We expect it to improve as we get into the second half and beyond. We've made this a strategic focus, so brands like Black & White continue to really do well in Mexico, India.

We've taken Bells into a number of markets at a primary price point. That's also doing very well. So, we're on track and there were a few markets that had some technical comparisons in the first half. Underlying confidence remains strong.

Kathryn Mikells:
And I'll go ahead and talk a little bit about margin progression at the Company and overall, how productivity plays into that. And so, if I went back to the time at the AGM meeting, we had discussed that for the first half we expected to see a little bit of pressure on margins coming out of two things;

So, one, we were lapping the sale of the UBL shares last year. That gave us a GBP28 million gain last year. And then, as we've really been ramping up our productivity program, we're incurring some upfront costs associated with that which we're flowing through the P&L.

We're not taking them as an exceptional. And, as you would expect in ramping up the program, that's a little bit heavier in the half.

As we look into the second half, those costs should be lighter. The benefits from the program across our P&L are accelerating and that's really going to help to drive margin expansion in the second half.

So, I would say overall, as we look at our three-year goals for productivity, we have to get a great number this year because we've got to offset the fact that we're embedding those costs into our base this year that are running through our P&L, but we're feeling very good about where the overall program's at.

We're really picking up momentum across the Company and across every aspect of the business. So we should exit in a really good place at the end of this year.

Sanjeet Aujla:
Just a follow-up on the US please, Ivan. Where do you think US market depletions are …?

Ivan Menezes:
Sure, the market, we figure for spirits is running around 4 percent to 4.5 percent is where it is. So, from a depletions standpoint, we're getting in line.

If you look at the Nielsen and NABCA data, we're still slightly behind, but I'm very pleased with the momentum because relative to where we were a year ago, you can see consistent improvement come through.

So, what I said at the start of this fiscal year, we expected to be in line with the market at a run rate as we close this fiscal year, and I expect to be at that.

Sanjeet Aujla:
Great, many thanks.

Simon Hales:
Three questions as well, please. Firstly, Ivan, could you talk a little bit more about how the demonetisation actually affected you in India and your business on the ground in the half? I'm just trying to understand a little bit more how it really affected day-to-day sell-in and how we should think about quantifying the ongoing impact that you mentioned as we move into Q3.

Secondly, you've had now a very encouraging, I suppose, 12 months out of Europe, with growth rates running at around about 5 percent and you flagged in your presentation, Ivan, some of the excellent work you've been doing on the ground to support that.

How do you think about the midterm opportunity for growth in Europe now? Is it a mid-single growth sort of region, much stronger than we've seen perhaps over the last three to five years?

And then finally, maybe one for Kathy. You're still guiding towards a 21 percent tax rate, Kathy, and you're flagging again the focus on governments pushing up potential tax rates for multinationals. Perhaps the exception may end up being the US where you've clearly got a very big business.

How do you think about the possibility if we do get corporate tax reduction in the US; that having a significantly positive bearing on your Group tax rate?

Ivan Menezes:
Sure, I'll take the first two, Simon. On demonetisation, firstly, if you look at the spirits business in India, we sell in about 60,000 outlets compared to I'd say classic FMCG which could go up to as much as 8 million, 9 million outlets. So we tend to have bigger, better capitalised retail structures and distribution chains in place.

We did a lot of action and moved very quickly to support the business while this was happening, including putting customers on direct payments. We were getting them set up to take credit cards and debit cards and our team worked that very effectively.

We reported a fall in the first half on NSV in India. We reckon the impact was probably about 3 points in the first half, of demonetisation, and we expect that now -- that was just two months of demonetisation really playing through the half. We expect the impact to continue into the third quarter.

Clearly, things are getting better. In the urban markets, normality is returning in terms of the availability of cash for consumers. As you know, 80 percent to 90 percent of consumer transactions are in cash. The rural markets are still a little challenged. There is still a quota on the amount of cash you can take out every week.

So we believe we're on an improvement trend, but that clearly, we expect to see some impact in the third quarter.

On your Europe 5 percent, I would say I would be happy with Europe consistently delivering at 3 percent to 4 percent.

We saw some fantastic performances in Continental Europe, in Iberia, Germany growing double digit. I think a more prudent place to assume Europe, which is what I've said now for a few years, getting Europe to a steady 3-plus- percent enables Diageo to deliver its medium-term guidance. Obviously we're going to be shooting for more and keeping the momentum we've got.

I'm really pleased with the share gains we are seeing now coming through in Europe. And as I showed in my presentation online, this is coming through very consistent improvements and executions that have been happening over the last few years. So I'm feeling very good about Europe.

But I'd just be a little cautious on the environment as well. There is -- potentially, the external environment has some more downside risk. So my view would be 3-plus- percent is steady; is a very good outcome for Europe.

Kathryn Mikells:
And then I'll take the last question. You referenced our 21 percent tax rate and overall, the external environment clearly is continuing to change when we specifically look at the corporate rate overall in the US and some of the things they're talking about there.

Ultimately, tax is a lot more than just about the headline rate. I think we've really got to wait and see where policy lands in the US and then we'll be able to better assess things.

Simon Hales:
Thank you. Thank you very much.

Fernando Ferreira:
A few questions please. First of all, I was hoping to get some colour on depletion trends. In some of the markets, you posted very strong sales growth, like China, Continental Europe, Mexico, Colombia and what can we expect for shipments in H2?

Also, when we look at vodka in your North American business, do you think we're close to the end of the price-reduction cycle as you mentioned that depletions have started to bounce back?

And then lastly, in scotch, we haven't seen yet signs of price realignment, right, following the greater competitiveness in scotch. So is that something that still might happen, or not, given that sales growth was pretty solid? Thank you.

Ivan Menezes:
Sure. Hi, Fernando. On overall depletions, we've guided that we expect the top-line growth rate for the second half to be in line broadly with the first half.

There are some slight ups and downs. We mentioned Chinese New Year had a bit of an early buy-in in China. But I see nothing significant that needs to get drawn out.

We will see growth rates go up and down on shipments, just based on some of the technical factors playing out in markets.

So, overall, I would expect our depletions momentum that we see in the first half to continue into the second half, with some slight adjustments by market.

On vodka, for the most part, I'd say the pricing adjustments in Smirnoff have happened. We did a bunch of them last year and we've made some more in the course of this year.

As we go into FY18, on Smirnoff I don't expect a lot more. We've still got some to do on Ketel. Ketel One, the price gap has widened, or in certain states and pack sizes, it's too wide and we will be looking at getting to the right competitive benchmark on Ketel One.

But compared to FY16 and fiscal 2017, I would expect vodka pricing in the US to stabilise as we go into FY18.

And then finally on scotch, as you see, the momentum on scotch is positive. It’s broad based; we're seeing it across all markets and regions. Johnnie Walker's strong.

The primary scotch whisky momentum will continue and that actually is our main lever to compete against mainstream local spirits and get that entry level of scotch consumption start in markets like Mexico and Brazil and India, etc.

We are making some price adjustments in a few markets. I don't expect it to be major. And certainly, as we look forward, I don't expect a major correction on scotch pricing or margins happening. They'll be more tactical and market-specific where we are out of line.

So, overall, I'd say the health of the brands and the underlying momentum gives me a confidence that we can continue building quality, volume and top line at the current pricing levels.

Fernando Ferreira:
Great. Thanks a lot, Ivan.

Nik Oliver:
Two from my side. Firstly, on the efficiencies in marketing. Can you just provide a bit more colour on where they're coming from? I think you mentioned consolidation of ad agencies, but any other sources, such as trade marketing, etc.?

And secondly, on the growth in LatAm, organically up 11 percent on net sales, all led by price mix. Can you give a sense of how much of that was inflationary pricing; and how much was positive product mix? Thank you.

Ivan Menezes:
Sure. I'll take the second one, and ask Kathy to talk on the first. So in LatAm, I think you've got to look at it at a market level. So a market like Mexico, we had very solid volume growth and value growth. Mexico grew volumes about 20 percent and we had organic NSV growth also at about 20 percent.

We have -- in Brazil, the volumes were tough, as was the NSV: we were down -- this is Paraguay, Uruguay and Brazil throughout, we were down 6 percent.

In the other markets, we had a good volume growth, and in Colombia and Venezuela, Venezuela the volumes were down, and that impacts -- and the organic sales that the new currencies show up.

So, overall, if I just leave the Venezuela impact aside, Latin America is performing well on a share basis and I would expect the volume growth to improve as we go forward.

We are gaining market share virtually across the board; in 80 percent/90 percent of our battleground in Latin America, we are performing and beating the competition. The quality of execution is very strong, and I expect the momentum to continue and volume to improve.

Kathryn Mikells:
And then just in terms of A&P spend in marketing efficiency that I mentioned. So this is something we've been working on for a couple of years, so you would have seen us in the last fiscal refer to this as well.

And what we've really been doing is trying to consolidate our spend with agencies: fewer agencies, bigger buy with fewer agencies, which gives us more leverage in the negotiation with those agencies, by consolidating our spend.

And then, really importantly, I spoke to ways of working, and that's really about making sure that we're using the agencies for the things that they really do well, and working with them efficiently, so we don't use them for more than the things that they do really well. And that's very much about how we work with them.

I'd then point to, as we look forward, something we'd refer to as marketing effectiveness. I mentioned in the presentation that was webcast earlier today that one of the things we're doing is we're deploying a tool we call a catalyst tool into our markets.

What that tool does is it really grabs both internal data and external market data to enable us to really look across our brands; look across our programs; look across how we're mixing our media, in terms of how we're spending our A&P and do it much more effectively, with better data and information, so that we're really targeting it towards the opportunities where we have higher returns.

So I would expect to see, as we're moving forward, for us to start to get more benefits from an effectiveness perspective as that tool is deployed, and people are trained up on it. And we will continue to work on efficiency, but we've really seen efficiency benefits more flowing through in recent period.

Nik Oliver:
OK, that's very helpful. Thank you.

Olivier Nicolai:
I've got three questions, please. First of all, you're expecting organic margin progression this year. Does this assume that marketing spend as a percentage of sales would be stable on the full-year basis compared to 2016?

Secondly, on slide 24 you have indicated that your hedge rate dollar/pound for 2017 is 1.45. What will it be for 2018, please?

And just lastly, just to follow up on Latin America which was very strong in H1, except for Brazil. Regarding Brazil, are you more confident about Brazil in 2017, or do you still expect the market to remain weak for the next 12 months? Thank you.

Ivan Menezes:
Sure, Olivier. Let me take Brazil, and then I'll ask Kathy to answer the first two.

On Brazil -- I'm sorry, that's Nicolai -- on Brazil, I don't expect it to get better. I think it's prudent to assume that conditions are going to remain difficult. We are focused very much on supporting our brands and ensuring, from a market share performance, we're healthy.

The mood music in Brazil is a little better, but I'd say it's still quite a volatile situation in terms of how the politics are going to play out. And the approach we're taking as we look forward is not counting on getting external help in Brazil over the next year.

Kathryn Mikells:
OK, and then just in terms of overall our organic margin progression. We are expecting to start to reinvest more of our productivity savings, specifically in A&P; and so we'll be up weighting A&P in the second half as a result.

If you try and think about the full year, I would say we'd expect A&P as a percent of sales to be more in line with what we saw in FY16, again with that increase coming through in the second half.

As you look at overall FX and the FX benefit that we've guided to on OP for the full year of roughly GBP460 million at this point, that's roughly split about 70 percent translation and 30 percent transaction.

As we've talked about, we do hedge fairly far in advance, and so as we look forward, we're already fairly hedged, especially on US dollar, as we look at FY18.

So we'd expect to continue to see a transaction benefit. Translation benefits, in terms of running through to OP for FY18, really have run its course at this point. But from a transaction perspective, we would expect to see a FY18 benefit. We'd expect that to be less than what we're seeing in fiscal 2017; again, simply because we're hedging fairly far in advance, and so our hedge book is still going to have a higher rate baked into it.

Olivier Nicolai:
Thank you very much. And if I may, I would also like to thank Catherine James for all her help over so many years. And I think -- I believe it's her last set of results today.

Ivan Menezes:
Thank you, that's very nice of you. Good to recognise Catherine at the end, but thank you for saying that.

Olivier Nicolai:
Thank you.

Ed Mundy:
Two questions, please. The first, just going to slide 21 of your pack this morning. I think there's a comment in there about you being excited about the opportunities that the works and the productivity program is opening up for Diageo. Is that opportunities over and above the existing GBP500 million? And if there are opportunities over and above that GBP500 million, would you look to reinvest those back into marketing spend to drive the top line?

And the second question is on Crown Royal in the US. Clearly, very, very strong momentum at the moment. How do you think about the risk of higher taxes on Canadian imports following the change of US administration?

Ivan Menezes:
Let me take the second and I'll ask Kathy to talk about productivity. The Crown Royal momentum, as you point out, it's strong, continues to be strong. We've got the underlying depletions running at about 10 percent growth and real strength across the whole franchise.

It's too early to speculate on where tax reform in the US is going to go, but we're obviously close to the situation both as Diageo and the industry. And nothing's really been decided, or there's no firm policy legislations in place, so it will play itself out. But we are confident overall we'll be able to manage through the Crown Royal situation effectively.

Kathryn Mikells:
And then specifically, I'll circle back to the GBP500 million of productivity savings and over the three-year period and how are we feeling about that on the basis of the first half.

Obviously, in this first year, because we're taking the costs associated with productivity and flowing them through our P&L, we need to outperform on productivity to just make sure that we're able to absorb that cost since we're not taking it as an exceptional.

I feel very good about where we're at for the half and the trajectory for the full year. I think that's going to put us on very good footing for fiscal 2018.

Over the three-year period, I would look for us, and certainly, we have a good degree of confidence, in delivering that 100 basis points of margin expansion over the three-year period.

So I think when you look at our results today and what we said about the expectation of margin progression in the second half, it puts us very much in line with what we've guided to over that midterm period.

Ed Mundy:
Great, thanks. And just as a quick follow-up, I think, Ivan, there were some comments on Bloomberg earlier saying that you're confident that the UK will get the same or better trade agreements post Brexit. I was wondering if you're able to elaborate on that a little bit?

Ivan Menezes:
If you look at the current trading arrangements in our category between the UK and the US, they're pretty good. We trade pretty much without tariffs. So that was my point: we've got good arrangements today, and now we'll see in terms of where the overall tax reform goes. So that was my point, was we're starting from a good place on the US/UK spirits trading arrangements.

Ed Mundy:
OK, thank you.

Ivan Menezes:
The only other point I'd make, which is the message clearly we are getting across or the industry's getting across, when you have brands that have provenance, that can't be produced anywhere else, like scotch whiskey or Canadian whiskey, that's part of the argument the industry will take into this debate on tax reform.

And the second thing I would say; ours is the category, unlike a lot of categories out there, which is subject to a federal tax already. We have a federal excise tax on spirits, and those are some of the arguments we'll be taking into the shaping of legislation here.

Anthony Bucalo:
On that issue of US tax reform, I think there's another issue here that's NAFTA which I guess there's been some discussion by the new administration of tearing up NAFTA and possibly starting over. Does that present any risk to your business on the tariff side maybe for Canadian whiskey or for tequila?

And the second, just a quick question, is that I noticed that scotch whiskey appears to have rebounded in China. Is that your brands or is that a category rebound? Is that just a loading ahead of Chinese New Year or is there something -- or all three? Is there any good news coming out of China on the scotch side?

Ivan Menezes:
If I take China first, I'd say the scotch category we see as broadly flat. We are outperforming it, but the underlying sellout momentum is strong for us, so both on the super deluxe, the Johnnie Walker Blue and malt as well as on Black Label. So we're in a healthier shape.

I'm looking at scotch at about a mid-single digit growth rate for us. The category is still weaker, but should be roughly flat is the way we see it right now. And so I expect mid-single digit on scotch to continue.

On NAFTA, again Anthony, we've got to see what happens. The WTO arrangements, for example, trading with Canada would not have tariffs on the spirits category, but we're going to be watching and clearly working closely with how legislation gets shaped here as an industry and as Diageo.

Anthony Bucalo:
OK, so you're not seeing a lot of risk from any major changes in NAFTA then?

Ivan Menezes:
I think it's too early to speculate. There isn't a clarity at all as to where the Trump administration is going to go on both tax reform and the implications of a NAFTA renegotiation.

But certainly, if you look at -- if you break up a free trade agreement and you revert to existing WTO rules, there's not a major impact for us.

Anthony Bucalo:
Great. Thank you.

Trevor Stirling:
Three questions from my side as well. First one, I'm looking at the scotch business which did very well overall; a strong performance in Johnnie Walker and very strong from Buchanan's, but maybe the malts slightly weaker.

If you had to pick out which countries and variants drove the performance of Johnnie Walker and Buchanan's, and then likewise, where do you see the upside of the malts? Some colour there would be great.

Ivan Menezes:
Sure. I'd say that performance on Johnnie Walker was pretty broad based. We made scotch a very important priority and Walker a very big priority across the world.

So you're seeing strong momentum in the US, way up to 6 percent, 7 percent, 8 percent NSV growth in the US. Latin America solid; Europe very solid, Continental Europe did really well on Johnnie Walker; India, up 23 percent.

In Asia we had some corrections, two places. One was Thailand, where clearly, in the first half, we had a much weaker half, given the situation in Thailand. And global travel Asia, we've changed some customers terms, so the Johnnie Walker business there is a bit weaker.

I feel very good about the health of the brand, the equity measures, and the market share we're seeing. Africa was strong, very strong with Johnnie Walker, including markets like Nigeria, up strong double digit. So the Johnnie Walker performance is robust.

Malts, you're absolutely right, Trevor; I'm disappointed in the malts performance. There are a few technical factors, but we're going to get much stronger performance out of malts.

The US did very well. They had double-digit growth in malts. There were some corrections we made in a few other markets, including travel retail, but the malt performance should be better.

Trevor Stirling:
So the second question, it's a bit of a technical one, but India was up I think 4 percent organically. IMFL was up 11 percent. What was it that was the offset that offset the very strong IMFL performance?

Kathryn Mikells:
Yes, it's the popular brands, and so if you look overall at India being up and prestige and above being up 11 percent, it's the much lower-value popular brands, which is really not our strategic focus within the business, that has declined.

And I would have noted one of the things that they talked about on the USL conference call is that we're actually doing some franchising arrangements with some of those brands in certain states, really recognising that the centre of gravity within the business is really in the prestige and above category.

I said that grew 11 percent and, importantly, when they look at the last three quarters, we actually gained share in that important segment, all three quarters.

Trevor Stirling:
Got you. Thank you, Kathy. And the final question, I note at the back of the press release that you talk about discussions are ongoing with HMRC around transfer pricing, and I was wondering if you were able to give us any more colour on that.

Kathryn Mikells:
I'd say the external environment on tax continues to change and so we continue to update our disclosure. Then transfer price, as you know, is the price that we set, kind of arm's length basis

within the Group, for all our goods and services and is a typical place that we would look at with countries. We have a very open and transparent relationship with HMRC, and so it's something that we're discussing with them.

Trevor Stirling:
Could I just clarify, Kathy, that was basically about transfer pricing into the UK and, therefore, the profit, if you like, under consideration, is relatively small in a Group context?

Kathryn Mikells:
So transfer pricing would be about all the goods and services both in and outside of the UK. And I would say it's one of the things that any country would look at. It's naturally under review in the context of any audit.

Trevor Stirling:
Great. Thank you very much, Kathy.

Andrea Pistacchi:
It's actually Andrea Pistacchi here. I have three questions, please, the first one on your US margin. In the recent past, you said not to expect too significant margin expansion in the US.

Obviously, you're at the very high level already. Yet you've delivered another very strong performance; margin's up 130 basis points. Marketing efficiencies there, one of the reasons, and you flagged that this will ease. Ivan, the other driver seems to be strong mix.

Is there any reason why mix should slow? Should we see the current pace of mix continuing to be a meaningful margin driver going forward?

A second question on the US. Now, one of your smaller competitors who reported recently flagged a slowdown in the market at the end of the year.

Nielsen also captured this, but there were some technical factors I think behind the weak Nielsen data. Have you seen, in December or recently, any slowdown? Or is there anything to indicate this could happen?

And the third question, I was wondering whether you could quantify, at least broadly, the upfront costs related to the productivity program, or what portion of the margin, [like in] other operating expenses, was attributed to this. Thanks.

Ivan Menezes:
Sure, Andrea. Let me take the first two, and I'll ask Kathy to take the third.

US margins, yes they were high in the first half, in part driven by the marketing efficiencies, etc. I don't expect that to continue. They will reverse into the second half. We'll still have good margin expansion for the year, but we will be spending more in the second half on marketing.

And I think going forward, as I said, I do not expect -- we're getting very good mix. Do I expect mix to continue? Yes, but we will also subdue it as things like we want to get our value brands performing better.

And, in fact, in this half, the rate of decline on the value brands did reduce, but I would expect that to continue. I would expect brands like our mainstream brands, like Smirnoff and Captain Morgan, to do a bit better.

So the level of mix improvement you've seen here, will subdue some. But overall, the US -- and then finally, I'd say this is the priority market for reinvestment. So, as we see opportunities to spend more, where we're confident of the return, we will be doing that.

The second question on the December slowdown, if you look at the Nielsen, there was a bit of a slowdown in December. As I've talked to the team and talked to our customers, distributors and retailers, there's nothing that suggests there's a shift in the underlying demand for spirits, and the trends underway. So I wouldn't yet read anything that suggests a slowdown there.

If anything, I would say if consumer confidence continues to build, I would expect the on-premise to do a bit better. And so we hold to our forecast of US spirits growing value in the 4 percent, 4-and-a-bit- percent range.

Kathryn Mikells:
And then again, I'll come back to the discussion about productivity and costs and just the margin progression. The big pop when you look at our margin year over year, in the half, is the UBL share sale that was worth 43 basis points, just in terms of that being in the comparable period.

As it relates to the upfront costs of productivity, that really, for us, is more of a phasing issue and getting them embedded into our base this year, because we're not ex-iteming this year. We're not going to ex-item next year.

And there will be ongoing costs associated with productivity where we've got to spend a little bit of money to save a whole lot more money than what we're spending here, but that is going to be baked into our base this year.

And even with it baked into our base, we're still on a track to have good margin expansion in the second half and deliver a full-year margin expansion consistent with the three-year guidance to get 100 basis points over three years.

Andrea Pistacchi:
OK, thank you.

James Edwardes Jones:
Your new Chairman's been in place I guess only for 3.5 weeks now, but can you give us any idea as to any ideas that he's spreading around the business? What sort of changes we should expect to result from his appointment.

Ivan Menezes:
Javier has been on the Board since July and he has taken over as Chair from January. He just chaired his first meeting the last couple of days. And he's been using his time to get around the business, meet the teams, and understand the business.

I expect I'll be able to -- we've seen him in action. He's going to be a great Chairman for this Company, aligned with our strategy and where we are going. He brings a terrific background and I'm looking forward to working with him.

James Edwardes Jones:
Can you be any more specific than that, Ivan?

Ivan Menezes:
Well, you know where we're going with our strategy and our performance ambition, and I'd

say Javier is aligned in terms of supporting us to achieve it.

James Edwardes Jones:
Right. Thank you.

Tristan Van Strien:
Got three questions, if I may. Just the first one, I understand there's a ruling lately in India that's going to ban liquor stores from 500 metres from the highway. It's coming, in fact, in April. So I just wanted to understand what proportion of your current 60,000 outlets are impacted by that. And can we expect some kind of destocking in the next quarter because of that?

Then the second one is around tequilas. Don Julio continues to be very strong. So can you give a bit of colour on perhaps the demographics and occasions that is driving that; who, what, where, when of tequila perhaps in the US, to understand the consumer insights around that?

And then lastly, a follow-up on the transfer pricing question a little bit. I'm curious to understand why you've chosen to produce your IMFL brands in Benin rather than in Nigeria, especially considering some of the historical border issues between the two countries. Thank you.

Ivan Menezes:
Benin is in Nigeria, Tristan. That's the --

Tristan Van Strien:
Oh, so not the country next door?

Kathryn Mikells:
Yes, yes.

Tristan Van Strien:
My apologies.

Ivan Menezes:
It's where our brewery is, yes.

Tristan Van Strien:
OK.

Ivan Menezes:
On the India ban, we're watching and understanding it closely. Retailers and state governments are looking at the ruling and figuring out how and where to implement it.

It impacts about 30 percent of the outlets. We will -- obviously, we're following it very closely and looking at how to manage our way through it. Will there be some short-term disruption? There will. Is it going to impact the long-term attractiveness of the business? No, it won't. And our team is literally, as we speak, following every move and ensuring we minimise the impact for us.

Don Julio, as you point out, a jewel of a brand. The way -- if I look in the US, what has happened in tequila is a lot like what's happening in whiskey around the world. This is a very high-interest category where consumers are looking for better quality products, the differentiation in the price points and the quality of the liquid. Authenticity plays a big role. The appreciation of quality and branding demands a premium.

You've got two broad spectrums. Tequila is clearly strong in the Mexican-American market and Don Julio does very well there because it is the authentic, original, leading ultra-premium tequila in its home market. There are some other tequilas which are upstarts. Don Julio is the original. And that helps in its franchise in the Mexican-American market because Don Julio is doing very well in Mexico as well.

But the crossover into the general market is also very, very strong. And what we're seeing is ultra-premium tequila, in particular, is a very hot segment, lots of interest, lots of bar call.

If you just go into the on-trade in any city in the US, tequila is a very major call not just in margaritas but in other forms of cocktails and on the rocks and so we're well positioned for it.

Don Julio does really well in the on-premise. We have a very high share of our business running through the on-premise and that bodes well for the future of this brand.

Tristan Van Strien:
Just a follow-up. So would you say disproportionately to the rest of your portfolio, Don Julio is

more geared towards the on-premise at the moment?

Ivan Menezes:
It would have a higher proportion in the on-premise than the rest of our portfolio. That is correct.

Tristan Van Strien:
Brilliant. Thank you.

Matthew Webb:
I just wanted to clarify the guidance on the marketing spend as a percent of sales, where I think you said it would be in line with FY16. Firstly, does that guidance refer to the whole of fiscal 2017 or was that just referring to H2?

Secondly, and sorry to be pedantic here, but is that guidance on an actual basis or on an organic basis, just because there's a bit of a difference between the two I think in H1.

And then thirdly, just to be absolutely clear, are you talking about the actual level of marketing spend here rather than what you could describe as your real level of marketing spend after factoring in cost savings? Thank you.

Kathryn Mikells:
Sure. Yes, yes and yes. So …

Matthew Webb:
OK, that's very efficient.

Kathryn Mikells:
Yes, we're referring to the full year. It is on an organic basis and we're not talking about underlying. We are expecting we're going to unweight A&P pretty significantly in the second half which is consistent with all of what you just said.

Matthew Webb:
Got it, got it. That's very clear. Thanks very much.

Laurence Whyatt:

Two questions from me. Firstly, on Crown Royal going into the US, it saw a very good performance in this half year. Could you give us some sort of idea as a split between the core Crown Royal brands and then the flavour variants that you've been putting out? I notice that Vanilla's been doing particularly well recently. And how much growth is coming from, say, Regal Apple and Vanilla in the core brands?

And also on Crown Royal, do you intend to continue to put out flavoured line extensions? And if so, how many flavours do you think the brand can sustain?

And then one question on India. You currently got 55 percent of USL, and India seems to be a very good growth market for you and you're pointing towards strong long-term drivers. Why would you not want 100 percent of the company or do you and would you like to implement that change? Thank you.

Kathryn Mikells:

Yes, so I'll start on Crown. I'll give Ivan the question about product flavours, which he can talk about overall in terms of our philosophy and overall approach to Crown.

So if you look at Crown, I think what's really important as you introduce new innovations is underlying how, overall, the trademark and core variants.

And so our core variant, Deluxe, continues to be in growth. Obviously, more of the overall growth right now would be driven by both the introduction of Vanilla, as well as now we're in the third year with Apple.

And what we've seen is Apple really recruited new people to this brand. It participated in a different occasion than Deluxe, much more orientated towards the shot occasion. It actually recruited more women into the trademark and we're very, I'd say, hopeful at this point, that Vanilla has launched really well. And again, we think it's going to be able to recruit new people to the trademark.

But overall, the base Deluxe is also in growth and the trademark is incredibly healthy.

And I'll hand it over to Ivan.

Ivan Menezes:
Yes, flavours; very, very clear, we're not going to be proliferating flavours on Crown Royal. We do some limited-time offers to bring excitement into the category. We are really going to watch how Apple and Vanilla perform.

The test for us is that flavour needs to bring new consumers to the franchise and it needs to add to the core brand equity, brand health. And we've seen, as Kathy talked about, Apple did that very strongly.

We really expanded the franchise. And it helped the base brand because we have base Crown Royal growing low-single digits right now in Nielsen and NABCA. So we're going to be very careful with whiskey flavours. And we're also learning a lot as we introduce them into the Crown franchise.

On India, we are satisfied with our position right now and, as you would expect, we always look at, is there a point in time we would want to take more. But I'd say, I wouldn't comment beyond that.

We have control of this Company. We've got a very high-quality Board in place, a strong management team player strategy and the strategy's working.

So, as we do in our other publicly-listed companies, we will always look from time to time as to whether we want to take up our stake or not but we're satisfied with where we are.

Laurence Whyatt:
Thanks. And just perhaps a quick follow-on on the Indian business and a follow-on to an earlier question. Could you give us a split of USL's sales, the different price points within Indian spirits? So you talked about the lower end and the more premium end and then the imports. Can you give us an idea of how that breaks down as a percentage?

Ivan Menezes:
Yes, what we call prestige and above, is about 60 percent of the business in revenue terms, a little more than 60 percent. And that's the competitive space where we are strategically focused, prestige and above.

And on the popular, as Kathy talked about earlier, we are looking at franchising some of that business out. But prestige and above is where the action is. That's where our business grew 11 percent in the first half. That's where we're doing a lot of our renovation, innovation, marketing and that's what's going to drive the margin expansion for USL over time, is getting the mix move up.

Laurence Whyatt:
Thanks. And so how does the remaining 40 percent split between the popular and the imports?

Ivan Menezes:
No, imports sits in prestige and above, right. So all our imports are in the 60 percent.

Laurence Whyatt:
Understood. Thank you very much.

Chris Pitcher:
Not many left after all that. A couple of questions. Firstly, on India; the performance through the quarter with demonetisation was certainly better than we were looking for.

Can you say how much of that was helped by extended credit terms to your customers? I noticed your receivables go up. We don't get the detail, or at least I haven't seen the detail at USL for the period balance sheet.

And then secondly, on Tanqueray; very good performance globally, gin is doing well, but with the big exception of the United States. Will you be putting a lot of money behind Tanqueray and gin to try and get the category going in the US? Thanks.

Ivan Menezes:
Shall I do Tanqueray and you do India?

Kathryn Mikells:
Yes.

Ivan Menezes:
On Tanqueray, I agree with you, Chris. The US needs to be doing better on Tanqueray and Tanqueray 10. We will be putting more investment behind the category.

It's interesting; the explosion we've seen in ultra-premium gin in Europe has not yet translated into the US in a meaningful way. However, I do believe it will improve.

And one of the things we're doing, for example, in adding to our activation army, is putting reserve ambassadors into the on-trade in a much bigger way in the US, and Tanqueray 10 will certainly be one of the brands we want to be building. So I'd say expect better performance on Tanqueray out of the US and we will spend more on it.

Kathryn Mikells:
And then, just as it relates to demonetisation and overall the working capital situation on receivables in India, the receivable situation is really not triggered by demonetisation. It's more just within certain states and certain customers that they have a little bit more slower receipt of payment there and not something that we would expect to be long lasting.

In terms of the overall impact, and I'd say the fact that they ended up doing a little bit better I think than where expectations were at, there's both a little bit of delay in terms of when it pulls through relative to what's happening at the retail level and there were a lot of activities. So our business, fairly urban-centered, the impact certainly more heightened in rural areas.

And then from a business perspective, there was a very big effort to try to get electronic payments into as many retail locations as possible. So India clearly is much more of a cash-driven economy, as Ivan referenced earlier, but there was a very big push to make that happen to also help to address the situation.

Chris Pitcher:
Thanks very much.

Ivan Menezes:
Great. Thank you, Chris. And thanks, everyone. Appreciate you taking the time for the call.

I hope you see, as we do, that we are confident for Diageo now in terms of delivering our midterm guidance of mid-single digit top-line growth and 100 basis points of margin expansion in the next three years.

The business is strong. The team's executing well. And we look forward, Kathy and I, to meeting many of you over the next few days and weeks. Thanks, everyone.