

Diageo F20 Interim Results Investor Q&A Call

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Operator: Good day, and welcome to the Diageo Interim Results Investor Q&A Call. Today's conference is being recorded. Your call today will be hosted by Diageo's CEO, Ivan, and CFO, Kathy. To ask a question today, please press star one. We are now ready to start the call. Ivan, please go ahead.

Ivan Menezes: Thank you. Hi everyone. Kathy and I are in London, and welcome to this morning's post-results investor call.

I'm pleased to share with you another set of good consistent first half results with broad-based organic growth across regions and categories. As you know, we are lapping last year's very strong first half and we have faced volatility in specific markets. And therefore, pleased that despite this, our performance is in line with our medium-term guidance of 4-6% organic sales growth, demonstrating our increased resilience as a business.

Our margin expansion continues even after three strong years, despite increased COGS inflation in this half. And this is a result of our continued focus on premiumization and driving everyday efficiencies. I'm particularly pleased with the strong growth in the US, our largest market, as well as good growth in Africa and Asia-Pacific, which more than offset challenges in India, Latin America and the Caribbean, and Travel Retail.

Across categories, tequila, Canadian whiskey and Chinese white spirits all grew double-digit, balancing softness in our scotch performance. We remain confident in the underlying performance of our scotch portfolio as the challenges were quite localized to a few specific markets. We made significant improvements in our AMP effectiveness through leveraging our proprietary tool catalyst and our strengthened consumer insight-led marketing campaigns.

This gives us the confidence to continue to grow A&P ahead of sales and we're seeing tangible results from this upweight in investment. Innovation remains a key growth driver for us as we recruit new consumers and occasions to our brands, as evidenced by the sustained growth of variants such as Crown Royal Regal Apple.

In the context of the market-specific challenges we saw in H1 and continue to face, I now expect the full year organic net sales growth to be towards the lower end of our medium-term guidance at 4-6%. I continue to expect organic operating profit growth to be roughly 1 point ahead of net sales for the full year. However, we won't be immune from any significant changes to global trade policy.

On the evolving Coronavirus situation in China, we continue to monitor this very closely. Our primary concern is the welfare of our employees and ensuring they have all the available information and support as the situation evolves. There will be an impact on performance. However, it's too early to be able to quantify this at this point in time.

So we remain focused on sustainably building our business through the disciplined execution of strategy to deliver consistent and resilient performance. And with that, we'll open up the line for your questions to Kathy and myself. Thank you.

Operator: Our first question comes from Simon Hales with Citi.

<note: Inaudible question due to bad connection as Simon disconnects>

Operator: Thank you. Our next question comes from Sanjeet Aujla with Credit Suisse.

Sanjeet Aujla: Morning, Ivan, Kathy. I think Simon was trying to ask this but I'll go ahead and continue. Just on the lowering of the guidance, can you just walk through the moving parts of that because on the one hand, you do have easier comparatives in the second half of the year across many parts of your business; however, the guidance implies no acceleration in the second half. So it'd be great to walk us through the key assumptions there and also if you would have lowered the guidance if it wasn't for the Coronavirus outbreak in the past couple of weeks?

Kathryn Mikells: Sure. I'm happy to take that. I would start with, and you'll recall that when we discussed our full year results from last fiscal, one of the key themes we had in terms of the strong results that we delivered was it was a quite muted year in terms of volatility. And that was part of what caused our outperformance.

If you look at what we're seeing in the first half, I would say we're seeing more volatility across the world and that's impacting our results. And we're not expecting that situation to necessarily improve in the second half. If you look at the places in the world where results were a little softer, I would point to India and the fact that in India, this is largely as a result of just the softening economy in India. And I'd say there's a lot of uncertainty associated with when and how that's going to improve.

As we look to the second half, we would be quite cautious about the economic situation in India. We pointed out specifically within our PEBAC market, Peru and Chile as being places that have been impacted by disruptive social unrest, and again, that's a situation that continues to be difficult. Mexico is also a place where we've seen just the overall economic environment weaken a bit and, obviously, we have a big Scotch business in Mexico and that has impacted our Scotch business overall.

I would say it's just the fact that last fiscal year, we had really muted volatility across the globe and that helped us in terms of the overall performance – at the high end of our mid-term guidance last fiscal. And we just expect that the world is going to continue to be a bit more volatile.

I want to come back to your mentioning about the Coronavirus because as you would've heard in Ivan's commentary, that's a situation that we just can't predict as we sit here at this point in time. And it's something that we'll just have to continue to watch closely.

Sanjeet Aujla: Got it. Okay. And perhaps just a quick follow-up on the growth in China you've seen in the first half of the year. Is that really distribution-led growth? Are you going into more provinces still?

Ivan Menezes: It's a combination of greater penetration, so rate of sale improving. If you look at the two businesses, SJF and primarily high-end Scotch whisky, both are very healthy and both are growing double-digit. And we're investing behind these brands. We're investing in innovation – in premium innovation in SJF. So we're seeing momentum in existing distribution and we are gradually

expanding distribution. It's very high-quality growth. And the brands and the businesses are in really good shape and growing market share in both cases.

Sanjeet Auja: Got that. And I appreciate its early days but any qualitative signs of how Chinese New Year has gone?

Ivan Menezes: Very hard to tell. Obviously, it came early so you can see in our first half results some of it. It's too early to call what the actual consumption has been over the last week. We will obviously be tracking that in the weeks to come.

Sanjeet Auja: Got it. Thank you

Operator: Our next question comes from Laurence Whyatt with Barclays.

Laurence Whyatt: Hi, Ivan and Kathy. Thanks very much for the questions. In the US, you mentioned that your Scotch business benefited first from trade loading ahead of the tariff impact. You said the Scotch is up 4% but Johnnie Walker is down 5%, so single malts are being presumably loaded. Could you quantify how much of that +4% was trade loading and how much is an underlying growth? And then secondly on the two vodka brands, Smirnoff and Cîroc, sales velocity has worsened a bit there. Could you give us some detail on what's happening in those brands and if there's anything you can do to try and improve that? And then finally your margins have improved despite declines in gross margin and an increase in marketing. How can we be confident that the cost savings you're putting through aren't going to be affecting the business continuity? Thanks very much.

Ivan Menezes: Okay. I'll take the first two and Kathy will address the last. On the US Scotch, it's 30 basis points of pre-buying of blended Scotch. That's 30 basis points of the growth rate of the US business. So, it's small. On vodka and Cîroc. The vodka category, as you can see, in the US is still challenging. If I take the three brands, on Smirnoff, we are stabilizing. The equity is building. The business is stabilizing. The quality of performance is better. We are easing off promotional intensity on some SKUs through our NRM initiatives, etc., but Smirnoff is a big brand and it's going to take time to do that consistently and stabilize.

On Cîroc, it's still challenged. And on Cîroc, we've always said this is going to be a long game to stabilize. We are taking some actions to reduce some of the less sustainable flavour innovations and trying to get the base more healthy. But I expect Cîroc to remain challenged in the US. It will take us over many years to get that brand stabilized in the US. It's better outside, clearly.

And then Ketel One, core Ketel One, the base brand is healthy and growing and we are just lapping incredible success of botanicals from last year but I remain positive on the health of Ketel One. Vodka overall clearly challenged category but gradually our health of our brand is getting better.

Kathryn Mikells: And then I'd say, look it just relates to continuing to drive productivity overall. I think we've shown quite good execution in terms of our productivity being driven by everyday efficiency, how we take that and look to invest in key areas of growth in the company to make sure that what we're driving is sustainable quality growth. It's a virtuous circle and I think we've been

quite sustained in terms of how we do that at Diageo. If I look at our first-half results, I'd say I continue to feel really good about what we're driving through everyday efficiency and you see that really come through our overall overhead line. Getting us a little over 100 basis points of positive improvement, which really helped us to offset both the gross margin softness that you saw and continuing to invest ahead in marketing, right. Which we've been doing very consistently and I expect we'll continue to do as we look forward in the second half. I'd say I feel very good about that.

As I look to the second half I'd also tell you as we look at gross margin, I'm expecting right now to get a bit more productivity gains in the second half that can help a little bit of that softness that we're seeing in gross margins and, overall, probably a little less than what we saw in overhead in the first half. But again, I think we've got a strong engine of driving productivity on an everyday efficiency sustainable basis and we continue to feel great about that.

Laurence Whyatt: Thank you. Just to come back on the scotch from Ivan. You mentioned 30 basis points on the blended category and as I understood it, the tariffs were on a single malt. So are you seeing no trade loading on the single malt, then?

Ivan Menezes: I don't like the word trade loading, please. We are talking about handling the situation of – we were anticipating tariffs late in last year and we didn't know what categories would get impacted or not. So, at that stage we had a plan to bring in more blended scotch because there was a risk which thankfully did not emerge. The 30 basis points is on total North America. That's the framing of blended scotch that was pre-bought because – until we knew what the tariff situation was.

Laurence Whyatt: That's very clear, thank you very much.

Operator: Once again, that's star one to ask a question. If you find that your question has been answered you may remove yourself from the queue by pressing star two. Our next question comes from Simon Hales with Citi.

Simon Hales: Thank you. I'm going to try again. Can you hear me, Kathy and Ivan?

Kathryn Mikells: We can, yes, much better. Thanks for calling back in, Simon.

Simon Hales: Excellent, thanks for taking the call – the question. I have three, please. Firstly, just on A&P spend trends. A&P is slightly ahead of sales in the first half but not much and I think really driven by the step-up we're seeing in Asia. How do we think about the step-up in A&P spend for the second half? Is it going to be broad-based across more of the regions? Perhaps a bit more skewed into H2 than H1?

Secondly, just going on from some of the comments on your US performance, the previous questions. I wonder, Ivan, maybe you could expand a little bit more on the performance of Crown Royal in the half. Very strong. I wonder if you could give us a breakdown as to how the base brand has performed versus peach and apple. And also Smirnoff Spiked Seltzer is clearly doing well. Where do you think you're gaining share from in the hard seltzer category? Are you seeing any cannibalization of your spirits brands do you think at all?

And then just a final one on cash flow, Kathy. Obviously \$300 million higher cash tax one-offs in the first half. You talk about those one-offs continuing for the full year. Should we think about incremental further cash outflows in relation to tax [inaudible] French government or in relation to the Group financing exemption situation in the UK? How do we think about that for the full year?

Kathryn Mikells: Okay, I'll go ahead and take the first question, also the second one.

Ivan Menezes: Sure.

Kathryn Mikells: As you look at A&P, I'd say we feel good about the first half and investing ahead overall in A&P. That consumed about 25 basis points of margin for us. If you looked back at what we've done in the last couple of years, that's been reasonably consistent. But as I look to the second half, the one place I would call out is in the US, right, so in US spirits over the last few years, we've increased what I'll call the A&P investment rate, by a rough order of magnitude 200 basis points or so in US spirits. We held that in the half. We can see that in the results. I would expect that's one of the places that in all likelihood would be further upweighted in the second half.

If we talk about some of the other areas where we would've seen an increase in A&P spend, we've talked about the fact that we're increasing spend behind scotch more generally. You would've seen a bit of an upweight in Europe. And then Asia you'd have to pick apart a little bit. I would say outside of the India business in Asia and especially in areas of strong growth that we would've seen scotch in China, Chinese white spirits, those would all be places that were upweighting spend. So, we always I would say make adjustments here in real time.

One of the things that Ivan pointed to is we have terrific tools now, right. If you went back two or three years ago, we were not as good in terms of how agile we could be to move spend to where we're really seeing the returns. And our catalyst tools which we continue to invest in and it's on every marketer's desktop, which really helps us to be much more agile because it's spend placed behind where we really see the returns coming from. That's some of the places where we see upweight and yes, I think if we look to the second half again, we would be looking to continue to invest ahead. Ill hand over to Ivan, and then I'll return to you.

Ivan Menezes: On Crown Royal, Simon, the brand is – if I start with brand health, it is at an all-time high, really, really strong. We've now had seven consecutive halves of growth in the brand. If you look at the breakdown of what's happening, actually Regal Apple is now the year sixth of launch and it's continuing to grow double-digit. If you look at Nielsen, [Inaudible], it's up 13%. Vanilla is up 10%. The base business is broadly stable, the base brand, but it's healthy. And the main thing Crown Royal is doing which we are very encouraged by is it's bringing new consumers into whisky and into Crown Royal. And our marketing is working well. We've upweighted our marketing spend against the brand in the last few years significantly. We feel good about Crown and the momentum continues to be healthy. Clearly, flavours have accelerated the growth but the flavours are bringing new consumers and new occasions. They're not cannibalizing the base.

On seltzer, we are a relatively small player in seltzer so we are riding the trend with Smirnoff right now. You can see it in the numbers. It's strong double-digit growth on our F&B business in the US. It is – our main – my main focus is ensuring we have a healthy beer business in the US and so while the trends continue, we will benefit but it's not a strategic area for focus for us. We see plenty of good growth in spirits and beer, and I view this more as riding the trend for now because it could be more volatile and we don't want to get overly dependent on it.

In terms of impact of seltzer from spirits, so far, in our analysis and what it says, it's mostly impacting beer. Inevitably there'll be some impact on spirits but as you can see in our performance, it's not – we don't see this as having a significant impact yet but we're tracking it. And ultimately, the simplicity of a premium spirit, whether it's whisky or tequila or vodka on the rocks with a splash of soda, the 'with soda' trend is very strong. And when you look at tequila growing at 33%, our tequila business, 35% in the US, I mean, there's huge trends in favour of premium spirits but still in the US market and that is underpinning some of our strong performance there.

Kathryn Mikells: And then I'll just get back to your question which was with respect for the higher tax payments that we would've seen in the half and that impact and the fact that in our guidance we basically said we're expecting to see that flow-through through the year. As you mentioned, we've had over the last several years a number of different one-off tax payments and in different tax jurisdictions, this always works differently. Some of them you actually pay ahead. Some of them you pay after the fact and then the cash flow is a year-over-year change number. I would say, as we look at those one-off impacts for the half, they will just flow through for the full-year. And when we get to the end of the fiscal, we'll be able to talk in more specificity about what we have seen in terms of one-off for the year and then, what, if anything, we would anticipate as we go into fiscal 2021. But that's really what's going on.

Simon Hales: Okay, that's very clear, thank you all.

Operator: Our next question comes from Richard Withagen with Kepler.

Richard Withagen: Yes thanks. Good morning. I have two questions, please. First of all, specifically on the US market and your marketing spending, can you discuss how your marketing effectiveness tools increase the return on your marketing investments and maybe give one or two examples? And related to that, should we expect further increases in marketing spending ahead of net sales growth in the next few years?

And then the second question is going back to productivity savings. Kathy, you mentioned you expect more productivity in the second half of the year. With the full year results last year you mentioned you expect \$100-150 million in savings or in productivity in fiscal 2020. Is that range still valid or do you expect to perform outside of that range? Thanks.

Ivan Menezes: Sure, I'll take the first. On US marketing spend, if you look at the last three years we have increased our marketing spend in US spirits by over 250 basis points. A significant upweight in investment and our share has gone up significantly. I'm really pleased with the quality of marketing and innovation coming out of the team in North America.

And with our tools, our ability to direct spending against effective programs and to adjust quickly is much stronger than it was a few years ago. As I talked about earlier, we have invested significantly in Crown Royal because we can see the returns there being really strong and it's working and delivering on our performance. But even on a brand like Baileys, we're now down to the level of sophistication where we can pick days in the year and geographies and, through our digital and social spending, can drive a purchase at a very granular level. This is clear – we'll continue – we're learning and getting better all the time, but the rigor now behind which we look at every dollar spend and where it goes and how we measure returns is much stronger. And the US is very capable and effective at this.

We've upweighted on a number of brands. We're constantly adjusting because not everything works, and then we redirect spend going forward. We don't have a requirement or a target that we will keep increasing spend reinvestment levels in the US. It really is the bottom-up. If we see the opportunities for good returns, we will spend more. At the same time, we're driving a lot of efficiencies and we're getting significant gains in how we buy media and the efficiencies of our spend, which is also contributing even more to the effective spend that we have in that market.

Kathryn Mikells: And then as it relates to productivity, you had referenced that at our last Investor Day we talked about the fact that we saw about £100-150 million annually of incremental opportunities and productivity as we look forward. That was supportive of our overall guidance of being able to grow operating profits about a point ahead of net sales. As you look at this year and what we're currently expecting, we're continuing to look at that and say we believe we can grow operating profits about a point ahead of net sales for the full year. And we had previously stated we thought the first half on operating profit growth, delivery and margins specifically, was going to be a little lighter than the second half.

I'd say we feel again very good about our execution of everyday efficiency and seeing those benefits continue to come through the business. They clearly support it, margin expansion in the first half and my commentary about the second half is we always have some phasing going on in productivity. And obviously as I referenced earlier, in the second half we are expecting to get a bit more in terms of our product-cost productivity-related savings, that we're looking for in terms of just helping to offset a bit of that softness that we're seeing in growth margin.

Richard Withagen: All right, that's clear. Thanks a lot.

Operator: Our next question comes from Nico von Stackelberg with Liberum.

Nico von Stackelberg: Hi. Good morning everyone. I just wanted to ask, because I know there are parts of the guidance that are certainly quite volatile and hard to forecast, but one part that you should have a pretty good feel for is the impact of tariffs, particularly, on Scotch going to the US. I was just wondering, could you please quantify this for us? And does the current operating profit assume that the current tariff situation remains stable? Thanks.

Ivan Menezes: Yes, to answer your second part first, we've assumed the current tariff situation remains stable. We're not assuming it's getting worse or getting better in the current guidance. We're really early in the game is what I would say. As we have announced to the trade, we are passing on the impact of tariffs on single malts and on Baileys. That's been already communicated to the trade in the US. Seeing the impact of that on actual sell-out is something we will watch very closely in the next few months. Obviously, we've got ranges and scenarios that impact and what I would say, all that is factored into our current guidance, that the current level of tariffs stay.

Nico von Stackelberg: Great. Thank you. And as a follow-up, can I ask about Crown Royal? It grew 11% in North America. It looks like depletions were up 8% in the period. So, slightly shipping ahead. And I also note that if I look through November, the last 12 months, the volumes are only growing around 2.5 so you're getting strong price mix. Does Crown still have legs in terms of price mix? Obviously, there's a broader premiumization trend but, certainly, the brand is being helped quite a lot by price mix, and so how sustainable is that?

Ivan Menezes: Yes, although with Crown, our depletions are broadly in line. The report is growing at about 9%. On many of our brands, we do really well. Crown captures, whatever, 45% of the market. Our performance in the independent channels and the on-premise, which is not captured in the data is very strong on many brands and so you see some of that momentum come through on Crown.

One of the things – we do see good opportunity for price and mix on Crown, and one of the things we are doing is really looking at the higher marks, like Crown Royal Extra, where we want to put a lot more focus, a bit like we do with Johnnie Walker Blue. So we are looking at building the top end of the Crown Royal franchise as we go forward, putting more focus behind that for gifting and brand building, and that should improve mix as well over time.

Nico von Stackelberg: Okay, great, and if I can just ask one more question. I've always wondered why Diageo gets something of a pass in terms of the fair market value of your maturing inventories. Could you maybe for the full year provide some sort of color around the fair market value of your maturing stocks? It seems like it'd be useful for the valuation equation. Thanks

Kathryn Mikells: I would say we don't look to attempt to disclose what we would say the fair market value is. We would say our assets are appropriately valued in our balance sheet, and we, like every whiskey maker across the world, have a good amount of stocks. All I would say is we build stocks very consistently across all of our whiskey brands and we're happy with the stock levels that we have.

Nico von Stackelberg: Yes, I guess it's at cost on your books and there is a fair market value and I also know – actually maturing stocks are excluded from working capital in your management compensation, so you have a slight incentive to build stocks. And we never really get any colour on the growth or the IRRs of your maturing stocks, and more disclosure would be useful, I think. But, yes, just a thought for consideration. Thanks.

Kathryn Mikells: Look, I would just comment that we try to create our compensation metrics in a way that the people across the organization can have an impact, as it relates to growing maturing stocks. We just look to do that consistently to support our brand and that is managed by a – I'll call it relatively few people across the company. But it's specifically an area that we don't move things up and down, but we actually just look to grow our stocks consistent with the categories that they support. I think we have done a great job in terms of actually everyday efficiency and delivering strong cash flow, and that's been supported by the metrics we have in our compensation programs that drive the things that people can actually impact. But thank you for the question.

Nico von Stackelberg: Yes, thanks. Appreciate it.

Operator: Our next question comes from Trevor Stirling with Bernstein.

Trevor Stirling: Hi Ivan and Kathy. There's two questions from my side. The first one returns to the theme of malts and the performance at the moment. We saw 12% growth last year, 17% first half. It really seems that the malts are kicking into gear after a few years of perhaps less-than-ideal performance. What do you put that down to Ivan? And I suppose secondly, do we have the stocks

to support that? But then secondly on the Coronavirus. I appreciate it's entirely way too early to talk about the impact. Can you talk a little bit about the impact of SARS back in 2003?

Ivan Menezes: Yes, sure Trevor. On malts, I mean, we put, a far more disciplined and focused strategy behind malts by – one of the things Diageo is blessed with is this wonderful 28 distilleries that produce the most beautiful single malts and we're spoiled for choice. One of the things that's happened is we put real discipline and focus behind the variants and the geographies and we've got better growth drivers. A brand like Singleton now is doing really well. Cardhu in Spain is doing extremely well. In the US, Lagavulin and so we, and the supply side is now better aligned to support sustainable growth over the long-term. I put it down to clearer strategy and better execution against it.

Kathryn Mikells: And then, look, I think if you attempted to go back to SARS, you have to understand our SJF business wasn't on at that point in time, and our scotch business was small. There's just no relative comparative there.

Trevor Stirling: Okay. Could I just ask one follow-up, Ivan? You mentioned that you were passing through the price increase in single malts. Are your competitors following, as far as you can tell?

Ivan Menezes: I don't know the answer to that, I wouldn't even speculate. So, I don't.

Trevor Stirling: Okay.

Ivan Menezes: And again, what I said is that we've communicated to the trade what we're doing. Which is why I mentioned it on the call, because that's been already communicated.

Trevor Stirling: Okay. Thank you, Ivan and Kathy.

Kathryn Mikells: Thank you.

Ivan Menezes: Thank you.

Operator: Our next question comes from Alicia Forry with Investec.

Alicia Forry: Hi. Good morning, Ivan and Kathy, three questions, please, from me. First, volume momentum has deteriorated. I appreciate India is a significant impact on this. But I'm curious about what's happening with your volumes ex-India and are you seeing any new trends emerge?

And then, secondly, the organic operating margin fell 160-ish basis points in India in H1 after several years of improvement there, as you've been improving the product portfolio. It seems to be cogs-driven. How should we think about this near-term? Have margins in India reached a sort of plateau?

And then, finally, on global travel retail, how should we think about the timing of recovery in this channel? We will lap Hong Kong later in the year and, presumably, the Middle East issues will work themselves out at some point. So, just curious on the timing of recovery there. Thank you.

Ivan Menezes: I'll take the first. Kathy, you do India margin, and I can come back to global travel.

Kathryn Mikells: Great.

Ivan Menezes: On volumes, you're right, India was flat, and it's almost a third of Diageo's volume, so that had an impact. If you take India, travel retail, and our weak spots in Latin America, like Peru and Chile, where we had volume decline, outside of that, our volume would have grown I think close to 1.5%. We are – there's solid volume growth coming in most places, including the US, which you can see is... there's no shift in trend here. I mean, we are seeing consumers are trading up to – more to spirits, and more to premium spirits, and we gain from that. I mean, our reserve brands were up 11%; that's 20% of the business. And then all those conditions remain strong.

Kathryn Mikells: And then on India, overall, we were pleased in terms of how much of the gross margin our softness in the India business was able to offset, especially in light of the difficult economic conditions that they're facing. The other thing that we're seeing that's just causing more pressure in terms of the margin is a fair amount of inflation in specific input costs. And one I would point to that has a big impact on them is base neutral spirits. And inflation in base neutral spirits for them has been truly significant. When I look overall at their result and how much they've gained in margin over the past year, while they have some specific challenges this year, as we look over the long-term, our expectations are unchanged for India over the longer term. Which is looking to have them have a top line growth more high single-digits, low double-digits and getting to a margin level of mid to high teens. And I think they've made terrific progress in the last three-year period in just making good gains against those long-term goals.

Ivan Menezes: And on global travel, we expect it to remain challenging, certainly, through the second half. And it's a little hard to predict the pace of recovery and when it comes. Our focus is really on execution and market share in the airports, in particular. On that standpoint, I feel good about how the business is doing. Sell-out execution and our market share performance in the measured global travel retail business, we are doing well. And that's what we can control. I'd say that we are assuming that things will stay tough in the second half, too.

Operator: Our next question comes from Edward Mundy with Jefferies.

Edward Mundy: Morning Ivan, morning Kathy, three questions, please. The first is on the buyback, where you're £1.1 billion through £1.25 billion. How should we think about the phasing of your £4.5 billion over three years? Should we think about equal phasing or is there certainly scope, once you've finished your £1.25 billion, to perhaps accelerate the phasing of that buyback?

The second question is around slides 34 and 35 in your presentation. I appreciate that you don't run your business from 1 July to 31 December, and there is – there are differences on shipment phasing from one day to the next. But on page 34 of your slide deck, your shipments, as I see, accelerated from 5 to 6.1; from 35, your depletions have slightly decelerated a little bit across most of the portfolio. Is that really around the on-trade that's not captured in the reports, or is there something else that we're not thinking about at this stage?

And then the third question is around gin. I think you disclosed that your gin portfolio grew 7% in the first half, and Tanqueray grew 13%. I was wondering whether you could clarify what the growth of both Gordon's Core and Gordon's Pink would have been in the first half?

Kathryn Mikells: Okay. I'll start with first question. As you would have seen, and you referenced, we completed £1.1 billion of the three-year program, which includes up to £4.5 billion of share buybacks and capital return in the first half. The way that we always talk about this, is we're looking to manage capital returns to shareholders against the backdrop of our leverage ratio, right. And if we had looked back in the last couple of years, we had a leverage ratio that was below the range we're targeting. We target a leverage ratio of 2.5 to 3 times, and that's an adjusted net debt to EBITDA number. And when we finished the first half, we were at 2.8 times, right, roughly in the middle-ish of that range. As we look to both the second half and into the next couple of years, we'll be looking to manage shareholder returns against that backdrop of the leverage ratio.

But right now, my overall commentary was we feel pretty good about execution against the £4.5 billion. We made a very good down payment in the first half against that three-year program.

Ivan Menezes: On the US depletion performance, our overall US spirits depletions have growth in line with shipment in value terms, so across this period in the first half. You raised the right point. When you look at our growth in the non-measured channel of the independent market and the on-premise, our growth rates have been higher, and we are performing very strongly in many of those states, which are non-chain states. And we put a lot of focus now on the US. In fact, we put a whole new organization behind it to really building our on-premise spirits in the US strongly. And I'm pleased to see that focus will continue to give us good benefits in the years to come.

On gin, Gordon's grew as well. Gordon's base was up about 3% and Pink, I think, was up about 1%. And in spite of having what was the decade's greatest spirits launch in the UK market, we had a phenomenal success last year, but it's still growing. And our belief on gin is the category still has good runway ahead of it. Yes, GB and Spain took off the earliest. But those growth rates will slow down. But the rest of Europe and then other markets, like South Africa, Brazil, and Australia, we are seeing very good growth.

Edward Mundy: Very good, thank you. And then just as a follow-up, the Captain Morgan Europe growth has really accelerated. Is there anything particular behind that relative to last year?

Ivan Menezes: I would just say we were excited about the brand. We put focus behind it. It's doing – it is one of the brands we're backing. And it has – as you point out, we are very pleased with the performance in Europe. And the growth drivers and execution against it are working well.

Edward Mundy: Very good, thank you.

Operator: Our next question comes from Marion Boucheron with MainFirst.

Marion Boucheron: Hi, good morning everyone, two question for me, please. One, on the COGS How shall we look at them going forward and the impact for that on the second half?

And the second question would be on the price mix that was very strong in the first half. Would you be able to give us some granularity of what has been in size, what's been more driven by net revenue management and what was mix?

And then I don't know if you have any colour to give on the innovation pipeline in the upcoming quarters?

Kathryn Mikells: I'll start with just how we're thinking about COGS in the second half. I would mention that we obviously have softness in gross margin in the first half. And part of that is coming from just the level of inflation that we're seeing relative to our ability to offset it through productivity. I had mentioned in India specifically base neutral spirits is one of the areas where we've seen higher inflation. I had mentioned in the past, and would certainly reiterate today, that Agave is another place that we can still continue to see inflation in relatively high prices.

And then the third thing I would mention is generally glass cost inflation has been another area of impact for us. As I look to the second half, I would say we're expecting to continue to see a lot of the similar inflationary impact. With regard to overall gross margin, I'd say we're also expecting to see a bit more positive productivity phasing against cost. I would say I hope to improve what we're seeing in terms of gross margin.

But it's always a bit of a game against what's happening in inflation, how much can we offset that in productivity and then obviously, what are we seeing in price mix. Ivan, do you want to take the second question with the price mix?

Ivan Menezes: Price mix, yeah. First the price mix, as you can see was strong here. We had price of about a point and a half and the rest is mix. Mix was always helped unfortunately by India being weak, some of the countries, the geographic mix is stronger as well. But our own capabilities and focus and discipline are really operating in all our markets. As you know, we are coming from behind, we still got a lot of room to improve. But with every period, we are getting better and better. And in many markets, we're seeing and taking more price mix in a sustained way. That's our goal. And the underlying trends of in-market mix also remain very positive with premiumization being strong. And as I said earlier, our reserve business, which is 20% of the business, grew 11%, so that is very strong mix operating in our favour.

On innovation, our focus on innovation is sustainability and consistency. As we look at the second half, we have a good pipeline. We are also – as we go into this calendar year, we are celebrating the 200th anniversary of Johnnie Walker, and you can expect us to do some exciting things on that brand as well in the course of – it will be second half and the first half of next year.

Our innovation pipelines are now built with the long-term focus to ensure we have consistency and our innovation capability continues to get better. And the focus on sustainability is also much stronger in how we develop and execute innovation.

Marion Boucheron: All right, thank you.

Operator: Our next question comes from Celine Pannuti with JP Morgan.

Celine Pannuti: Yes, good morning. Most of my question had been answered. I just wanted to follow-up on Europe. If you could talk about the overall growth environment that you've see in your categories and then also in the UK, whether you've seen any slowdown throughout the quarter?

Ivan Menezes: I'd say overall, Europe, as we saw the business grew 3%. If you take a 12-month – last, rolling 12 months' view, we are growing share. We have taken some price increases in certain markets and channels, and that has impacted some of the short-term performance. We do have variability across Europe. I mean, some of our markets, like Germany, Benelux, etc., are growing double-digit. Italy was strong, Spain is more challenged. Ireland is tough, flattish. The UK market, I feel good about; our beer business here, it's been strong. Guinness too was up 6% in the UK, and 1 in 10 pints in London is now a Guinness. This is our highest share ever on Guinness. And so, we got ups and downs but overall, the performance consistency continues and the environment is good.

I would say we see spirits well-positioned and premiumization trends strong, and even small categories like tequila, expensive tequila are growing very fast. Our single malts are doing much better. So, the Europe environment, I'd say is solid.

Celine Pannuti: Thank you.

Operator: Our next question comes from Andrea Pistacchi with Deutsche Bank.

Andrea Pistacchi: Yeah, good morning, I have three questions please. The first one on the US, where Scanner Data, Nielsen in particular, have proved to be not a very good predictor of your performance in the US, as you were also highlighting. That said, the Nielsen data in the past couple of months show, or would suggest a bit of a slowdown at the industry level through November/December. Have you seen a slowdown at all in the business?

The second question, please, on your guidance and on China; I appreciate of course the uncertainty on the situation in China. But could you give us any an idea of what situation in China you are factoring into your guidance, on how many months of difficult situation in China you are building into the guidance?

The third question, please, back to the US on Captain Morgan, which in the last two half-year periods has been positive, so a clearly better performance compared to the past two or three years. Is this a reflection of the work you've been doing on the brand, that you're confident that you've probably turned the corner on Captain Morgan?

Ivan Menezes: Sure, I'll take the first and the third and Kathy, you can talk about the guidance. On the US trends, again, I don't look at any particular month of news and read too much into it. We don't see – we look at the MAT trends overtime, I don't see a shift in US. The US Spirits market is probably growing 5-5.5% if you throw in all channels and everything, and we think that's fairly consistent.

On Captain Morgan, I'd say it's improving, but we've still got a lot of work to do, so we're far from declaring victory on Captain Morgan. The actions we're taking have stabilized the brand is how I would characterize it. We're going back with a lot of focus against the serve, the drinks, the MLS, the football sponsorship, which is just kicking in, in terms of its full impact. The marketing is much

more focused. We're getting smarter about some of the innovation that was on Captain Morgan which we're focusing -- some of it was not working so we're easing that out of the base.

But there's work to do. This is a big brand in a challenge category. The rum category is still very sluggish in the US, and I'm happy we're here compared to a couple of years ago, but still lots of work to do and too early to declare victory.

Kathryn Mikells: And then specifically as it relates to the guidance, we were clear that it's just too early to call the impact of the Coronavirus. And that's just a situation, that we'll have to watch closely.

Andrea Pistacchi: But your guidance assumes that of course, China will deteriorate in the second half versus H1, yes?

Kathryn Mikells: Again, it is too early to be able to call exactly what the impact is going to be. And as it relates to our guidance, we can't yet appropriately factor in something that we can't yet really call. It's just early days and too early to be able to call how it's going to impact the business. I would back up a little bit to say China is about 4% of our business, it's obviously growing strongly right now, but it's just too early days to be able to understand the impact.

Andrea Pistacchi: Perfect, thank you.

Operator: Our next question comes from Sanjeet Aujla with Credit Suisse.

Sanjeet Aujla: Yeah, hi. I just had a couple of quick follow-ups please. Firstly, just on mainstream spirits. We haven't heard you speak so much about mainstream spirits. Is it still a strategic focus for yourselves, particularly in light of the emerging market volatility that you're seeing? I noticed primary scotch was flat in the half, so love to get your assessment on that part of the business.

And then just on the Guinness turnaround in the US, can you try and pinpoint what's really driving that improvement?

Ivan Menezes: Sure, on mainstream spirits is still a focus and priority. You would see the performances were more subdued in the half, and primary whiskeys was impacted also by a weak [inaudible] in the UK. We also had weakness on Smirnoff in South Africa. It's a big brand. Those were some of the factors that drove it.

But if you look at Nigeria and Kenya, we're seeing really good growth and we're excited about the potential for mainstream spirits to build, and obviously, India is such a big market for us. Primary scotch is still a big priority. I mean, Black & White grew 5%. It's really on trend in many markets and absolutely, very much a focus for us to keep that business growing, and at good margins.

On Guinness, in the US, we are -- it's playing to the trends of better beer, more iconic beer and the experiential side of what we've put into Baltimore is working really well, the new brewery experience we've created there. So, it's a bit of all of it. Bottle beer is doing well. The on-trade draft

market in the US is still challenged. It's difficult, but we are doing really well on packaged and at-home.

And the marketing is working better and as I talked about earlier, our focus in the beer company is really making sure we build a quality, sustainable growth business, particularly around Guinness. And there's more exciting things to come around the brand in the next 12 months in the US market as well.

Sanjeet Aujla: Thank you.

Operator: Our next question comes from Nico Von Stackelberg from Liberum.

Nico Von Stackelberg: Hi there. Pardon for the collective sigh around the city on this, but there has been no question around Brexit. And I was just wondering, could you just give us a quick update on Brexit even in the event of a no free trade agreement outcome. You said in the statement that there will be no direct financial impact to Diageo; basically, it won't be material. And just can you walk me through why is that the case? And secondly, there would be no change to the medium-term guidance in the event of a no FTA outcome, right? Thanks.

Ivan Menezes: Yes, very simply our ability to trade within the EU doesn't change much. Under WTO conditions, we will trade tariff free. If there's some complications in borders and shipping products, we know how to handle that. I mean, we ship to 180 countries. So, it's immaterial, the impact within the EU.

The UK government, we had a number of EU FTA agreements in many countries where scotch benefited, and the UK government has got the vast majority of that value covered, or grandfathered, or continued in the post-Brexit scenario. So, we don't have risk on that front.

And finally on the upside, and it's not immediate, but clearly as UK develops new free trade agreements with emerging countries around the world, we see good opportunities actually for scotch and gin to benefit, but that's more medium term than immediate. And our supply chain is a very indigenous supply chain that we are not relying on shipping a lot of products from Europe into the UK. We don't have the complexity of many other manufactured products to deal with. Those are the main reasons why we say we can take the Brexit within our current guidance however Brexit plays out.

Okay, I'm going to call it to a close there. Thanks very much everyone for your joining us on the call and for your interest in the company, and look forward to meeting with many of you as we, Kathy and I go on the road show in the next few days. Thanks a lot.

Kathryn Mikells: Thanks everyone.

Operator: Thank you, ladies and gentlemen, this concludes today's teleconference. You may now disconnect.

