Diageo F21 Preliminary Results Investor Q&A Call

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Ivan Menezes: Hello everyone and thank you for joining our preliminary results call for fiscal 21. I'm delighted to welcome Lavanya, our new CFO. Lavanya and I are sitting in Park Royal in our office on a sunny day in London, a rare occasion. Great to have you here Lavanya.

I hope you've had a chance to read our press release and watch our presentation webcast on diageo.com. Diageo delivered an excellent set of results in fiscal 21. We performed very strongly across all our key financial metrics while continuing to invest in long-term growth and building on our successful ESG track record.

Organic sales up 16% in fiscal 21 and up 6% compared to fiscal 19 on a constant basis. All of our regions grew organic top line with 3 of the 5 growing net sales above fiscal 19 on a constant basis.

North America, our largest and most profitable market, performed particularly strongly. We also delivered excellent cash flow generation. Our strong foundation going into the pandemic enabled us to respond quickly to changing consumer trends and we have emerged stronger. We are benefiting from our broad geographic footprint, well positioned portfolio, data analytics and tools and creativity and our lean cost base.

We upweighted our investment in effective marketing and consumer-led innovation, and we gained or held off-trade market share in over 85% of total net sales in measured markets creating strong momentum for sustainable long-term growth.

While we expect near-term volatility in some markets, we believe we are well positioned in fiscal 22 to benefit from both the resilience in the off-trade and the recovery in the on-trade. I am optimistic about the growth prospects for our industry and for Diageo. Spirits continues to gain share of total beverage alcohol globally and premiumization trends remain strong.

The 5% increase in our final dividend and the restart of our capital return program in May reflects our confidence in the long-term outlook while delivering consistent returns for shareholders.

Before we move to Q&A, I'll just turn it over to Lavanya to say a few words.

Lavanya Chandrashekar: Thank you Ivan. I'm honored to be stepping into the role of the CFO, especially at such an exciting time of growth for Diageo. I look forward to building on Kathy's tremendous achievements, partnering with Ivan and the team to drive sustainable top line growth while using productivity to enable smart reinvestment and drive value for shareholders.

From my prior role as CFO of our North America region, I know first-hand how effective Diageo is when we make focused strategic choices and invest consistently behind them. While I have had the chance to meet many of you, I look forward to meeting those of you who I haven't met very soon.

I'll now hand the call back to the operator to open the phone lines for your questions.

Operator: Thank you. We will now take our first question from Simon Hales from Citi. Please go ahead.

Simon Hales: Thank you. Good morning, Ivan. An official welcome Lavanya, to you, in your new role. I have 3 questions, please. Firstly, we've obviously seen a significant up-weighting of marketing investment through 2021 and more generally in recent years. I know you talk about in your outlook statement the desire to continue that reinvestment as we look forward as well. But how should we think about the overall rate of investment in 2022 and beyond? How do we think it develops as a percentage of sales? I'm just trying to get an idea of where things are headed and where your spend priorities really are in 2022. So that's the sort of first broad question.

Secondly, if you could talk a little bit more about the inflationary pressures that you're seeing as we head into the new fiscal year? Is that more on the distribution and logistics side? Or is it sort of on the COGS side that you're starting to see some building pressures there? Is there any skew between H1 and H2 when we think about how that will hit the P&L from a modeling standpoint? And how confident are you in your ability to pass some of those things through in terms of pricing?

And then, finally, just a quick one around the tax rate guidance. What are the drivers of that sort of higher tax rate of 22% to 24% going forward, please?

Ivan Menezes: Great, thanks Simon. I'll take the first, just give you a headline on inflation, but then turn it over to Lavanya on inflation and tax. Marketing investments; so I would say the way to think about our approach and philosophy is: number one, we see good quality, sustainable growth in this category for Diageo. The premiumization trends are strong, spirits gaining from beer and wine. Secondly, our tools and analytics of understanding marketing effectiveness, as we've talked about before, is I really feel very good about and they keep getting stronger and better. Third, the shape of the economics of our P&L with very positive price mix and strong cost discipline on everything that the consumer doesn't feel and touch, gives us the confidence that we have the ability to deliver margin expansion, as you saw in these results, while upweighting marketing.

Now having said all of that, we don't have a percent of sales philosophy for the next few years. We actually build our marketing investment plans bottom-up and teams have to justify them. But our orientation is to invest behind quality sustainable growth because we can deliver strong economics with that.

Diageo is well funded in terms of our level of marketing investment right now. Our share of voice is very strong. We've significantly upweighted media spend across the markets, and you can see the results in market share because we put an enormous focus on what we call quality market share. And we really assess that carefully. It has to be brand equity, consumer-led market share performance. So I'm feeling good about where we are. Could you see us increase it? Yes, you could. But we don't have a strategic posture to upweight our marketing spend in the year there. We build it on the basis of the business case and the opportunities we see. Certainly our orientation will be to lean in to invest where we see the opportunities, and we certainly get the return, as hopefully, you can see in these results.

On inflation, I'll turn over to Lavanya, I just have a headline comment I'd like to make, which is: the nature of the Diageo business is we can take inflation in our stride. The nature of current inflation. Lavanya will talk more about what we're seeing happening. And again, it starts with strong mix and trading up in these numbers. Our reserve brands, the top 25% of our portfolio was up 36%, the Johnnie Walker Blues and Casamigos and Cîrocs of the world. As you know, those are higher-margin businesses.

We are doubling down on our cost productivity, which has been now a muscle the company has built well. Our brands are strong, just to your earlier question, and brand health is strong. Our ability to manage price and mix as well is strong. Then the final point I'd say on categories like whiskey; the Johnnie Walker Black Label we sell today, it's useful to remember, the liquid was distilled at least 12 years ago. So we do have a buffer in the nature of our stocks and how they flow through the system.

I'll turn over to Lavanya to address the specifics on inflation.

Lavanya Chandrashekar: Simon, to answer your question on inflation specifically, you asked where are we seeing it come through? Is it in COGS or sitting in distribution logistics? It is in both cases. To start, our inflation rate has been around 3%. What we're seeing come through now is picking up a couple of points. We're definitely seeing the pressure from a commodity perspective: oil, corn, aluminum are all going up. From the distribution logistics perspective, it's really supply and demand. As demand has picked up, rates have gone up.

I won't comment specifically about if it's going to be higher or lower from a modeling perspective or half 1 versus half 2. It's hard to predict in these very volatile times. At present we definitely see inflation picking up.

As Ivan said, we have multiple tools in our arsenal to deal with inflation. First and foremost, I'd say one of the biggest tools that we have is the premiumization trend. It's strong. Half our growth has come from the super-premium plus part of our portfolio in fiscal 21. And as Ivan mentioned, this part of our portfolio has better margins.

The second thing is volume leverage. We've grown 11% volume in fiscal 21. I think that's a big differentiation versus a lot of broader CPG businesses and that enables us better fixed cost absorption that flows through to the bottom line.

The third is we are able to take pricing where it is required. We've taken pricing on Baileys in North America. In higher inflation markets such as Nigeria and Turkey and we have taken several rounds of pricing. We've been successful at growing the business in all of these places. Baileys in US Spirits is up 31% on 17% volume growth. We've really been able to demonstrate our ability to what I would call walk and chew gum at the same time.

The last thing I would say is our culture of everyday efficiency which Ivan referred to. It's really embedded into our culture now. In fiscal 21, everyday efficiency was able to offset inflation. Going forward we are confident in our ability to take inflation in our stride and continue to support our brands as they deserve to be.

Your next question was on tax rate. I'll be brief on that. This year our effective tax rate went up from 21.7% in fiscal 20 to 22.2% in fiscal 21. It is really a combination of drivers but the biggest one is market mix. As our business grows and in markets such as China and the U.S our effective tax rate has increased. As we look at fiscal 22 that is going to continue to be a factor resulting in our tax rate guidance going up. In addition to that there are known external factors such as the proposed increase in the U.S. headline rate. We don't know exactly how much it will be or what the timing is but we are assuming right now that it will happen sometime during the course of fiscal 22. In addition to that – overall the tax environment with governments seeking to recover from the impact of COVID and the G7 agreement on minimum taxation

– we expect all of these to contribute to the higher effective tax rate in our guidance but also the wider range that we have put out as our effective tax rate guidance.

Operator: We will take our next question from Sanjeet Aujla from Credit Suisse.

Sanjeet Aujla: Hi Ivan, Lavanya. A couple of questions from me, please. Firstly, on the U.S., Ivan, in your outlook comments, you're talking about the market reverting back to mid-single-digit levels on this high base. And I guess given the importance of tequila now in your portfolio and the significant upweight in marketing spend you've had, seems like you're going to continue on that journey, would you expect to be growing ahead of the category through F22?

My second question is really on margins. Again, I appreciate you're not giving any guidance for fiscal 22. But when I look at an organic basis, I think your margins at the end of fiscal 21 are still 170 basis points below fiscal 19 levels. Would you expect to fully recover that in the fullness of time over the next 2, 3 years? How should we think about that? Thank you.

Ivan Menezes: Okay. I'll take the first and hand to Lavanya on the margins. On the U.S. market, firstly, we clearly see the U.S. industry momentum remaining robust. As the on-trade comes back, it is coming back strong. I love the American consumers' enthusiasm to socialize outside the home. Bars and restaurants are full. And we are, by the way, also growing market share in the recovery of the on-trade to the extent that you can measure it through NABCA and what we pick up from our distributors. We're doing very well on the on-trade recovery.

Going forward, what I'm really pleased about is the share momentum in the U.S. You may or may not have seen the most recent Nielsen that just came out a couple of days ago. Even in the last 4 weeks, that momentum is continuing. If you look at the last 12 months, 6 months, 3 months, our share momentum has steadily improved and we're now running 50, 60 basis points of market share gains in the last month and 3 months.

That, in part, is driven by the momentum in the portfolio. Yes, Tequila is strong and we still see a lot of runway for our tequila business; both Don Julio and Casamigos are doing really well. But it's also the full portfolio. Our whisk(e)y business, Crown Royal, Johnnie Walker, Baileys, as you saw in these numbers are up 31%. So I expect us to continue. We are in a position where we should be able to outperform and gain share as we go through fiscal 22.

Lavanya Chandrashekar: I'll answer your second question on margin. As we discussed in our earnings update at interims as well as at the end of fiscal 20, part of what has caused our margin pressure has been mix or region/market mix. The shutdown of the global travel business has impacted our scotch portfolio, particularly as scotch is one of our better margin products within the portfolio. Then the second piece of it is the shut down in the on-trade has significantly impacted our beer business, especially in Europe and Turkey. That has also led us to be significantly impacted from a margin perspective.

The question on do we expect margins to revert to fiscal 19 levels. I think it's a matter of recovering from COVID and as our scotch business grows and we gain back our beer business in the on-trade in Europe, those will substantially help us to recover margin back to fiscal 19 levels. And on top of that, all of the things that I mentioned in my last answer to Simon. Premiumization, volume leverage and a combination of revenue growth management supported by headline pricing will also be key drivers in us being able to recover margins over time.

Operator: We will take our next question from Andrea Pistacchi from Bank of America.

Andrea Pistacchi: Morning Ivan and morning Lavanya, 2 questions, please. The first one on your outlook commentary where you say that you expect near-term volatility in some markets. Are you seeing anything, are you referring to anything specific that you're already seeing, maybe any markets that have deteriorated? Or is it more of a general comment around potential risk of lockdowns? And I think you flagged India in the prepared remarks as a market that could be volatile, elsewhere where do you see some risks?

And then on the U.S., you were saying you're referring to the last 3, 6 months where you've been gaining share and this has come across clearly in the data we've been seeing. How do you see, since the reopening, and since you've been facing the more difficult comps in the off-trade, how has the market been performing in the last 3 or 4 months? Would you have a number for the market depletions?

Ivan Menezes: I'll take the first, and Lavanya can cover the second on the U.S. market. We don't have a particularly more sophisticated crystal ball as to how the virus and the pandemic impacts are going to play out. We have scenarios, and obviously we model against scenarios. I am cautiously optimistic and confident. However, we know the nature of the pandemic that things can turn, quickly, and so that's what's reflected in the statement and that's also our caution in not giving guidance. If I take the specifics, we know what's happening in South Africa, right? On, off, on, off, and it's just reopened a couple of days ago. Could it go into prohibition again? It could. India has been up and down. Parts of Southeast Asia are tough. Indonesia. I'm talking about the virus and the pandemic. So, it's no more than that. We don't have any particular geography we are concerned about. We are hopeful that the European reopening will continue and the U.S. reopening will stay, of the on-trade momentum that I talked about earlier. That's what's behind our statement there. It isn't any particular specific concern in one geography. It's just recognizing that with the Delta variant and the numbers are going up and down. That's why we just want to be cautious. Now we're very much focused on what we can control and what we can drive. Building our business, gaining market share. I mean that's what we're focused on.

Lavanya Chandrashekar: Yes. I'll answer the second part of your question, Andrea. In terms of the U.S. market, what we have seen happen here over the last 3 or 4 months is a very strong reopening of the on-premise. By our estimate, about 85% of the on-premise is now open and what we're seeing is what we predicted, which is consumers coming back to celebrate with family and friends and enjoying a wonderful cocktail in their neighborhood bar or restaurant. That's essentially what we're seeing. In terms of the market itself, we're seeing the market continue to be very resilient. More importantly what we are really proud of is that we are continuing to gain share in the market. Both Nielsen as well as NABCA, we are growing share strongly on our U.S. business, both spirits as a percentage of spirits but, equally importantly, we are growing share of total beverage alcohol.

Andrea Pistacchi: Just a quick follow-up on that, Lavanya. You say about 85% of outlets have reopened. When you think of on-trade spend, would you say that, in the recent month or 2, on-trade spend is back to or very close to pre-pandemic levels in the U.S.?

Ivan Menezes: Yes. The on-trade -- there are geographic differences but, if you look at Florida and Texas, it is absolutely back and ahead and it's coming back strongly. As I talk to our distributors in the last few days, the on-trade recovery is definitely very close back to pre-pandemic levels if not ahead of it. And it's coming back strong with premium brands. Tequila and spirits are doing very well in the recovery of the

on-trade. We're feeling good about it and our market share, as I pointed out, where you can measure it is NABCA in about 15 states and we're gaining strong share in the recovery of the on-trade in those NABCA markets. Another point I should have mentioned on volatility is global travel. That's going to be a slow recovery and that's also a little hard to predict the pace at which global travel will come back.

Operator: We will take our next question from Olivier Nicolai from Goldman Sachs.

Olivier Nicolai: Good morning Ivan, Lavanya. I've got 3 questions, please. First, on North America, your strong step-up in marketing investment as a percentage of your sales this year. Should we expect marketing investment to continue to grow ahead of sales from this already very elevated level going forward? Or could we actually expect some operating margin progression to resume in North America in the midterm?

Secondly, to stay on the U.S. You mentioned the price increase for Casamigos, which makes a lot of sense considering the demand. When I look at the numbers, on Page 8 of the press release, the price mix for Don Julio appears to be negative. Is that an effort of trying to change relative price positioning between those 2 brands, which is so far relatively similar? Or is it me just reading a bit too much into this and it's just a question of timing?

And last question is you are reopening a few ghost distilleries. Port Ellen, Brora, and you've made a lot of investment in scotch in recent years. Now do you see single malts playing a bigger role in the reserve portfolio going forward? And can we also expect direct-to-consumer sales to become much bigger in the future?

Ivan Menezes: Olivier, I'll take your second and third and Lavanya can come back to the North American investment in margins. No, I think what you're seeing in that Don Julio number is purely mix. It's probably more Blanco and Reposado than Don Julio 1942, which is the single biggest luxury spirits brand in the United States. We're constrained on the supply. So no, Don Julio is really healthy. We're taking price. We're not discounting this brand. We don't have enough. And it's probably the mix effect that you're referring to, which is more Blanco and less Reposado and Añejo and 1942. Early data point I will give you, which is in the state of California, which you know is the most developed tequila market in the United States, Don Julio is now the #1 ultra-premium tequila brand. The health of this brand is really, really strong.

On our investments, yes, really delighted about our investment in Brora and Port Ellen. Brora is producing now. Port Ellen is going to open next year. In our scotch strategy, we clearly see opportunities for continuing to build Johnnie Walker and Buchanan's and accelerating the growth of malts. But even within blends, on Johnnie Walker, the top end of Johnnie Walker is where we're seeing acceleration. And we've got some very exciting plans on Blue Label where again we see good growth but we believe we can get significant growth on Blue and Gold and Green and the higher marques of Buchanan's. But malts are definitely on trend and we have a very clear strategy and investment behind building the malts brands and building the top end of it. A brand like Mortlach, which we really want to build, and it will be slow, but we intend to build Mortlach as the pinnacle of malts over the next 5 to 10 years, and we're investing behind it, and we're also liquid constrained, but there's a clear malt strategy which I think is going to be very exciting and accretive for Diageo.

Lavanya Chandrashekar: Olivier, on your first question on the North American marketing investment. How we think about North America marketing investment, I'll start with saying that despite our strong

growth in North America on the business, the 20% growth, we are still only a 7% share of total beverage alcohol. Despite the 79% growth of our [global] tequila business, we are still only a 10% share of the tequila category [US]. We believe we have a strong runway for continued growth and that's really what drives our decision to continue to invest strongly behind our brands. We, of course, measure our marketing investment very carefully. We have discussed several times before tools such as Catalyst, which enables us to ensure that we are looking at our marketing investments and making sure that we're always ensuring that we are supporting our brands to sufficiency.

The second thing that I would say is: levers that we have to drive operating margin, volume leverage, as we grow our volume in markets such as North America, we gain substantial operating margin due to leverage mix as we grow out the premium part of our portfolio and everyday efficiency.

The last thing I'd say is our North America margins are still significantly accretive to the group margin. So accelerating investments behind the North American business and growing North America disproportionately is good for Diageo.

Operator: We will take our next question from Trevor Stirling from Bernstein.

Trevor Stirling: Good morning, Ivan and Lavanya. Two from my side, please. The first one, Lavanya, I think from your Page 13 and looking at the comparison with and without Travel Retail and Guinness, would it be right thinking that if you had a full recovery in Travel Retail and the GB and Ireland on-trade, you're probably looking at about 6 percentage points of sales coming back? And presumably, a bit more on margin.

And the second question, maybe for Ivan. Looking at your 2-year CAGR slide, Latin America is 5% with Travel Retail still depressed in a very strong recovery. I wonder if you could give us just a bit more color on what's driving that strength in Latin America.

Ivan Menezes: Sure. I can start with Latin America. When we were sitting here 12 months ago, I would not have expected the pace of recovery we've seen in Latin America. It really is quite broad-based. We're seeing very good growth across all the markets. Brazil has had astonishing growth at 62%. Mexico is strong. Scotch whisky has come back very strong. And it's not just primary whisky, where we had good success with Black & White and White Horse and those brands. Buchanan's and Johnnie Walker has also come back really strong.

So here's what's happening. We are a very tiny share player in the TBA markets in Latin America. Our focus has been very much on growing share of TBA and looking at the occasions in which we can take share also from Beer. And in the at-home occasions through the lockdown, I'd say our marketing approach and commercial execution pivoted very strongly to winning in that at-home occasion. And our premium brands came back really strong. Johnnie Walker is up 29%, Buchanan's up 23%, Old Parr. So I'm feeling good and the margins have come back which is also really encouraging. We had over 600 basis points of margin improvement in LAC.

With Alvaro, who heads up Latin America right now, we're setting our sights on really ensuring that this business, it is high margin, and can be really growth accretive for Diageo and Alvaro and the teams across those markets have exciting strategies on how we can go about it. But scotch whisky vibrancy and health is really encouraging and the premiumization trend. All of that is supporting what you see in these numbers and our confidence that Latin America will continue to be a really good growth engine for us.

Lavanya Chandrashekar: Trevor, on your first question, yes, your interpretation of that stat is correct. It excludes the negative impact that we had on our business from the shutdown of the global travel business, which is down 62% this year versus last year and the impact of Guinness, which in total terms was flat in fiscal 21 versus fiscal 20, although there's been a big kind of regional mix difference there within the Guinness numbers. Our 2-year compounded annual growth rate versus fiscal 19 would have been 6%. So that's exactly what we were trying to communicate in that chart. I hope that answers your question.

Operator: We will take our next question from Mitch Collett from Deutsche Bank.

Mitch Collett: Good morning. I also have 3 questions. Firstly, can I ask if you can comment on stock levels, particularly in the U.S., are you back to normal now everywhere? Or are there parts of your business where stock levels are below or above where they would ordinarily be?

Secondly, just to go back to the increase in marketing it is up about 70% on a 5-year view in absolute terms. I think as a percentage of sales it's the highest we've ever seen. I know you've commented that you want to keep investing, but should it be a constraint to profit growth in F22? And also I noticed you mentioned it was one of the drivers of good working capital performance. Can we infer from that, that the timing of marketing investment this year was somewhat back-end loaded?

And then finally, Ivan, you mentioned in the slides that the Diageo has emerged stronger as one of your key points. I just wondered if you could clarify how you mean -- what you mean by stronger? Do you mean higher growth, higher margin, more heavily invested or maybe even all of the above?

Ivan Menezes: Sure, Mitch. So why don't I take the emerge stronger and then I'll ask Lavanya to address stock levels and your marketing spend question. When the pandemic hit 16 months ago, we set internally a very clear focus in February, March of last year around what we wanted to do is steer this company to emerge stronger. What that meant was a couple of important things. One is quality market share was our focus. We were not focused on financial plans. We removed the annual plans that we had in place and we said to every market and business around the world: focus on quality market share.

Now quality has a big definition that goes with it, which is all about price and mix and building brand equity and investing behind it and the commercial execution that goes with it. And then the second thing was to really ensure we took care of our customers, our people and the communities in which we operate. We call it “enhance our look-back reputation”.

As I look at where the company is today, I would say on both fronts we have performed really strongly. We stayed invested to ensure that the business, not just in marketing investment but in capital spending in Scotland and in acquisitions. We went out and bought Aviation, and did Lone River and Loyal 9. Obviously, the financial strength of the company is important. To me cash flow is a really important measure if you look at our working capital discipline and how we have come through. Receivables and bad debts have never been lower, stock-in-trade is really, really healthy around the world. All those dimensions bring us to a point where we do feel the company is stronger and that is what we set about to do and we are feeling good about the platform that we are on as we go into fiscal 22 and beyond.

Lavanya Chandrashekar: Yes. Mitch, your question on stock levels, as Ivan said, we are very comfortable with where our stock levels are. On a global basis they are still not back to pre-COVID levels. It is really about the culture that we have built over here over the last several years of sell-out. We came into the crisis with healthy stock levels. In terms of what we have seen happen with stock levels in North America,

the primary thing that we have seen was – as we ended fiscal 20 – destocking in the market. It was really driven by the uncertainty and the volatility that existed as we were exiting last fiscal year and the hesitancy of the distributors and retailers holding higher stock levels as well as our desire to match sell-in to sell-out. What we have seen in fiscal 21 is really the replenishment of those inventory levels. They are still below historic levels but now at a comfortable place is what I would say.

Your other question on working capital and did we feel it was back weighted. That was marketing spend back weighted and is that what is causing the working capital increase in fiscal 21. We always want to ensure that our marketing spend matches with what is happening in the marketplace. We try to spread our marketing spend across the year to best support our business in line with how the market is evolving. What we have seen at the end of fiscal 21 is up-weighting of marketing spend in certain regions and markets, mainly driven by how the on-trade has opened back up.

In North America, 85% of the on-trade is back open. As that started to happen in March, April, May and June, we were keen to invest in and support bars and restaurants that they open back up and support our business in the on-trade. The second thing that has also impacted working capital spend is just production levels. We have come out of this year with strong growth rates which has required us to pick up production versus where we were at the end of last year where we were actively pulling back on discretionary spend.

Operator: We will take our next question from Edward Mundy from Jefferies.

Edward Mundy: Morning Ivan and Lavanya, 3 questions from me as well, please. The first is I think in H1, you said that you had held or grown off-trade market share in 70% of total net sales value, and that's risen to 85% at the end of the year. Could you talk about what the big movements were and what really drove that?

The second question is on the U.S. market. I think, Ivan, you mentioned that you expect the U.S. market to revert back to sort of medium-term run rate of mid-single digits. I think, historically, it was running about 4. Is there scope for the industry to grow more than 4, do you think, as more people have made cocktails at home and more people have tried premium spirits?

And then the third question for Lavanya. You talked about the focus on everyday efficiency and obviously Diageo's done an awful lot in the last 5 years or so. Are there any learnings from the other companies that you've worked at that can apply to Diageo when it comes to sort of really driving everyday efficiency?

Ivan Menezes: Okay. I'll take the first 2. Just on the market share reporting, I think if you read the fine print, we've added some more markets. Actually, the market share momentum hasn't changed on a real basis because the basis on which we're reporting the 85% is a bit different. It's consistent to where we were in the first half, broadly, but it's still very strong performance.

If you look at where we are in the most important markets, the U.S., pretty much all of Europe, there are a few small exceptions, we're significantly gaining share. And across Latin America, actually, Mexico, which was losing share in the first half is now in the second half is gaining share. Most of our markets in Latin America are gaining share. We have pockets where we are behind. Pockets in Southeast Asia, where we are not quite gaining share yet and we have in the beer business in Nigeria, a little behind, but Guinness has done astonishingly well in Nigeria. Overall, I'd say the health is strong. we're also losing a bit of share in Canada where we're underperforming the market.

On the U.S. market, our assessment is there should be a bit of an uptick. It's hard to quantify and it's early, and there's a lot of dynamics that work with the recovery of the on-trade and also the return to work is the phenomenon we need to understand. The extent to which it happens and how it impacts consumption occasions and moments.

What I've always said, Ed, is consider the pre-pandemic trend as the floor because the core drivers of consumer taste, demographics, premiumization, spirits growing faster than beer and wine. We believe all those will continue. There certainly is the opportunity for it to be higher and I think we'll just need to see. I'd be cautious to declare it. What I'm comfortable saying is the pre-pandemic level is the floor.

We certainly intend to keep the vibrancy of spirits, the spirits category very high as our competitors are as well. The marketing innovation that's happening in spirits continues to be very effective in the category. We did see spirits penetration increase faster than wine and beer penetration in the last 12, 18 months. Those habits of at-home consumption should stick and it's discovering your 'inner mixologist' and having that delicious Tanqueray and tonic or Bulleit bourbon Manhattan or on the rocks versus a boring glass of wine or a boring bottle of beer from the fridge. I think those habits will stick. So cautiously optimistic it could be a little higher than the pre-pandemic trend.

Lavanya Chandrashekar: Ed, on your last question on everyday efficiency. What I have admired in Diageo since joining Diageo 3 years ago is really the fact that productivity and everyday efficiency is truly embedded into our culture and our ways of working and our business rhythm. And it's not a program anymore. It's just something that every one of our 28,000 employees just do every day.

Having said that, the job is never done and there continues to be opportunities that we are always pursuing. I would say that we see opportunities in the supply chain area, we see opportunities to continue to simplify and streamline our processes end-to-end and drive further efficiency in shared services. It's just the availability of data and how the world is evolving from a digitization perspective also provides tremendous opportunities for us to continue to pursue productivity. I think our great progress, in fiscal 21, we were able to offset inflation through productivity and going forward I think we will continue to look for more avenues to drive efficiencies.

Operator: We will take our next question from Laurence Whyatt from Barclays.

Laurence Whyatt: Good morning, Ivan and Lavanya. Thanks very much for the questions. Two from me, if that's okay. Firstly, on the U.S. business, tequila has obviously been the standout performer. The comps even in recent months have been pretty high and still the growth rates that we've seen in Nielsen are still well elevated over those. Could you give an indication of what sort of level of growth you're potentially expecting this year in tequila? Should we expect that to slow down somewhat or do you think the growth that we're seeing at the end of fiscal 21 could be maintained? And, linked to that, what percentage of U.S. sales at the end of this year are coming from tequila?

And then my second question on the Indian business. There's been a bit more chatter in U.K. press about the potential trade deal with India that may include a reduction in the tariff on imported alcohol, which would presumably include scotch whisky. If any tariff was reduced, hypothetically speaking, would you look to reduce your prices in India at a similar level or a commensurate level to the tariff reduction that may be seen in the country? Thank you very much.

Ivan Menezes: Sure, Laurence, I'll take those. On tequila, it's about roughly 20% of the U.S. business, and it's obviously very fast growing. I won't give you a number in terms of what we expect for this year, but it's obviously going to be very fast growth. Casamigos grew 126%. I'm not sure that's going to sustain but you're going to see very, very fast growth. Now one of the things we feel about the tequila category going forward is that we do see a lot of runway. This category is – if you look at the dynamics at work – cutting across demographics, it's cutting across occasions, the versatility of drinks and the association with the health and wellness of agave, all of those bode really well.

The other thing I'd say to you, which it's an interesting data point. California is the most developed tequila market in the world. If you look at Nielsen sales, tequila is about 20% of spirits in California. A lot of the country is still sitting at about 10% or lower. This trend has a lot to run and what we're really excited about is it's happening at the top end. Our growth rate is double the growth rate of the tequila category because the acceleration is happening at the top-end price points, so we feel good about that.

On tariffs, again, it's the discussions between the U.K. and India are happening. It's more promising than ever before. It's obviously too early to call what may happen. We expect there to be some gains, hopefully, in the next year or 2. I mean, clearly, we will have to reflect our pricing. If we have elimination of tariffs, it will impact the pricing in the marketplace, but we also have global pricing norms on brands like Johnnie Walker. But the bottom line is we would see an acceleration in our scotch whisky, bottled in origin scotch whisky, business were tariffs to come down, and we've modeled all those scenarios and we'll see it through in the next year or 2 depending on where the talks get to between the U.K. and India. It's more encouraging than it's been, I'd say, in decades, and we have scenarios of the amount of whisky we'll need to lay down in Scotland as tariffs come down. It is going to impact our plans.

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

Alicia Forry: Hi. Good morning and thanks for taking the questions. I've got 3, please. The first one is on your guidance for margin expansion in fiscal 22. Does this include an assumption of price increases to recover the slightly higher cost inflation that you've mentioned? Or can efficiencies cover that inflation yet again in fiscal 22?

Secondly, you mentioned having taken some successful price increases in LAC and in Africa. But you've also mentioned elsewhere some down trading in a few of those markets. I just wondered your thinking behind taking price in those markets at their various stages of recovery across the emerging market landscape.

My third question is on Africa where it seems like you've made quite a big focus on the off-trade and on e-commerce. Now both of which, historically, have been a bit challenging in that region. I was just wondering how you've gone about making the African off-trade work for you so successfully? Thank you.

Ivan Menezes: Sure, Alicia. Why don't I take Africa and then Lavanya can do the margin and price increases. Our Africa business which, by the way, is strongly on-trade driven. The beer business has a lot of on-trade out-of-home consumption. But we did, as we point out, we did pivot strongly in the off-trade. Our business is up 20%. We had good growth across all the regions. Our beer business was up 19%. Spirits up 21%. Guinness actually was really strong in Africa, up 32%. We did a few things in Africa, not unlike everywhere else in the world.

The shift to off-premise in marketing and commercial execution we stepped up significantly. In markets like Uganda we went into e-commerce platforms for home delivery with boda boda guys on motorbikes who would deliver your beer and spirits to your home. In Kenya we did the same. We pivoted on working with e-commerce platforms that developed in these emerging markets. I would say that in part is what helped us to sustain the growth there. Mainstream spirits has done very well in Africa and we are really glad it was up 29%. That business is nicely building for us and it is margin accretive for us. These are locally made spirits. That lends itself to at-home consumption and off-trade as well. That has been part of what has supported our growth.

Lavanya Chandrashekar: Your first question Alicia was in terms of our guidance on margin expansion and will this include pricing. I would say that pricing is one of the levers that is in our arsenal to be able to drive margin expansion. The other ones are obviously volume leverage, mix, premiumization and the return of the growth of scotch whiskey, growth of the more premium portfolio as well as the return of on-trade beer are all going to play a factor in being able to drive our margin expansion. Our objective will be to negotiate with our customers the right pricing required in individual markets as needed.

In terms of your second question on down-trading. We have seen some down-trading in the emerging markets in our value brands as consumers have looked for value in more challenged conditions. I think our mainstream businesses in Africa was up 29%. We saw primary scotch up in Latin America, especially in the first half of the year as well. What we are very proud of is that we've been able to keep consumers in our portfolio because we have the breadth and depth of the portfolio to be able to cater to consumer needs, both in environments where there is significant premiumization and trading up happening, but also in circumstances where consumers feel the need to temporarily trade down. We've seen the impact of both. But, in total, 50% of our growth has come from the super-premium and above segments of our portfolio. Our reserve business has grown 36%. In aggregate, we have clearly seen far more premiumization impact on our business than down-trading.

Operator: We will take our final question from Chris Pitcher from Redburn.

Chris Pitcher: Thanks very much. Just a couple of questions. Following up on the discussion around Travel Retail and Guinness impact. The details you have given at the back of the statement show that combined they were a very high-margin contributor in fiscal 19 and profitability has fallen off significantly. Can I just understand a bit more of the economics? I would imagine Travel Retail is much more of a variable cost business and therefore margins won't have fallen very much, or as much. Is it Guinness that has really seen profit drop very significantly? And that's where the operational gearing coming back is, i.e., you are more geared into an on-trade Guinness recovery than you would be necessarily to a travel retail recovery?

And then secondly, on Casamigos. I remember at the time when the deal was announced, it was sort of slightly a headline grabbing price. But the volumes have massively exceeded certainly our expectations at the time. Even with higher agave costs, and I would assume some incremental capital investment, have you covered cost of capital this year? In which case that would be kind of a positive indication. Thanks.

Lavanya Chandrashekar: I can take your questions. On the impact of travel retail and Guinness, what we need to remember is that a significant portion of our travel retail businesses is premium scotch, super-premium scotch. Part of what we have seen and was demonstrated in the financial statements that we have put out there comes from the fact that we have lost a significant portion of that very profitable scotch business that flowed through travel retail. That is definitely a portion of impact that comes from

the reduction of our Guinness business as well. That has been really a tale of two cities. We have seen Guinness on-trade do poorly in Europe mainly due to the restrictions of the on-trade. But then, on the other hand, we have seen the Guinness cans business pick up. Guinness in total, in aggregate, at a global level is flat. But that mix between the loss of the very profitable on-trade business versus the gain of the off-trade cans plus the loss of premium scotch is what has contributed to the margin decline.

Casamigos. I would say that we have been very pleased with the acquisition of Casamigos. The brand has outperformed all of our expectations at the time of acquisition from a top-line basis. It is a very efficient model of driving our business in terms of how the brand is supported and how it has grown. Yes, we are very pleased with the return on capital that we have had from the Casamigos acquisition.

Chris Pitcher: And just on the contingent payments you are making, is that a good indication? Are you well ahead of the sort of 10-year earn-out? That's a good indication of how it's been progressing. Is that the way to think about it?

Ivan Menezes: Yes, it's way ahead of our expectations. We are really, really happy with it. In spite of agave price is being higher, the cash flow that this acquisition has turn off has been superb and the brand still has a lot of runway ahead of it.

Thanks very much and I appreciate everyone calling in and appreciate your interest in the company, and Lavanya and I look forward to talking with many of you over the next couple of weeks. Thank you.

Operator: This concludes today's presentation. Thank you for your participation.