Diageo F22 Interim Results Investor Q&A Call

Date: Thursday, 27 January 2022

Conference Time: 09:30 (UTC+00:00)

Ivan Menezes: Hello, everyone, and thank you for joining our interim results call for fiscal '22. I hope you've had a chance to read our press release and watch our presentation webcast on diageo.com.

I'm very pleased with our results for the first half of fiscal '22. It builds on our strong momentum in fiscal '21, and demonstrates our world-class brand building, supply chain excellence and agile culture. Organic net sales were up 20%, all 5 regions delivered double-digit growth and exceeded net sales in the first half of fiscal '19.

Growth was broad-based across categories, and I was particularly pleased with the strong growth in scotch, up 27%; the continued outperformance in tequila, up 56%; and the recovery in beer, up 22%. We also delivered a significant improvement in operating margin, up 131 basis points, while increasing our marketing spend ahead of net sales growth. We achieved this while managing higher cost inflation and ongoing disruption from global supply chain constraints.

Our advantaged portfolio, combined with effective marketing, excellent commercial execution, and successful innovation, enabled us to gain or hold off-trade share in the majority of our markets, and we also gained share in the on-trade as it continued to recover. We are investing in long-term growth, including production capacity, digital capabilities, and our Society 2030 goals. And we're delivering consistent returns for shareholders, increasing our interim dividend by 5%, and accelerating the timeline for completion of our return of capital program to 2023.

While we expect continued volatility in the near term, I'm optimistic about the growth prospects for our industry and for Diageo. We believe we are well positioned for resilience in the off-trade and further recovery in the on-trade. We expect to continue benefiting from the rapid premiumization of the spirits category, and its share gains within total beverage alcohol. Our premium differentiated brand, Guinness, is well positioned for key growth trends in beer. I am confident in our strategy, and our ability to execute strongly through the remainder of fiscal '22 and beyond.

Operator: We will now take our first question from Pinar Ergun from Morgan Stanley.

Pinar Ergun: I have 2 questions, please. The first one is to what extent have supply constraints impacted volumes, especially in North America? And do you see any signs of improvement in the supply chain situation? And the second one is, do you see any possibility that consumers might spend less on premium spirits as the cost of living goes up? And, I guess in that context, can Diageo continue to raise prices with a limited impact on volumes?

Ivan Menezes: Hi Pinar, I'll take the second on premiumization trends and ask Lavanya to address your first question on supply constraints. I would say the premiumization trends, as you know, have been very long dated and steady in the U.S. and in other parts of the world. People drinking better has been a trend that has really sustained through lots of cycles, economic cycles and disruptions.

The second point I'd make is, if you look at the U.S. market, the average American household that buy spirits, this is about half the households, they spend about $1 a day on spirits purchases to consume at home. So, when you're faced with an economic crunch, our product is an infrequent purchase, people typically buy spirits 6, 7 times a year, they buy a few bottles of a category. So, if you're drinking Ketel One vodka, you're buying a few bottles a year, and it's only a few dollars off a premium to a low-priced vodka. And so, we do believe, actually, that the sustainability is good.

The other thing I would say is, if you look at the demographics, young adults, in America, again, 21 to 35, over-indexed in buying premium spirits, the multicultural population over-indexes in buying premium spirits, and you see these demographic trends also very positive for premiumization in spirits. So, we're not immune from overall consumer confidence and spending power, but I would say within those shifts, we still see our higher-priced brands growing faster, and that tailwind should continue for Diageo.

Lavanya Chandrashekar: I'll take the first part of your question, Pinar. On supply constraints impacting volumes in North America, yes, we are seeing issues that are impacting our business in North America. But having said that, our U.S. beer business in North America grew 3% volume in half 1. If I look back at pre-COVID levels, volume growth from this business was somewhere between 1% and 2% at the top end. So yes, we are seeing issues, they're spotty. But having said that, I think the organization is doing a fantastic job of navigating them and being able to grow volume faster than we have historically grown on the business.

Let me talk a little bit about where we are seeing constraints. Two areas, one is on certain parts of our portfolio we're seeing constraints in terms of aged liquid. That's true on Crown Royal, and that's true on tequila, being liquid constrained. And then on Bulleit, we have a very specific issue around glass, and that really is impacting just the Bulleit bottle, which is a very bespoke bottle, and we are working with our strategic bottle supplier on that brand to resolve those issues.

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

Sanjeet Aujla: Ivan, Lavanya, a couple of questions from me, please. Just following up again on the supply chain dynamics in North America. Can you give us a bit of a time frame as to when you expect those constraints to be resolved or certainly moderating from what we've seen in H1?

And then secondly, as you think about the pricing outlook particularly in Europe, can you give us a sense of what sort of magnitude of pricing you feel you're in a position to take in the region? I think we've seen a lot come through in emerging markets already, but I'm particularly interested in how you're thinking about Europe.

And then my final question, just on China, if there's any colour you can give us on the current sell out trends into Chinese New Year particularly against the heightened lockdowns that we've seen in recent weeks?

Ivan Menezes: Yes. Why don't I take China and pricing and ask Lavanya to cover supply chain. On China, we see the environment is solid. I mean you see in our numbers both baijiu and scotch whisky continued good momentum. You do have the impact of COVID lockdowns in various parts of the country that does impact business. I'd say going into Chinese New Year, it's solid but not exuberant, and in particular, I'd say for our baijiu business, the large-scale banqueting occasions are going to be less, and large-scale gifting is going to be a bit less. But we remain confident on continued strong growth in China on both scotch whisky and baijiu. And we're gaining share, and we're feeling very good about the momentum there, and certainly for the longer term, we feel very positive about the growth prospects of China.

On pricing in Europe, I'd say if you look at what we've been doing in Europe, we've been investing behind the brands strongly. We're gaining market share. Actually, we've gained in 5 out of 6 markets, we're gaining significant share. And our spirits business is performing very well. As we've talked before, we've got multiple levers to manage the inflationary impacts. Volume growth helps us, and there's very good volume growth in Europe. Mix is positive, and we will be taking some price, so the combination of productivity and pricing will offset inflation, but we're very surgical in how we apply our price increases, but you will see more pricing coming into Europe because of the inflationary pressures.

Lavanya Chandrashekar: Sanjeet, I'll take your question on supply constraints in North America. As I've mentioned to Pinar, we've got to look at this in the context of the overall performance of the business, which has been absolutely fantastic in delivering volume growth in North America as well. And really, our organization has been able to achieve very strong results because of the proactive approach that we have taken to this area, and because of the strategic relationships that we have with key suppliers. In North America, as an example, the procurement organization has been able to bring in new suppliers to the market, and this has allowed us to increase our glass capacity by almost 25%.

Now on Bulleit specifically, the teams are actively working on it, and we think it's going to be a matter of months to be able to resolve it. It's not going to be a long-term issue by any means.

On the aged liquid constraints that we have, we have a number of tools in our arsenal that help us to work around that. The first thing is demand shaping; we are able to move our A&P spend to parts of the portfolio where we do not have similar constraints. Look at our results on scotch in North America as an example, and Johnnie Walker in North America, with strong double-digit growth in the scotch category. So we are able, through a combination of revenue growth management and pricing on the constrained areas, as well as the demand shaping, to tackle constraints in these situations.

Operator: We will now take our next question from Simon Hales from Citi.

Simon Hales: Three from me as well, please. Can I just follow up on those pricing comments? Are you seeing competitors really following or matching the price move that you've been making in the U.S. and Europe? That's my first question.

Secondly and more specific to your business in the U.S., there was some mixed brand performances in the first half from the volume and sales momentum point of view. Clearly, your premium brands have done very well; tequila, scotch, et cetera, showing strong growth. But some of the more mainstream ends of the portfolio, Smirnoff and Captain Morgan, look like they're struggling a little bit, while Baileys and Bulleit admittedly, given some of the supply constraints on Bulleit, are under a bit of pressure. Can you give us a little bit more colour of the drivers there and, perhaps more importantly, how we should think about how those trends will evolve in the second half?

And then just finally, a quick final one on CapEx. Clearly, you're upweighting CapEx this year. I appreciate there's some catch-up in that sort of CapEx expectation. But how should we think about CapEx really beyond 2022?

Ivan Menezes: So I can do the first two and Lavanya can cover CapEx. I'd say pricing, Simon, the revenue growth management capabilities we now have are really embedded. The analytics and data is very good. As I talked about earlier, we're investing behind the brands; brand equity is going up, and we feel reasonably confident about our ability to take measured price increases and sustain the market share momentum we're looking at. You have different competitive dynamics in different parts of the world, but it's clear, the inflationary pressures are high for everyone right now, and I'd say our customers are also understanding, because everything they're buying right across the spectrum is facing more inflationary pressures. So, I do believe we will be able to sustain, kind of, discipline and pricing and as I said, surgically applied. And we really want to keep the momentum of growth, and make sure we're recruiting more consumers to our brands. And our investment levels in the brands and equity is very high.

On the U.S. brands, I would just say, as we come through the bounce-back of COVID and some of the supply chain issues there are, you're seeing some little differences in the portfolio on shipments versus depletion, so I'll just answer your question directly on the three brands you mentioned.

On Captain Morgan, actually, our depletion momentum is positive. So, it's low single digits, but it's in growth. And if you look at market share momentum where we've been losing share, as you look at 12 months, 6 months, 3 months, it's improving. So, Captain should stabilize and be better. We've got a big program with the NFL, which we're excited about and we're in season right now, so you should see some improvement there.

Smirnoff depletions is about flat. I'm talking the U.S., and again, we've got good marketing and innovation coming behind Smirnoff. So, these two big brands will be below the North American growth rates, but we just need them to be stable to slight growth, and we do see that happening.

Baileys actually is positive, and what you're just seeing there is the lapping effect of some of the shipments and coming off tariffs and all the things that happened on Baileys. But we're very positive on Baileys in the U.S, and again, it's in high single-digit type depletion growth as we looked at the last 6 months.

Lavanya Chandrashekar: Simon, I'll take the second part of your question on the upweighting of CapEx in fiscal '22. We have guided to -- we will -- we expect to spend between GBP 950 million and GBP 1 billion of CapEx in fiscal '22. This is higher than our previous guidance and really comes from the catch-up of projects that were paused or put on hold due to COVID and now coming back online and actually the need to continue to invest in the business.

From a capital allocation strategy perspective, our strategy remains unchanged. Now our #1 focus will be to continue to invest in the business, and this includes capital investment as well as A&P spend. From a CapEx perspective, ensuring that we have sufficient capacity to meet the growth ambition of the business and the growth trajectory that we're seeing on the business today is critically important.

We also continue to invest behind strong consumer experiences. This is a large part of how we support our brands. We opened Johnnie Walker Princes Street back in September, and that has been a real boost to what consumers -- when consumers visit Princes Street, they come away with the love for the brand that's remarkable and unmatchable.

And in terms of digital capabilities, that's been a key focus area as well. We continue to invest behind digital capabilities to support our commercial growth of our business, our marketing effectiveness, understanding as well as improving our marketing effectiveness as well as in building capabilities, even in terms of the supply chain. So that will remain our key focus area to continue to invest behind -- in our business.

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

Mitchell Collett: I've got 2 questions. First, can you comment on inventory levels at the end of the half, ideally by region, particularly given the gap between depletions and shipments that you may have on a few brands that you've just mentioned?

And then secondly, I think COGS per litre in the first half was up 1.6% year-on-year. I appreciate you say in the statement that COGS have benefited from some of your productivity efforts, but can you perhaps comment on how you've kept COGS per litre at that level given the premiumization you're seeing and then what you would expect is a reasonable level of COGS inflation for the second half?

Lavanya Chandrashekar: Sure. I can take both of the questions, Mitch. So on stock in trade inventory levels, I assume you're talking about trade stock. With essentially what we have seen across the business at a group level and within North America, what we're seeing is our stock in trade is relatively flat year-on-year with shipments in line with depletions. There have been some differences across different parts of different brands within North America, and that comes from we were -- we had increased stock levels to support the opening up of the on-trade in certain brands and in other places because of just managing the timing by when product gets to the market due to various supply chain issues. We've just seen some differences between shipment and depletion at a brand level. But at the total North America level as well as at the total group level, our shipments have been in line with depletions.

On your second question on COGS and how are we able to manage COGS inflation and what do we see happening on inflation, back in -- at the end of our year-end, last fiscal '21 year-end result, I had said with you that we are seeing a higher level of inflation. And we're seeing that come through in terms of both commodity costs as well as energy costs. We're also seeing the impact of higher logistics costs due to just shortages of drivers and containers, et cetera, that's impacting everybody, not just Diageo.

Where we are seeing the leverage that we have to offset inflation, first of all, I'll remind you that because of the nature of our business and the percentage of our business that have aged product, we have a natural buffer against inflation just because the whole -- a large percentage of what we are selling today we actually laid down the liquids several years ago, more than a decade ago in many cases. Other than that, we're seeing the benefits of volume growth. We grew volume 9% in the half, and that contributed significantly to margin benefit. Premiumization clearly contributes to our gross margin.

From a COGS perspective, we are -- productivity has been a big part of what has enabled us to keep growth muted despite inflation. And that's really embedded into our every day. And we're seeing COGS productivity come through on -- from a procurement perspective, from a manufacturing perspective, also from a logistics perspective. So we're seeing it really play out across the board.

And then from a margin -- going back to looking at margin, I mean revenue growth management has enabled us to take smart pricing, manage trade spend, manage mix -- a few mix in a way that allows us to grow our margins.

Operator: We will now take our next question from Celine Pannuti from J.P. Morgan.

Celine Pannuti: Yes. My 2 questions, number one, I would like to understand what is your best guess of what the market growth is in the U.S.? You said that 3% volume, it seems to be slightly ahead of the market. Could you say what the market growth rate overall is?

And then my second question, I mean you have made at this point about virtuous circle of reinvestment. And clearly, 85% of your business gaining or holding share is very impressive. That said, I was looking at the U.S. and how much your A&P has been increasing, and I look at 3% volume which may be a bit ahead of market but it doesn't seem to be that much ahead. So is that an unfair observation? Or should I look at it on a total basis including the price mix benefit and it is the cost of moving consumer towards premium products? And what does that mean? Do you think that the support level maybe has been a bit oversized in the first half?

Ivan M. Menezes: Yes. I can start and let Lavanya jump in. I'd say now when you look at market growth rates with all this COVID kind of comps and what was happening last year and this year, you just have to be a bit careful. So what I would say in value terms in the past 6 months or the first half of this fiscal, we estimate the U.S. market in value terms growing at about 9-10%. But you have to remember, it's what it was lapping.

The long-term growth in the U.S., let me just address that now, I mean what we see is, pre-COVID, you had the U.S. market industry growing at about 4-5%?. We believe as things return to normal, it will grow at that or a little bit faster as the steady-state return of -- because the U.S. underlying demographic and taste trends are still very positive.

The investment in marketing is very targeted, and we've got really good confidence on how we spend it by brand and get the returns. And you've seen us do this in the past few years. The U.S. is a top priority to invest behind because our goal here is to have a sustainable growth engine in North America and one that will grow share, outperform the TBA market. And as you know, our margins are incredibly high.

There is nothing structurally changing in the economics of our U.S. business, right? It's not like the cost to compete has gone up or our margins are under pressure. These are very deliberate choices we are making to sustain not just this quarter and this half performance, it is really about the next few years. A lot of the A&P investments will pay back year 2, year 3, year 4. We're building a number of smaller brands that will get bigger 5 years from now. So that's how I would address your point on the marketing reinvestment going up in the U.S.

What the capabilities Diageo has built in the last few years now gives us a lot more confidence in really smartly investing and being very clear on the returns we want and the returns over time.

Lavanya Chandrashekar: Yes. I'll just build on that, Ivan. Celine, the way we look at marketing investment is really from a return on investment perspective. So it's not linked to volume growth alone but really looking at it from a perspective of what's the overall financial return that we get on investment. And as Ivan said, over time, we've built several tools and a lot of capability in this area. In the past we've talked about tools such as Catalyst which allows us to forecast what a return on investment of individual marketing spend would look like as well as then, on the back end of the program, measure and track whether we actually got the benefit that we were expecting.

Our North American business is a high-margin business. All of our investments that we are making in this market has allowed us to grow the business ahead of market to grow share in a sustainable manner. And frankly, this growth is very accretive to the group P&L. As Ivan said, it's a deliberate part of our strategy to build a sustainable growth engine for us with the North America.

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

Olivier Nicolai: Just 2 quick questions, actually following up on the U.S. First of all, you mentioned in the press release that the price mix in the U.S. was plus 12%, and you obviously mentioned channel mix, premiumization and pricing. Would you be able to quantify the pricing element per se?

And then if we look at, well, this year, 2022, can you give us an idea of the magnitude of the price increase you've been taking so far in your U.S. portfolio?

Lavanya Chandrashekar: Sure. Olivier, we don't break down the pricing that we have taken in our disclosures. But what I will say is that we look at pricing as a very surgical part of tools within our overall revenue growth management suite of tools that we have. We've taken pricing on tequila in the first half of the year. We have taken about 4.5% pricing on tequila. And we've been able to execute it while continuing to grow the business, strong -- very strong double digit, 60% growth on that business and growing share of spirits as well as growing our share of tequila. We've taken some pricing actions on Crown, where we have been liquid constrained. We've also taken some pricing action on Guinness.

And so again, these decisions are made individual brand by brand based on the strength of the brand equity, based on the strength of the marketing programs that we have. And as we take these pricing actions, we are doing so in a database manner and balancing our growth -- top line growth with margin growth.

In terms of what we should expect to see as pricing in the second half of the year, I'm not going to give you a clean enough answer that you would expect on this, but I will say that we will continue to evaluate pricing opportunities on a case-by-case basis, both in the U.S. as well as in other parts of the world.

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

Andrea Pistacchi: Yes. Three, please, if that's possible. First, I just wanted to follow up again on pricing in the U.S.. You said where you've taken pricing, and clearly, the pricing environment seems more favourable than it has been in a long time. So, the question really is, is it possible to start thinking, or are we far away from the point where you can really take pricing on some of the brands where there hasn't been pricing in years, like the vodka portfolio or brands like Captain Morgan?

Second question, please, on emerging markets, where you've got very strong momentum, how do you feel about this momentum continuing as you'll be up against tougher comps, and with inflationary pressures building on the consumer? And do you expect much divergence in performance among the regions in the next 6, 12 months?

And then please, the last one on SG&A. It seems to me, given the organic basis points impact from SG&A, it would suggest that SG&A organically was up quite strongly, probably low double digit. So, I was wondering whether you could give a bit more colour on what drove this significant increase in SG&A.

Ivan Menezes: Okay. Andrea, why don't I take the first 2, and Lavanya, the third. On pricing in the U.S., again, I'm not going to get into specifics of pricing by brand. What I would say is we are and do intend to be able to take more pricing than historically. The brands have been well invested in, and the capabilities we have in revenue growth management are really embedded and delivering. So, you should see better price realisation coming through on our U.S. business. And we manage the portfolio, so as Lavanya talked about, on tequila and Crown and a few places, we've taken more significant price increases. Over time, we will look at it across the whole portfolio and ensure we can deliver the right balance of volume, price and mix going forward.

On emerging markets, I would just guide you to our medium-term guidance for Diageo that we laid out a few weeks ago. In the total growth for Diageo of 5% to 7%, we expect emerging markets to grow a bit faster than that. All the fundamentals actually are intact; the demographics, the penetration of spirits being low and increasing. Scotch is very vibrant; you see it in our Johnnie Walker and scotch numbers which came through really, really strongly, and I'm really pleased about that. Most of the growth in scotch, the growth rates in the emerging markets were much faster. There is some bounce-back effect, but what happened through COVID is we did see in-home penetration increase for deluxe scotch, and we see the recovery as the on-trade opens also strong.

So, we're feeling positive about the emerging market momentum. I mean you see there is very strong momentum in Latin America. Africa has come back nicely. Guinness and beer is doing really well. Our Guinness business is up 19% in Africa, Johnnie Walker is up 19%, Smirnoff is up 15%.

And then in Asia, India had a very solid performance, including scotch which did really well. Now emerging markets always have a level of volatility, but the long-term prospects, we feel very good about, this being an accretive growth business for Diageo in the years ahead.

Lavanya Chandrashekar: Yes. I'll take the question, Andrea, on overhead on SG&A. Yes, on a dollar basis, our SG&A has increased, although it has increased far slower than our overall growth rate. On our overheads, we are seeing significant operating leverage come through driven by the growth of the business, and really the reason behind it is that we're lapping a period where we had pulled back on discretionary spend in a significant way at the start of COVID, which has continued through to the first half of fiscal '21. As things have started to revert back to normal, I mean, we are back in the office, as Ivan said, the Investor Relations team, Ivan and myself, we are all back in the office again. We have had some modest recovery of travel, thank God, and so it's just a reversal as we think about getting back closer to normal.

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

Edward Mundy: Three questions from me, please. There was a comment, I think, in your previous presentation around gaining share of TBA in the on-trade, presuming this is partly a Diageo comment given that half of your brands are in strong execution, but is there any early evidence that consumers are drinking more spirits and cocktails than in the on-trade as the recovery comes through?

The second question is really around tequila that continues to be a good part of your growth engine, and we're about 5 years into the cycle. What gives you confidence there's still plenty of runway left for the category and how do you think about the risk of new entrants, some of these other celebrity-endorsed brands? How do you ensure that your brands stay relevant and don't lose their momentum?

And then the third question, Lavanya, on the buyback, could you just run through the reasons for the acceleration and bring it forward by year?

Ivan Menezes: Yes. I'll take the first 2. We are seeing spirits momentum in the on-trade a little stronger. I'll take the U.K. as an example. So, the recovery across the spirits, beer, wine, cider has been strongest in spirits and premium spirits. And in other parts of the world we see the on-trade coming back, there was a concern that people would down-trade when they go back to the on-trade, and that hasn't happened. So, as a broad statement, I'd say in most markets, we are seeing positive trends for spirits in the on-trade as it reopens.

The tequila growth, I'd say when you cut the consumer understanding on tequila, and I'll focus on the U.S. before the rest of the world, we still see a lot of runway. The category's appeal across demographics is significant. It has crossed over, the multicultural growth is very strong. It cuts across age segments, it cuts across gender, it cuts across dayparts, the occasions, and the nature of drinks. It's not just shots and margaritas as it used to be many years ago. So, we see tequila growing faster than the spirits industry. It's obviously not going to grow at the kind of rates we're seeing right now forever, but we do see it for the next 5 to 10 years growing faster than the spirits industry, so taking a bigger share of total spirits.

The international growth in tequila is just starting. It's very small. But we do see at the high-end bars around the world, the mixology community is very connected, and tequila is making its way onto drinks and cocktail menus, and bartenders are excited about it. I expect that to be a slow build, it's not going to explode. So, in total, we do feel positive about the long-term growth trends for tequila, and that, in part, is also guiding the investments we're making in Mexico around agave and distilling capacity.

Lavanya Chandrashekar: And I'll take your question on the acceleration of the buyback, but maybe I'll just remind us that when we announced the share buyback program back in July 2019, we announced a £4.5 billion program to be completed in 3 years. And we completed £1.25 billion by January 2020, but then we paused the program in April due to COVID and restarted it in May 2021. We have announced that we plan to complete £1 billion of buyback by March this year.

The reason for accelerating the completion of the program to fiscal '23, it's simply because our leverage ratio is back to the bottom end of our target leverage ratio range. We target a range of 2.5x to 3x net debt to EBITDA. We ended the half at 2.5x and in line with our capital allocation strategy. Where possible, we returned money to shareholders in the best method possible. When we restarted the program in May 2021, we had extended the completion date from what was originally end of '22 to end of '24. Given that we are back within our range on leverage, we pulled it forward to fiscal '23.

Edward Mundy: Very clear. And Ivan, just coming back to tequila, clearly some of the other celebrity-endorsed brands are getting traction. The Rock's tequila is now at 600,000 cases. I mean how do you ensure that both Casamigos and Don Julio stay relevant and don't lose momentum?

Ivan Menezes: Yes. I'm sorry, I didn't address that. The key is keeping these 2 brands incredibly vibrant, aspirational, recruiting. We've gained outsized share in tequila with Don Julio and Casamigos. And so that share momentum within the category we've got to keep doing.

I would say we feel good. These brands are incredibly healthy, they're on trend, we have premiumization within Don Julio happening at a terrific pace. And as we may have mentioned before, we're constrained on liquids, on 1942 and Ultima, some of the higher price points. So, I would say keeping these brands really healthy, it is a premium brands business. It's not like the wine business; you absolutely have the power of the brands playing a very important role in this category. And what Diageo needs to keep doing is ensuring we're at the top of our game on keeping these 2 brands and their market share momentum within tequila. I feel good about the ability of the team to keep doing that, and we start from a very strong base of brand equity momentum.

Operator: Will now take our next question from Trevor Stirling from Bernstein.

Trevor Stirling: Lavanya and Ivan, 3 questions from my side as ever. First one, Ivan, looking at the 8% CAGR over the last 3 years, which is incredibly impressive performance, but then looking at a regional level, I'd say probably the 1 region probably underperforms compared to potential is Asia Pacific. I wonder if you could talk a little bit about that, about the reasons behind that. But Latin America, incredibly strong performance, and that seems to be pretty broad-based but primarily scotch. Is that fair? So maybe a little bit of colour on those 2 regions.

And then finally, I noticed that you're investing as well behind the Diageo One B2B platform. Is that something that's oriented more towards distributors or where you have direct-to-retail relationships or a bit of both?

Ivan Menezes: Yes. So, I'll take the first 2, and Lavanya can cover the B2B platform. The 8% growth, as you say, is over 3 years now, this business has gone through the COVID disruption and we're at that level. The Asia Pacific numbers, there's a few things going on. You've had less of a bounce-back in growth yet. Even through this half there are parts of Asia that have been more challenged. So, you see in this half, Asia Pacific only grew 13%, whereas Latin America grew really strongly at 45% and Africa grew at 23%.

Within Asia Pacific, China we feel really good about, and it will come back. Australia has been a bit tough and parts of Southeast Asia. So, that impacts the CAGR. But I remain very positive about looking forward that India and China should be very accretive growth engines for Diageo, growing faster than our average. And Southeast Asia, scotch is coming back nicely. And then we have some drags. Australia will be low growth, Korea is low growth, Japan is lower growth. So, developed Asia will be lower growth.

Your second question on Latin America, the momentum is in the scotch recovery, I think our scotch volumes were up 20-plus percent in the half. Deluxe scotch, Johnnie Walker was up 40-plus percent in volumes. And what was interesting to see is the at-home consumption through COVID, the penetration of high-priced whisky increased at a faster rate, and as conditions have improved and the on-trade comes back, we're seeing really strong growth and we're gaining market share right across, other than Mexico, where we're slightly behind. Everywhere else, we're gaining very strong market share in Latin America.

And I'm very positive about the outlook for what we can do. We brought this lens of TBA share, and that's driving us over the last couple of years. The way we activate, the occasions we're going after, looking at the bigger pool has just opened up more opportunity. And it's not just scotch, Tanqueray is doing really well. Our gin business is also performing nicely. Baileys is good. Smirnoff is coming through as well. So, feeling good about Latin America.

Lavanya Chandrashekar: Sure. Trevor, I can take your question on Diageo One. It is a B2B platform. And it allows us a single point of engagement with our customers. They're able to access their account. They're able to access any other Diageo content, and they're able to do so from any device anywhere at any point in time. It's something that we have in place now in 6 markets, and it enables us to provide better customer service to our customers, more digitally enabled service to our customers.

Operator: Will now take our next question from Nik Oliver from UBS.

Nik Oliver: Two from my side, please. First one on the emerging markets but this time on the margins. I guess, operational leverage, particularly in Africa and LatAm, has surprised to the upside in the good years like now and the downside in the past. Is there anything you can share with us in terms of cost structure, fixed versus variable or anything else, to maybe help us model these better going forward?

And then the second one and back to the U.S., you called out very good growth in the spirits RTDs. Where is that sourcing from? I guess some of it is cannibalizing spirits, but is a bigger part coming from outside the spirits market, beer, et cetera?

Ivan Menezes: Yes. Why don't I get started. On the margins on Africa and LAC. So in Africa, when we went through the lockdowns, the beer business is a fixed cost business, right? So, you take a big hit on the downside as volumes drop, but they recover really fast as the volumes come back. So, while we were going through that correction, wasn't particularly worried. We knew we would get the economics back on the business. And you take a market like Nigeria, we've had significant margin expansion come through as that business has come back.

And so, what you look at going forward, to your question is, if you've got big volatility -- hopefully we won’t have the swing of the COVID-type volatility – but when you have volatility in volume due to external factors, it does impact your margins. And what we stayed true to is staying invested and not trying to manage this business for short-term margin when we went through those cycles.

On Latin America, it's similar dynamics, but it’s more the mix. When we were at the height of COVID, the scotch whisky business deluxe volumes dropped. They're very high-margin businesses, and now they're coming back very strongly.

So, you take the long view on both Africa and Latin America, and we do see margin expansion in both markets driven by volume growth, premiumization, pricing and productivity. And so, we would expect steady margin expansion going forward. But as we know, it's never a straight line, and I think what you see in Diageo's approach is, we are steering the company through volatility in a way where we're really focused on getting quality sustainable growth and the economics to the right place, and not having knee-jerk reactions to short-term disruptions in the external environment.

Lavanya Chandrashekar: I'll take your question, Nik, on U.S. spirits ready-to-drink. First of all, I'd say that it's a very small percentage of the business right now, and so 50% growth on a small number, while really good, it's a small number.

But the second thing that I'd say is one of the dynamics that we're seeing playing out in ready-to-drink, which really caters to a convenience benefit for our consumers, it's the same thing that we're seeing in the rest of the U.S. market, where consumers are choosing to drink better. They're looking for more flavourful liquids and, frankly, more premium offerings. And so, one of the dynamics we're seeing play out in the U.S. category is that consumers are willing to pay a significant premium to have fantastic products such as Crown Royal cocktails in a can. And so that's one of the drivers that we're seeing for the growth of our spirits RTD business; coming from people who may have been drinking other products in a can, now moving up to a much better experience, frankly, with Crown Royal in a can or Tanqueray soda or Tanqueray & Tonic in a can or Ketel Botanical Spritz in a can.

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

Chris Pitcher: A couple of questions from me. In terms of the recovery in Guinness and Travel Retail, it was striking that the Travel Retail LatAm is back to pre-COVID levels, obviously, mindful of travel restrictions. When do you expect the other markets to get back to pre-COVID levels? Or do you think reduced business travel might make those structurally lower?

And then could you give us a sense of how many of the Guinness outlets in Europe and Africa that you were trading with, pre-COVID, are back trading to give an idea of the reduction there?

And then lastly, on CapEx, you mentioned raising CapEx. But in terms of maturing inventories, those stepped up in the first half. Could you be on track for £5 billion this year? Can you give us a sense of how much you're investing behind the strong recovery in scotch particularly in, obviously, Latin America?

Ivan Menezes: Okay. I'll take Travel Retail and Guinness recovery. Travel Retail, we're nowhere back. There's a long way ahead to recover to pre-COVID levels on Travel Retail. I would say we remain confident about the channel, that it will recover. You got to remember, a lot of our growth is consumer traveling, the personal traveller. We're not relying on business travel as much to drive the recovery. And, if you look at what the aerospace industry, the airlines all predict, it's a little hard to call, but we do expect that to be significant interest in consumer travel returning. And we've had fast growth in the recovery as you see travel pick up. So, I would say, to get back to where we were, it's probably another 2 years, maybe a bit longer, but we will just focus on gaining market share through that recovery because it's very much going to depend on passenger numbers.

The Guinness, was your question how many on-trade outlets have closed, Chris?

Chris Pitcher: In terms of the addressable market, as the market recovers in terms of number of outlets you're trading with, has there been a structural reduction in the number of accounts you've got?

Ivan Menezes: Yes, there is a level of shakeout which there's been historically as well. As you know, the on-trade business has a degree of churn. The weaker outlets do drop out, and then you have new entry coming in. I'd say the consumer dollars, though we feel good will come back, even though the fleet of outlet composition will change a bit, unfortunately, for financially weaker outlets that just haven't been able to make it through. I mean generally, and this is more a global number, we expect 10-15% of outlets would be unable to recover through the shock of what COVID has represented to them. But then you're also seeing new capital come back into the sector to expand and create new outlets or invest behind the existing fleet.

So overall, Guinness recovery is happening fast as conditions improve. And the brand is in healthy shape in Europe. And we are seeing very good momentum actually, not just in the on-trade but also in the off-trade. And some of the innovation and brand building is now kicking in. I'm very positive on the future for Guinness in Europe, and it was really strong in Africa, and it's strongly growing in the U.S. So the brand is in very good shape.

Lavanya Chandrashekar: Yes. I'll take the second part of your question on maturing stock, and I think you were referring to the fact that our maturing stock inventory has increased at the end of the half of fiscal '21, now close to, I think £4.8 billion. We look at our investment in maturing stock as an investment in the future sustainable growth of Diageo, and we continuously evaluate what level of liquid to be laying down across the portfolio on scotch, on Canadian whisky, on American whiskey and now on the aged variant of tequila, as an example, on an ongoing basis. This is critically important for us to be investing in the future growth potential for Diageo.

Chris Pitcher: Can I quickly follow up on Guinness 0.0 in terms of the draft launch in the U.K., is that pulling ahead? I know it's in a short bit of Dry January left, but how is that launch going?

Ivan Menezes: We've got production constraints. The demand is way beyond what we expected on Guinness 0.0. So, over the course of the next year, we hope to get back into a position of supply. So that's what we're dealing with right now, the demand is far outstripping the supply.

Okay. Well, we'll draw to a close. Thanks, everyone for joining the call. I appreciate your interest and support for the company and look forward to catching up with many of you. Lavanya and I will be doing the road shows virtually and look forward to catching up with many of you in the next few days.

Operator: This concludes today's call. Thank you for your participation. You may now disconnect.