Diageo - F24 Interim Results Q&A Conference Call

Tuesday, 30th January 2024

Introduction

Debra Crew

CEO, Diageo

Well, good morning, everyone, and thank you for joining our interim results call for Fiscal 2024. I hope you had a chance to read our press release and watch our presentation on diageo.com.

The first half of fiscal 2024 was challenging as we lapped high single-digit growth in the prior year and faced an uneven consumer environment alongside the inventory challenges in LAC. Performance in the half was in line with the update we issued in November.

The Group's organic net sales or NSV declined 0.6% in the first half of fiscal 2024 and organic operating margin declined by 167 basis points. Excluding LAC, organic net sales grew 2.5%, driven by good growth in Europe, Asia Pacific and Africa. And our Group organic operating margin declined 53 basis points excluding LAC, and that is entirely driven by an increase of 70 basis points in our marketing reinvestment rate.

We unlocked a further $335 million of productivity cost savings across cost of goods, marketings and overheads.

We generated strong free cash flow of $1.5 billion, up a $0.5 billion, while continuing to invest in the future growth potential of our brands. This was driven by strong working capital management and once again, we increased our dividend up 5%.

Specifically in North America, while NSV declined versus the prior year, we delivered sequential improvement when compared to the second half of fiscal 2023, as our actions and interventions in the region began to show an early impact. We are focused on returning to high quality share growth as the US spirits category continues to normalise.

Outside of the COVID period, this was the first time North America delivered operating margin improvement since the first half of fiscal 2018.

In LAC, having conducted a review of inventory levels and monitor performance in the critical holiday season, we have taken action and have further plans to reduce inventory to a more appropriate levels for the current consumer environment by the end of fiscal 2024.

Looking to the second half in this uneven global consumer environment, we expect our organic net sales growth rate to gradually improve compared to the growth rate for the Group in the first half, and we expect an organic operating profit decline compared to prior year, but we expect the rate of decline to improve compared to the first half of fiscal 2024.

While the operating environment in the near term will continue to present challenges, I am confident that we remain well-positioned and resilient for the long term. We are diversified by category, price point and region and we’ll continue to invest behind our iconic brands to maintain our position as an industry leader in total beverage alcohol, an attractive sector with a long runway for growth.

My focus is to generate long-term sustainable value for shareholders by driving performance of our brands, meeting global consumers evolving tastes, and stepping up our operational excellence to win quality market share.

Q&A

Laurence Whyatt (Barclays): Three for me, if that is okay. Firstly, you said that you have been a bit disappointed by these results in the presentation that you gave. But have you seen anything in the last six months or otherwise that would shape your belief that the US spirits market could grow at 4 to 5 medium term, and that you would expect to take share within that market? And could that happen in 2025 or at least FY2025? And is there any reason why you can't hit your medium-term total guidance range in FY2025?

Then secondly, on a Bloomberg interview that I saw, you mentioned that inflation was moderating but it is still there. At your most recent CMD, you said that we should expect flat margins until inflation starts falling away. Do you maintain that it would be impossible to see margin expansion in FY2025?

And then finally on India, it is facing an election this year. Are you aware of any other regulatory changes that could possibly take place in this market in the medium term that might improve reducing the regulation and help spirit sales?

Debra Crew: Thanks, Laurence. So, I will take your first one on just US and medium-term guidance in fiscal 2025 and then, Lavanya, if you can just take the inflation and then India.

So yes, there is a lot to unpack there. So look, from a US perspective, as I mentioned in the presentation, we are seeing it still normalising, it is not normalised. And I mentioned it not being linear. And I would say, look, if you would have asked me six months ago, we were heading into summer, we were definitely looked to be tracking back into that mid single digit-growth that you have seen the US market consistently perform.

Then fall came. And quite honestly, we really saw a consumer more under pressure and it trended more toward low single digits than mid single digits. I mentioned I have been in the US quite a bit over the past eight weeks and talking with customers, and I saw this bear out a little bit this morning in the NABCA data as well.

November, I would say, ended up being better than expected, so a nice improvement. Early December, I think customers were worried. But then December ended up, people referenced the last week particularly of December trended better. And so, you saw NABCA this morning, I think had the industry 3.3%.

I am not seeing anything change in the fundamentals, particularly as we look at the medium to long-term that would say we know the number of drinkers and volume growth is really driven off of that. Also spirits stealing beer and wine occasions, that has not changed. We are actually seeing that including in this environment.

And then you look at pricing, what we are looking at, unlike what we have done the past couple of years, we are seeing pricing get back. Particularly if you are talking about in the US, you are talking about more in that 1% range, if you look historically. And then it is really about premiumisation.

Laurence, I mean you still see what is driving the category is super premium plus price products. So, none of that has changed. It really is this near-term consumer sentiment, this normalising into this post-COVID new normal. There is still supply chain noise. In our results, we had some supply chain normalisation. We were lapping some replenishment on tequila as an example.

So, we are finally getting through that. We are finally getting through some of the price increases in lapping those. So that is why as what we reference in our guidance for the second half and then going into fiscal 2025 is, as the consumer environment improves, we would expect the industry to improve. We would expect us to continue also to outperform that because nothing has changed in our portfolio either.

If you take a look at what is growing, tequila is driving the growth, we feel great about our tequila portfolio. In fact, I am very excited that we 100% own DeLeon, so we have got a broader super premium price portfolio that will help us on tequila. So, there is nothing that has changed within the fundamentals that would make me say that the US cannot get back to mid single digits.

As far as when? I am not going to predict the industry. Could that be six months? Maybe. But look, there is elections coming up and it could be 18 months as well. I mean we have just not seen this come back in a very even linear way. So that is why we built our guidance the way we have.

Look, it is January to be talking about fiscal 2025 already. It is a bit early, but we wanted to let you guys take a look at what we were seeing. We do see progressing back toward mid-single digits, but a little early to call where the consumer environment is going to be six months from now.

Lavanya, you want to take the inflation question and then India?

Lavanya Chandrashekar: Sure. Laurence, on inflation. Look, the word that I would use is it is an extremely volatile environment. Having said that, we are definitely seeing signs of inflation moderating. UK energy prices have definitely moderated here over the last period of time. We are also seeing more moderation, and corn has come down quite substantially. Aluminium is moderating. So definitely, I think that we are seeing commodities move in the right direction.

And as we have always said, as inflation moderates and the benefits of our supply agility programme kicks in, we will be able to get back to operating margin growth.

From a productivity perspective, I just draw everyone's attention to the $335 million that we have generated in productivity in the first half of this year, which is higher than any of the prior years going back to fiscal 2020. Outside of LAC, our operating margin decline of 53 basis points is more than entirely driven by A&P upweighting of 70 basis points. So, I do think that we are running this business in a very disciplined manner.

Your third question on India. Generally during elections in India, what we have seen in the past is that there are temporary restrictions imposed by various states in terms of like the sale of alcohol. So, I think that would be something that we would anticipate.

The team in India know how to manage through this, and I am sure that they will continue to do a good job on that.

More broadly, trend on regulations has been moving in the right direction in India. Several of the larger states have reduced their state import duties or excise duties on alcohol products over the last, call it 18 to 24 months. We are still hopeful around the FTA, and we are expecting that the strong growth that we have seen on the scotch business in India, 16% growth on scotch, Johnnie Walker growing 21%, with regulations moving in the right direction, I think this all bodes really well for Diageo as the largest player in this segment.

Olivier Nicolai (Goldman Sachs): Three questions, if I may. Just regarding LATAM, first of all. Could you give us a bit more colour on your inventories by type of product? Essentially, is it mostly primary scotch, which is the issue? Or is it actually more premium scotch as at Johnnie Walker, even Johnnie Walker Blue, where you need to see that is taking off?

Second question regarding the mid-term guidance, you do not expect organic EBIT margin to grow ahead of organic sales short-term and including in 2025. Is it driven by a specific region, such as North America, where you need to reinvest more or is it a broad-based comment?

And just lastly, Lavanya, just following up on the presentation that you have done this morning. Considering your net debt to EBITDA level and the higher interest rate environment, how should we think about the sustainability of the share buyback beyond full year 2024?

Debra Crew: Great. Thanks. I will start with the Latin America and then, Lavanya, if you can take the EBIT margin and share buyback questions.

Look, on Latin America, there is really two answers there. We have got scotch. It is really scotch and tequila. I mean when you think about our Latin America business, it is a heavy scotch business, as well as there is of course tequila in Mexico. And what I would say is, as we have referenced, there was a lot of premiumisation in the region as we went through the COVID super cycle, and we have seen down-trading.

But I think your question is getting to, is this sort of too much of the right stuff or too much of the wrong stuff?

What I would say is, look, in Brazil, it is the right stuff. It is just too much of it. And it is in our scotch portfolio. I would say in Mexico, where we are seeing some real downtrading, we probably do have too much of the premium tequila in that market. So, two different answers for two different countries, but I think that should give you a scope.

But I just will reiterate for what we have announced this morning, we have run multiple scenarios against this in the current consumer environment, and still feel confident that we can reduce the inventory to the appropriate levels by the end of the fiscal. And so, Lavanya, if you want to?

Lavanya Chandrashekar: Yes. So, Olivier, on operating margin, your question was, is it a specific region? Let me actually start the other way around. In the first half of this year, if you exclude Latin America, we grew net sales 2.5% with operating margin down 53 basis points. As I said, that was all entirely driven by marketing.

Where did we increase our marketing investment? We increased our marketing investment to support the global tequila rollout, so that was primarily APAC and Europe, and we have seen strong results there. Tequila growth contributed to almost 19% of the growth of Europe, and equally in APAC as well. And that is investing for the long term. We are building a new category in these parts of the world. It is going well off of a very small base, but it is an important investment for us.

We invested in Johnnie Walker in Europe, which has grown double-digit. And we invested in India, which grew 9%. I gave scotch numbers earlier, 16% growth. And we have invested in Chinese white spirits.

And so, what does this tell you about how we approach A&P investment, is that we invest where we see the best ROI possibilities. We are extremely disciplined about it. And where there is an opportunity for us to grow the business both for the long term but also more immediately and we see good returns, that is where we will make the investments.

So, going forward as well, I would say that our investment strategy will continue to be the same. It is not like the cost to compete has gone up in one region or one market or anything of that kind. I think we will be disciplined, and we will approach each investment decision from that perspective.

In terms of share buybacks, after having a multi-year programme, we have moved to having more of a year-by-year programme. We announced a $1 billion share buyback programme for this fiscal. We have completed $0.5 billion. We will be completing the other half of it by the end of this fiscal.

We remain committed to our leverage ratio, the target range there being between 1.5 times and 2 times, sorry 2.5 times and 3 times. I am looking at a bunch of numbers here, sorry. And we will stay very disciplined towards our leverage ratio as well. And if there is a great investment opportunity, we will do what is right for the business. If we end up outside the range briefly, we will come back into the range. This is a business that has a very strong balance sheet. We generate strong cash flow. The $1.5 billion in cash flow that we generated in this half, which is up $0.5 billion despite operating profits being down, it is a clear indicator of that.

Edward Mundy (Jefferies): So, one question from me is tequila. I think you pointed to some pockets of downtrading within the US and also increased price competition within whiskey and tequila. Tequila has been a really strong growth engine for you, certainly over the COVID super cycle. And as you take a very long-term view and you do not want to impact your brand equities from excessive promos, I mean how do you protect your share within high end ultra premium tequila?

Debra Crew: Yes. I think there is a couple things just to dig into our US tequila results, and then I will talk about the market in general.

For one, our shipments in North America look a lot worse on both Don Julio and Casamigos than what we are seeing in depletions and ultimately, what we are seeing at the point of consumption, where we can track it. So as for instance Don Julio, our depletions were plus 12%. We also see that same kind of plus 11% to 12% also in the Nielsen NABCA data. So, you can really see it is still performing at double digits, but yet in our shipments showing up at plus 2%.

Likewise, Casamigos shows as a big negative, as a minus 14% in our results, but the depletion volume is actually positive. So that should tell you a little bit about last year. Reposado in particular has been kind of the hot part of our portfolio, and it just took us longer to recover on that aged tequila. And so, we were lapping that replenishment last year as well as some price increases on both of those. So, we do feel better about the underlying performance of that ultra premium tequila portfolio that we have.

To your question about how do you handle the price competition going on? Look, it was a really crazy, I would say, in particular the last three months of the year, where it was not only within tequila but also in other categories like cognac that impact ultra-premium tequila. There is quite a competitive environment out there. And so, certainly we do not want to take these great brands that we have driven down into competing at that level.

That is why it is so important that we expand our portfolio. That is the reason I am so excited about getting control of DeLeon. And also, of course, Astral came to us. We bought that with the Aviation acquisition and 21 Seeds, that has been about a year or so that we bought that brand.

So, we are rounding out the portfolio to have the full price ladder because we think that is important to be able to effectively compete across all the areas that we are seeing in tequila. And tequila is still being driven that super premium. And yes, ultra premium has been under a little bit of pressure. I mentioned especially when you get over $100 bottles, that is where you are seeing some downtrading from those $100 plus bottles into really the aged tequilas, the Reposado and the Anejo for us is seeing a lot of heat right now. So that is tequila.

Edward Mundy: Debra, do you think the downtrading from, let us say, the 50 to the 30, the more cheap 100% agave, do you think that is due to the economic cycle or do you think it is a little bit more structural?

Debra Crew: I think, look, there has been a lot new competition out there and at the shelf. I think people are out there experimenting. It is exactly what we would expect to happen. As the category gets big, you actually have people trying more and more. That being said, our household penetration, all the underlying pieces of our equity, people still feel very, very good. So, I do think some of that is just the promotional cycle and just some of the new entries of people going out and trying things.

I think I tend to look at how brands are performing and on-premise and where they are calling it. Our on-premise performance in tequila is still very strong. So, this comes back to when people are paying for something, they want to make sure they get what they want and the right thing. And so, when they are calling drinks, they are still calling Casamigos. And Don Julio, in particular, is really having a cultural moment right now.

Celine Pannuti (JP Morgan): My question is really a follow up on this one on the US. I think listening to your call this morning, it feels that there is more discussion about, or you are a bit more cautious about the US market and we just discussed a bit more about the downtrading. So, I also see that price-mix is 1.4 in the half and in the last two half, which came from 7, 2.8 and now 1.4. So, my question is, are we in an environment with more promo and downtrading where we see the risk of that price-mix even becoming negative?

And then how should we think about the profit? Is that magnified when you see downtrading at your profit level? Or is there a way that you can offset that? You have spent a lot on A&P. I presume when you sell $100 bottle, you need a lot of A&P for that, but is there a way that you can offset? Should there be more pressure from the price-mix standpoint?

Debra Crew: Yes, I think what you are seeing in some of the price mix, do not forget that, for us, we were lapping, but honestly, I think it is quite broad across the industry. We are lapping now those price increases. So, what you were seeing before was sort of this really historic levels of price within spirits that came in last year in response to inflation. And so, we fully lapped that within the half. So, you see that price in particular come down.

Look, that being said, what I would say is the promotional environment, I think a lot of it had to do with people were lapping big numbers from prior year. Perhaps some people have more inventory out there that they were trying to do something with. We are not really seeing this being something that is for the long term. I think this was really something in response to the particular environment that we are in right now.

And then Lavanya, if you wanted to say something about A&P?

Lavanya Chandrashekar: Yes, I just pick up on the price-mix piece of it as well. The 1.4% that you referenced, Celine, is what you see in our accounts. So that is the shipment price mix that you have. And in this half, that has been negatively impacted by what Debra referred to just a minute ago, about our tequila lapping the replenishment of inventory in the prior year.

If you look at it from a depletions perspective, mix is significantly stronger. And in fact, in my presentation, we did put up a slide where we kind of showed the difference between shipments and depletions in the US on the super premium plus price segments, where shipments were down double-digit, I think 11%.

But when you look at it from depletions and a consumption perspective, the picture looks quite different. I do think that the underlying mix that we have within our portfolio is significantly better than what you are seeing in the accounts in the half.

But as Debra said, some of the extraordinarily high pricing that we have seen over the last two fiscals, last year price for us was high single digits. The prior year was mid single digits. We are seeing that pricing come down both across our categories, but also more broadly to the prior point on inflation moderating.

On P&L, look, the more premium products tend to have better margins. I mean that is how the structure of the category is. But we have many levers to drive profitability within this business. I mean volume is one of them. The work that we do on productivity helps us to offset inflation and drive margins. And as you have seen, we have done very well in the half, and we have guided to further stepping up our productivity to delivering $2 billion of productivity over the next three fiscal years. So that is definitely a help.

We will continue to drive price, but in a very disciplined and surgical manner, and that will contribute to productivity as well.

A&P. A&P investment really comes down to where a brand is in its growth cycle more than anything else. And so, maybe, Debra, you can?

Debra Crew: Yes. Well, I think as you look at the US, to your question. Actually, our brands are actually at a pretty good rate. Where we are really investing in A&P, it really is in markets where we do not have quite the scale to be able. So, Lavanya mentioned earlier, India, Chinese white spirits, some of this are places, we are going after new occasions in Europe. We mentioned earlier a little bit about the tequila investments that they have made, the non-alch category that is going after new occasions.

That is really where we are adding in A&P investment. I would say from a US perspective, look, we do not manage to a rate. We are at good levels, and we look at that and feel like we have got what we need against those brands.

Sanjeet Aujla (UBS): My questions just coming back to the medium-term guidance, you do not seem to be endorsing that 5% to 7% for fiscal 2025, but should we still consider that to be a relevant framework for F2026 onwards?

Debra Crew: Yes. I think, look, what we are trying to give, like I said it is January, so we are trying to give an early look and we are saying progressing back toward medium-term guidance at this point. It just would not be prudent with the current consumer environment and some of the uncertainties in the macros to be able to say much more about it than what we have.

But that being said, medium term guidance is still what we are looking at. And as I answered on the first question, we feel very good about the fundamentals. We feel very good about our portfolio and where we are at. I am disappointed in the half because of the LAC performance, and we were disappointed by the North America share and missing that. We did not miss by much, but we missed it.

But we have got a second half. And the team has put together very strong plans. Always difficult to predict share because you have to predict what competition is going to do. But I feel very good about our plans on Crown, our plans on convenience. We have got some exciting innovation launches.

And so, we are still very much about our medium-term guidance. It is just the current operating context that we are in right now.

Sanjeet Aujla: Got it. And just a quick follow up on tequila again. You have spoken quite a bit today about the need to broaden the price ladder within tequila. How long does that take to meaningfully impact your performance? Is it a six, 12 months kind of timeline or two to three years to build the brand awareness on some of those smaller brands?

Debra Crew: Well, listen, actually on the half, if you take our total tequila portfolio, we did gain share in spirits. So, already we are getting some contribution you can see from those brands.

DeLeon before the mess, we grew DeLeon 150-some-odd-percent in fiscal 2023. So, we feel very good about the brand, we understand the brand. And so, to have full control of that we are very excited about.

And so, I see a lot of opportunity there. 21 Seeds also, we are feeling very good about that. Astral is just launching. So, to your point of how long will that take? We have got some markets that we are really focused on, where we feel like it will make the most impact to our portfolio, but we are managing this as a total portfolio. But I feel good about where we are at, and I think there is really great opportunities yet still to go.

Simon Hales (Citi): So, I have got one main question and then just one quick clarification, if that is okay. Firstly, I think we are all just trying to get our heads around given the move dollar reporting, what that means from an FX standpoint going forward. You have clearly indicated in the press release you expect a big tailwind from transactional FX in the second half of the year based on H1 rates, but I wonder if maybe Lavanya, you could give a bit more clarity as to which currencies are driving that?

And associated to that, appreciated it is early, but when we think about transactional FX into the first half of 2025, I suppose I am crucially trying to understand whether we see any unwind of that H2 2024 transactional benefit in 2025. So, that is a slightly technical FX question.

And then just to clarify really, Debra, on Latin America. You said you were confident that the destock would be done by the end of 2024. I just want to check, there is not any assumption therefore going forward in your fiscal 2025 cautious guidance you have put out this morning of further destocking.

Debra Crew: Yes, so I will take Latin America, while Lavanya will do FX. I am not going to do FX. Okay. So yes, just to be very clear on Latin America, we are not looking at that in relation to what we put out for fiscal 2025.

In fact, I mean actually we would expect as we lap that inventory issue, that clearly gives us a bit of a tailwind, right? That is actually a good guide for fiscal 2025. That being said, it is a weaker consumer environment, right? That is part of how we got into this.

And so, what we do not want to do is over-predict at this point how quickly that consumer environment recovers in Latin America. So, I would say the consciousness in fiscal 2025 is really around the consumer environment in NAM and in LAC. That is really the cautiousness, but it does not have to do with the inventory. It is more about the consumer environment and not wanting to over-predict a steep recovery.

So, Lavanya, you want to try to handle that FX question?

Lavanya Chandrashekar: Yes, so let me first start with this fiscal, Simon. So, for the full year, what are expecting to see as the tailwinds on transactional FX really comes from the pound, the Mexican peso and the Euro versus the dollar. So that is the three main currency payers. And so that is where we are expecting to see the transactional FX benefit flow through.

In terms of fiscal 2025, look, I mean, that is a long way off, but here is how I would think about it. The two things that impact FX for us is one, of course, the prevailing rates, right? And then the second is the hedge positions that we take. And especially on these main currency pairs, that is where we hedge on a rolling basis.

And so, I think those are the two things that I would look at to be able to build a model on what you would expect to happen on FX. We are not providing guidance for fiscal 2025 FX right now and we will definitely come back with more clear guidance on it as we get into the fiscal year as we traditionally do. So, July is when we do that.

Chris Pitcher (Redburn Atlantic): I have got a question on Latin America. In the presentation you listed an impressive list of initiatives underway to improve visibility, but [inaudible] in other markets. Raise the question, why are you not already doing things such as data sharing independent stock counts and investing more behind your sales resources? Would it be fair to say the region had lacked focus and resource for many years? And hence in hindsight, the high operating margins you were delivering were unlikely to return to those? And as sort of a follow-up with transatlantic freight rates to LATAM now down to pre-pandemic levels, so the economics of primary scotch is improved such that you can give brands like Black & White and White Horse a push again and that could help capture some of the volume loss to down-trading in Mexico and Brazil, but again would limit the scale of any margin recovery in the region.

Debra Crew: Yes. So, a couple things on that. I will take the resourcing. You can talk about transatlantic rates. But I will just say before I get into this is, yes, the team is really focused on, we do have a broad scotch portfolio. And so, we can absolutely pivot to where the consumer is going down there. And actually, we do have great margins on our primary portfolio as well. So, I will just get that one out of the way.

So just talking a little bit about Latin America and what we are doing there vis-à-vis sort of the rest of the world. It is quite unique in how we go to market in Latin America compared to many of our other markets.

I think we talked about that a little bit with the presidents as we went kind of around the room at Capital Markets Day and people talked about the various ways that we went to market that way.

Latin America is a place. I have operated in it before in other categories, and it is not unique to our category, this multiple layer structure. First of all, you are never going to have perfect visibility, but what you try to do is have enough visibility so that your models and your estimates give you a better idea of what is going on with the inventory.

It really was a perfect storm of what happened to us because we were coming off of this COVID super cycle. So, I would say two things behind the resourcing that we had in Latin America. I would say first it was rapid growth in a region, remembering how much bigger and frankly more material it became to the Group in a very short time span.

And so, hindsight being 2020 is we looked at the resourcing and the robustness of some of the models down there. We certainly have taken a look at that and said this is not good enough. And so that is where we are making some additional investments, and making sure that really these models are much more robust. And maybe the biggest thing that did not come through is it is about the frequency of which you revisit some of these pieces and assumption.

I mean you are not going to be doing physical counts daily, but you need to do it frequently enough so that you are not making any misjudgments as you do some of these calculations and triangulation about what kind of inventory you have out there.

So, I would say we are upping the quality of the data, making it a real focus. As you can imagine, we have a lot of governance around this. And these are activities that we have elsewhere. I mentioned some of the technology stuff that we are bringing over from China. China can be another place where you can have some of these issues, but we do not have these issues because we do have some of that technology in place in China.

So, it is a matter of just learning from the rest of Diageo and bringing Latin America up to where the standard that we would expect it to be. And like I said, we have had great learnings there and we are putting those into action to make sure that we do not have this type of misstep again.

Lavanya, do you want to take the margin question around LATAM?

Lavanya Chandrashekar: Yes. So look, what I would say, Chris, is that yes, we are going to be making some additional investments and some of it is going to be in overheads in Latin America. But the nature of our business in Latin America is what drives our margin structure. And Latin America business is mostly a scotch business, especially when you look at a market such as Brazil.

And as Debra said, our margins are very strong on primary scotches as well as of course on the more premium scotches. Overheads is a very small percentage of our net sales across the company, but more so in a market like Latin America, where a lot of our sales is run through distributors.

And so yes, if we end up adding, I do not know, a dozen people, that is not going to move our margin in Latin America in any significant way. The reduction in freight rates of course helps us. It helps us for Latin America, but it also helps us across the world. So, the structural economics of Latin America are not going to be materially changed here because they are driven by the categories and our scotch sells at the same price point around the world. I mean it has to, because it is a single product that we sell everywhere.

Chris Pitcher: Sorry, can I just push you on that? If I look at the margins in Latin America post the collapse of Venezuela, they averaged high 20s, 27, and then they expanded rapidly during the pandemic to the mid-30s. Are you saying that you expect to get back to mid 30s again, or is high 20s a much more sustainable margin in Latin America with the additional overheads it sounds like you need to put in?

Lavanya Chandrashekar: Our Latin America margins got all the way up to the 40s. Operating margin was in the 40s in the last fiscal. And again, this was driven by two things. One, we have been very disciplined about taking pricing on our entire portfolio to offset the impacts of inflation and devaluation.

We do this across all of our emerging markets, especially on our global portfolio of scotches and tequila. We are very disciplined about that because we do try to keep these brands to operate within a corridor of pricing around the world. And so that will continue to be the case.

The second thing that helped us with margin improvement in Latin America was scale. The business has grown at a 15% CAGR over the last four years and that has added significant scale to us and operating leverage, which has helped us to improve operating margins. And again, both of these are structured improvements.

Debra Crew: And supply agility. So, we also have done some things within our supply geographic footprint that also has structurally, I would say, helped our primary scotch margins. So look, we do not give out margin guidance by region, but certainly there are things that have advanced, I would say, structurally in the market from that the period of time in the 20s.

Sarah Simon (Morgan Stanley): I have just got one question on cash flow. You talk about it growing organically. Obviously, the first half you had a very strong working capital inflow. What do you mean by organically?

Debra Crew: Lavanya, you want to talk about cash?

Lavanya Chandrashekar: We expect cash flow to grow for the year, Sarah. I mean I think the word organic just implies that it is net of FX, but maybe because the question has not come up, I take this opportunity to talk a little bit about our working capital improvements that we have done here in the first half of the year, which I do expect that these are structural improvements that will continue to benefit us.

We have right-sized inventory, and again, inventories had increased. Our days inventory in our system had increased through the COVID period, and that was simply because of the volatility in supply chains that we saw. We have added quite a bit of data, analytics and technology into the system to help us to get to the right safety stock levels. We have started to make some structural interventions as well in terms of where we hold inventory closer to the market versus in every market or holding it only in a market like Scotland.

More of that will come through as we run through the supply agility programme. That will help as well. And we have made some structural changes on creditors as well, improvement of work processes, standardisation of work processes, getting to better terms with suppliers as our contracts come up for renewal. So, these benefits are structural, and I expect that they will continue.

Sarah Simon: Okay. I mean obviously the free cash flow in the first half; the growth was exceptionally strong. Are you saying it is going to grow organically, but can you give us a kind of range in terms of what that organic growth might be the full year and then what that implies in the second half?

Lavanya Chandrashekar: The way I would think about it, Sarah, is two steps. One is cash flow is correlated to operating profit and directly driven by operating profit. So as the business grows and as operating profit recovers, I would expect that cash flow will improve.

The second thing I would say is in terms of our days of working capital, we have seen an improvement driven by some of the interventions that I just mentioned. I mean those are structural interventions. Those will continue. We are not going to go back to increasing safety stock and inventory levels back to the COVID period as we go forward.

We will continue to invest in Capex, we'll continue to invest in maturing stock as we have done in the first half of this year.

Mitch Collett (Deutsche Bank): I will ask one question. I think Debra, you said in the US that there has been no change to the fundamentals as you see it. But I think one possible change is that the growth in prepared cocktails appears to be cannibalising the rest of spirits. And then on top of that, some of those cocktail players are now coming into the mainstream spirits category. So, I guess I would be interested in your thoughts on that and your strategy to fight that headwind. Because so far, although I appreciate you have already got a big F&B, business, within ready-to-drink cocktails, you have very much gone for a premium multi-serve strategy. And with that in mind, I just wondered why you have not maybe had a more aggressive push into mainstream single-serve canned cocktails given that that is where the growth is currently?

Debra Crew: Thanks for your question, Mitch, because actually we have not talked a lot about it. But we are launching our Smirnoff Smash vodka spirits in the second half. So, we are getting a bit more into these canned cocktails as well as we are expanding our Crown canned cocktails into a multi-pack of lemonade. So, we certainly are into it.

We have a targeted participation in this ready-to-drink cocktail space. We are wanting to keep it premium. We are wanting to make sure that it is differentiated, and we want to make sure that it adds to our brands and builds our brands. To your point, we have been in the F&B space for a long time. This can be a space where you are kind of in and out if you do not do it right. And so, we want to do it right.

So, we are very excited about getting into a bit more mainstream on those ready-to-drink cocktails. And you did mention, look, the ready to serve piece as well. We feel very, very good about the launch of Ketel One. The Espresso Martini and Cosmo are already showing up. You can see those in the database already reading through on Nielsen in a great way.

And we do have the Tanqueray Negroni and Astral Margarita also launching in the second half. So, we are upping our game, I would say, across convenience.

You mentioned though the fundamentals to this. Actually, we do not see it cannibalising spirits. If you take things in cans that are not beer that has been fairly flat over the last, I would say, three fiscals as we have looked at it. You had quite a peak during COVID. But as you take a look, it really is sort of trading people up from that seltzer space, right?

So, seltzers are in a decline, and of course that is still the bulk of those canned things that are not beer. And what you are seeing is growth in F&Bs and growth in the cocktails in a can. So what we are seeing there actually is premiumisation across that convenience cocktail.

And so, look, we are going to play in it in the way that makes sense for our portfolio and that will certainly help us from a share perspective and get us in the game. But yes, we are not seeing that take cannibalisation from core spirits.

Lavanya Chandrashekar: In fact, we are seeing quite the reverse. Like what we are seeing is that consumers coming into Bulleit ready to serve are then choosing to buy. A lot of them were not Bulleit drinkers are now choosing to buy Bulleit, the base brand. So, we are seeing this as being quite incremental to us.

Andrea Pistacchi (Bank of America): Just wanted to compare a little the US with Europe. So, you seem a bit more cautious on the US for the next six, 12 months, given the environment, but you seem more confident on Europe, where you are also now lapping some big price increases. The question is, what are you seeing really on the ground in Europe in terms of consumer pricing environment and what has given you this, let us say, incremental confidence? Is a difference that you are gaining share in Europe, the tequilas you are rolling out? Or do you think you will be able to take a bit of more pricing this year?

Debra Crew: Yes, I think it is several things actually and some of them you mentioned. We are gaining share across most of Europe, which certainly helps us. And of course, Guinness being a big part of our gains in Ireland and GB, where Guinness is a big business. And so that certainly helps us.

The other thing is how our portfolio is arranged. Actually, in Europe we have much more of a standard price portfolio. So, I talk about our broad portfolio in the US, and we do feel like we can go wherever the consumer pivots to. But still super premium plus is driving the growth in the US market. In Europe, we have got more of a standard price portfolio, which I think is helping us weather what is going on in Europe. And we are gaining with some of the premiumisation.

So, we are really getting both sets of benefits of the now and the future, and we have really a full TBA portfolio that is helping us.

But certainly, I will add we are lapping double-digit. We did call that out in the second half. I think we referenced resilient growth, but this is certainly a tough comp for us in Europe.

[END OF TRANSCRIPT]