Diageo F22 Preliminary Results Investor Q&A Call

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Ivan Menezes: Hello, everyone, and thanks for joining our preliminary results call for fiscal '22. Hope you've had a chance to read the press release and watch our presentation webcast on diageo.com. I'm very pleased with the quality of our excellent results for fiscal '22. Our teams have executed with tremendous agility and resourcefulness despite stronger headwinds, some supply chain disruptions and geopolitical events in the second half. Sales were up 21%, with double-digit growth across all regions. Growth was balanced with volume up 10% and price/mix growth was 11 points, with price contributing mid-single-digit growth. Diageo's 3-year compound annual growth rate of organic net sales was 9%. North America 3-year CAGR was 12%, and for Europe it was 6%.

On a constant basis, Diageo is 28% bigger than it was pre COVID, in fiscal '19. Our share momentum continues, we gained our held off-trade share in the majority of our markets. We have an advantaged portfolio, which we continue to actively shape towards fast-growing categories and our super premium plus brands grew 31%. We continue to invest, A&P grew 25%, and we had a record year on CapEx spending over £1 billion on capacity, sustainability and setting the business up for future growth.

Our strategic pricing actions across all regions and our supply productivity savings more than offset the absolute impact of cost inflation. We had strong gross margin expansion and leverage of operating cost drove further, significant, improvements in operating margin, while increasing our marketing spend ahead of net sales. Our strong cash generation enables us to keep investing for the long term, including, as I talked about, production capacity, supply chain agility, digital capability and our Society 2030 goals.

Now, while we expect the operating environment to be challenging in the near term, with several headwinds, ongoing volatility with Covid-19, and a potential weakening of consumer spending power, I am confident in our ability to navigate that. We are staying very close to our consumers, leveraging our digital tools and data capabilities to quickly spot trends and respond with speed. Also confident in the resilience of our business, with our advantaged portfolio, effective marketing, strong commercial execution and innovation, we are well positioned for the continued premiumisation of the spirits category, and it’s share gains within total beverage alcohol. Our icon global brand Guinness is beautifully positioned for growth within the category as a premium beer.

So with that, Lavanya and I are here in Soho in our London headquarters, and I'll open up the line for questions.

Operator: Our first question comes from Sanjeet Aujla from Credit Suisse.

Sanjeet Aujla: Ivan, Lavanya, three questions from me, please. Firstly, you called out headline pricing of mid-single digit in fiscal '22. Given the heightened cost headwinds the industry is seeing, is it reasonable to assume you would require more pricing in fiscal '23 to navigate the headwinds? Secondly, you called out in your prepared remarks, U.S. tequila household penetration running at 15%, half the levels of whiskey. Do you think in the fullness of time, whiskey is a relevant benchmark, particular household penetration? And thirdly, just on capital allocation, with the remaining £1 billion or so of the buyback, it feels like your net debt EBITDA will end up being below your targeted 2.5x to 3x range in fiscal '23. Can you just give us a sense of how you think about capital allocation? And to what extent you will re-lever to get into that range?

Ivan Menezes: Thanks, Sanjeet. I will handle your second one on tequila and ask Lavanya to handle your first on pricing and inflation and capital allocation. So on tequila, I'd say what we're seeing in terms of the underlying dynamics in the category is very positive. The category has very broad momentum across demographics, across multicultural America, across age groups, the versatility in drinks, and we're seeing really good momentum. Agave has very positive associations. And as you know, we've got 2 of the hottest brands with Casamigos and Don Julio.

Regarding will tequila hit the whiskey penetration level, we don't know. We can't project for sure. What we can see is the runway or fast growth ahead of the U.S. tourism industry for many, many years, still. And again, if you look at it regionally, so the most developed states are places like California and Texas and Arizona, where the percent of spirits volume in those states, Tequila represents about 20% of the volume. The value will be higher. If you look at the rest of America, states like New York, Florida, New Jersey, there's a lot of America where the share of tequila is still sub 10% of the total market. And the consumer traction, we're seeing everywhere.

I do think what we're planning on is attractive growth ahead of the spirits industry for the next 5 to 10 years in the U.S. And then we also see attractive growth developed globally. That will build slower, but there's a lot of tequila interest. You know we track a huge number of mixologists and bartenders on our Diageo brand Bar Academy, through our relationships and tequila is hot everywhere. It's showing up in the top bars in cities right across the world. So we expect momentum to also build over time, and that will be slower. The top end of the market and globally as well.

Lavanya Chandrashekar: Yes, Sanjeev, I'll take the first and third part of your question. The first one was on pricing. We've taken mid-single-digit price. Your question was, are we planning on taking more in fiscal '23. But before I get to price, maybe one point, we grew volume 10 percentage points this year. We grew price/mix by 11 percentage points. And within that price was about mid-single digits. What we've been able to deliver this year, as we did in the prior year as well, is really a very balanced growth algorithm. We've done this by investing in the business. We increased our A&P investment in the business by 25%. The combination of the pricing that we took and the productivity that we generate through our everyday efficiency program, more than offset the absolute inflation that we had this year.

Now in terms of what do we see going forward. I think what we see going forward is the same. I think we will continue to execute our entire suite of revenue growth management and price will be a lever within that, and we will continue to invest in the business. We will continue to drive productivity, and I think this flywheel that's really working for us is what gives us the confidence that we will continue to grow this business in a sustainable and consistent manner.

The third question was around buybacks and capital allocation. Our capital allocation strategy remains unchanged. It's very, very clear. We start with investing in the business. As you've seen this year, we have increased our investment in business, both our marketing spend as well as capital spend, we invested £1.1

billion of capital this year into expanding production, into our consumer experience centres, into digital and analytical tools and into our sustainability agenda. That has continued to be our #1 priority area. For fiscal '23, we have guided to between £1 billion and £1.2 billion of CapEx.

Our second priority is M&A, and we've been very active this year on M&A. In terms of bolt-on acquisitions we acquired 21Seeds [flavoured tequila] and Mezcal Unión this year. We've also divested and pruned parts of our portfolio. That continues to be our second focus area from a capital allocation perspective.

Third, we are a progressive dividend payer. We have announced a 5% increase to dividends this year and we intend to continue to be a progressive dividend payer.

And last, we do return excess cash to shareholders. The board takes a very rigorous approach to this. We will complete our £4.5 billion return of capital program in fiscal '23 and if its warranted, and if the Board believes that's appropriate after we have invested in the business, after we have done the M&A that's available to us and after paying dividend, we would consider a further return of cash.

Celine Pannuti, JP Morgan: Two questions for me. My first question is on your outlook. You talked about the volatility of COVID but as well the potential weakening of consumer spending power. What I would like to know is what is your expectation and how demand may shift in this regard, regarding the volume, but as well the premiumization, which has been quite strong, as you alluded in your prepared remarks. And what actions could you take in that environment, be it to protect top line but as well bottom line? And my second question, maybe it's somehow related, but we've seen that you continue to invest a lot in the business with A&P up strongly in North America. What kind of flexibility do you have for this spending? As we look into 2023, if the environment becomes more challenging, are you able to give us a guide on how you think A&P will evolve for '23 for the group?

Ivan Menezes: Celine, I'll take the first and ask Lavanya to handle the second. So the first thing I would say is we do not have and nor do we pretend to have a crystal ball on how consumers are going to behave in the next 6, 12, 18, 24 months. Clearly, the economic pressures are real. The spending power pressures are going to hit and get worse for a few quarters. What I would say is we're staying extremely close, real time to understanding shifts that are happening in occasions, in motivations, in the brands and price points that people are buying.

One of the imperatives in the company, we've built incredible agility and restlessness in our culture. We said we're going to double down on that as we go into next year and beyond. And we've just had our leadership group together, the top 100, and we just talked about how we're going to do that. We've got incredible data and analytics and the ability to track it. So I just wanted to start with that.

Now if you step back and zoom out and look at the category, this category does have very good resilience if you look at it over a decade. And certainly, through the financial crisis, we saw volume growth continued in the international spirits, and we saw a few quarters of a bit of down trading, and then premiumization came right back.

We have an advantaged portfolio, when you look at our categories, price points and the geographic footprint, we have resilience built into the diversity of our portfolio, and we have agility to switch and move quickly. So let me give you an example. If we see down-trading accelerate we have the ability in the

United States to pivot our execution and support to brands like Smirnoff and Captain Morgan very strongly. If we see pack size of change, and we're tracking all of this, the 175cl is going up or the small sizes on premium brands increasing, we have the agility in our supply chain to move very quickly and in our marketing dollars to ensure we're tracking these shifts in consumer behaviour.

This is why we reiterate our medium-term guide. We believe Diageo has the strength and the consumer connection to be able to navigate through these volatile times. And again, I've said this before. We should not forget our category is an affordable category. The spirits sold in a typical U.S. household is a dollar a day on our spirits category. It's an infrequent purchase and that also brings a lot of resilience. You're only buying a few bottles of Ketel One vodka a year.

The combination of all that, we tend to skew to a higher-income consumer in the United States, where nearly 60% of our business comes from households that make $80,000 or more. It's a higher skew than the beer business, et cetera. The final point I'd make is the affordability of spirits. A Don Julio Blanco on the rocks in terms of equivalent serves, is the same cost to the consumer as a $10 bottle of wine. A serving a Crown Royal is the same as a seltzer, white claw.

Spirits has tremendous value and huge desirability and aspirations, and the underlying trends of younger consumers moving towards spirits continue. You put that picture all together, and we're not taking anything for granted and we have been hyper connected and restless and tracking shifts. But we feel confident that we're going to stay invested and we're not retreating. We're going to invest smartly to ensure we come out of this stronger much as we did through the last 2, 3 years of the Covid volatility. You can see where the company is today relative to where we were in fiscal '19, and we intend to do the same again.

Lavanya Chandrashekar: Yes, Celine, I'll take the second part of your question. As Ivan said our orientation is to invest in the business. As I said before to Sanjeev, the flywheel of growth is really working. As we invest in the business, we strengthened our brand equity and we're able to drive more price, drive more productivity and drive more premiumization, drive volume growth, very importantly drive market share growth, and that allows us to continue to invest in the business.

But we do so in a very disciplined manner. We do not have a target reinvestment rate for our marketing spend. But we do have a lot of discipline in making sure that we get a good return on investment for all of our marketing dollars. Our brand team put together the plan, It's a combination of brand creativity as well as using our tools and their data to ensure that we're able to drive the best effectiveness.

And so we will make the decision market by market, brand by brand as we go into the year. We'll do it based on where we see the consumer and where we will get the most effectiveness and efficiency of spend. This is what we've done over the last 2-plus years, and it's working. We are growing or holding market share 85% in measured markets. And we'll continue to follow the same flywheel.

Simon Hales, Citigroup: Two or three for me, please, if I can. Firstly, Ivan, wondering if you could just talk a little bit more about any change in consumer behaviour that perhaps you are starting to see in the U.S. I mean clearly, we've heard from some of the U.S. retailers this week like Walmart flagging changing spending patterns amongst their customer base. I appreciate – that's not a like-for-like customer base necessarily with yours – but what does the real-time data that you referenced that you get in your business, what's that really showing now in terms of occasion shifts on to off-trade moves that we're perhaps starting to see any down trading at all or even just pauses in the trade up momentum in some of the spirits categories in the U.S.? Or is that data just showing no change at all right now? So quite a long-winded first question. And then secondly, a number of your competitors have talked about supply chain constraints sort of impacting their businesses late. You've clearly had issues for a while around things like Crown Royal. Are there any other particular sort of issues you'd call out? Anything we should be worried about, particularly with regards to glass supply when it comes to fiscal '23?

Ivan Menezes: I'll take the first and Lavanya can talk about supply chain. Our consumer behaviour so far, and I qualify it by so far because we read this day by day, week by week. To your point on the U.S., we are not seeing either slowdown or down-trading trends just broadly. Obviously, we analyse this at excruciating detail. But at the headline level, we are not seeing it which doesn't say won't come. And we are staying very alert to it and the channel product category mix, the on-trade is strong and continues to be strong as we've gone into July. We're feeling good about the on-trade momentum. And that's a big piece actually of our momentum because we're gaining share in the on-trade in the U.S., I think a 83 basis points in the NABCA data, which tracks on trade. And we're really well positioned for that recovery. When we cut price tiers and look at all the analysis as to -- has there been any shift in trends. I'd say not yet, but it's too early to call. I think we'll obviously watch it. And as I said in my earlier remarks that we were ready to move very fast to ensure that we can sustain our performance in the U.S. market.

But the core fundamentals of spirits momentum, people drinking better, continues, and the demographic shift and taste shifts in America are very positive for our category. Younger Americans are drinking more spirits than beer and wine, and you can see that as the cohorts come through in the demographics. Multicultural America is very good for our category, and our brands are very healthy and well invested. And we only have 7% of the TBA dollars in America. So there's a lot of opportunity even in a slowdown for us to gain from other weaker parts of the TBA market. So you put that all together and we're clearly not going to see the torrent rates of growth that we've had even in these numbers, North America growing at 14%, as we said in our F '23 outlook, we expect this growth to slow down but still very attractive -- so that's how we're looking at the current dynamics, no real shift, but tracking it very closely.

Lavanya Chandrashekar: Simon, on your second question on Slide 2. I begin with reminding us again that we have grown volume 10 percentage points this fiscal year, and that comes on the back of growing volumes 11 percentage points last fiscal year. So our supply organization have done a fantastic job of being able to ensure that there is sufficient availability of our products to consumers all over the world at the right time and at the right place.

We did have some constraints on aged liquids Crown Royal, mainly because demand has outstripped all expectations by such large extent. Also on some of our aged variance of tequila, like 1942, continues to be rather elusive to find. But in the first half of the year, we did have some issues with Bulleit. That was very specific to the particular shape of that bottle and the design of the bottle, we had some issues with procuring enough of it at the right time. That has been solved, Bulleit is back on shelf for consumers to enjoy.

If I step back and think more broadly to your question on bottles, I mean the 2 things that I think really distinguishes Diageo, one is we have a global reach and we are able to leverage our global reach to ensure that we are able to meet demand, and then the second one is the strategic relationship that we have built with our suppliers. This is true for our bottle suppliers, but more broadly as well. And this is what has enabled us to navigate what has been a very difficult supply environment, as well as we have done.

Simon Hales, Citigroup: Got it, can I just come back and just clarify, Ivan, in terms of your remarks with regards to what you're seeing in terms of consumer behaviour trends? You're clearly seeing no down-trading as things stand. Does that also mean you've seen no change in the rate of up-trading as we've moved through the back end of fiscal 2022 and perhaps into July? And overall, based on what you're seeing at the moment, and your confidence in the agility of your business, are you confident you can deliver organic EBIT growth in 2023 within your midterm guidance range?

Ivan Menezes: Yeah, I mean we've reiterated our midterm guidance range, so on that in terms of growing profits slightly ahead of sales, yes, we have seen us do that even through the tough period of high inflation so we fully intend to do that. There's not been a dramatic -- a significant shift yet, and also it's too early to call. There is strong consumer exuberance this summer in Americas. The jersey shore is humming. By the way, this is what I spend all my time on. I talk to customers, I look at all the data, I talk to distributors, to be the critical different factor for Diageo is really understanding the consumer and the shifts and being able to see them fast, and execute against them faster than anyone else with flair and impact and investment. So I mean, I'm consumed with it because I love it. I mean this is what I really follow very closely. And I'd say there's nothing I see right now. To your point, the shifts in the price category dynamics, but you know 4 weeks also doesn't make a trend. So you have to really look at this understand it. And when I was in the U.S. last time, I visited a lot of retailers and you've got pockets, I mean the multicultural urban America, you can see the pressure on categories like cognac and even our Ciroc brands in certain DMA's in America. You see that coming through, but broadly, at the same time, you've got very strong momentum on high-end tequila continuing in many parts of America, so we're all over it. And as of now I certainly don't see, I mean you will only have to go back to the financial crisis. I mean you potentially could see a bit of down trading for a few quarters or the higher priced is growing a little slower, but that doesn't give us concern, and it's not going to cause us to change strategy, we feel really confident about our ability to steer through this effectively.

Olivier Nicolai, Goldman Sachs: Hi, good morning Ivan, Lavanya. Just 3 questions, please. Firstly, you've done some disposals in beer in Africa recently, first in Ethiopia and more recently in Cameroon. Is there any change of strategy in Africa and potentially more beer disposals to come as your spirits sales are becoming bigger? Secondly, on the U.S., a very impressive growth overall. I've noticed spirits ready to drinks also grew by 18%. And it's about 4% of your North America sales. Can you give us an idea of how big this category could become? And how much distribution gain still to come in the U.S.? And lastly, you partly answered that question before, but Ivan, you were obviously running North America back in 2008, 2009 during the last recession. If the U.S. does enter into a recession this year or next year, can you tell us how Diageo today is different from 12 years ago. And the lessons you've learned from the last recession where you were running North America? And where do you see the risk for your business now, if any? Thank you very much.

Ivan Menezes: Thank you Olivier, let me take the first and the third and Lavanya will talk about RTD. Our beer strategy is, as you know, we operate an asset-light model in beer with Guinness brand. And by the way, I could not be happier with the health of the Guinness brand. It's the strongest I've seen in my 25 years at Diageo; right across Europe, U.S. and Africa. The actions you see at stake, Ethiopia and Cameroon is part of really getting an effective asset-light model and route to market around the world on how we build our beer business and that is a smart decision in terms of ensuring we still see good growth for Guinness in West Africa. But we're going to do it through a less capital-intensive model. So no real change in our strategy.

We're delighted with the performance of Guinness. As you may have seen where we've announced a EUR 200 million investment in Ireland to go open a carbon neutral brewery. We need 1 more, we're overcapacity in Dublin. So remain positive about it.

On your U.S. recession point, yes, I remember very clearly, I was there during the financial crisis. The main point is that Diageo is so different today than where we were then. Our portfolio is different, health of our brands is different, the data and analytics have had are different, the whole commercial execution, the innovation and marketing machine and our talent is different. So I feel the company is in a much stronger place. I mean, we have an intense sell-out culture, right, we know exactly what's happening every day. We didn't have that in those days. And so, what I said earlier I think the company is much fitter, much more agile. And our portfolio is much healthier. I mean we've got momentum in tequila, in whiskey, in our reserve brands. And it's not just tequila that's driving our growth, We've got super growth happening on Johnnie Walker and Bulleit and Crown Royal and Ketel One. So I do feel we're in a much healthier place.

Having said that, we're not taking it for granted. We're paranoid about it. And as we talked about earlier. We're tracking it very closely. But we've got the ability to capture where the consumer moves. And let's not forget, there is a very good balance relative to beer and wine. And in the dynamic of a more stretched consumer, that's why we feel there's resilience here for the spirits category.

Lavanya Chandrashekar: Olivier, I'll take your second question on RTD. If you just step back and think about it, RTD plays in the consumer benefit area of convenience and beer; FMBs, malt beverages and seltzers, all of these also play in that same area of convenience. What we've seen happen here in this segment in the convenience areas, Consumers are preimmunized, exactly the same trend that we're seeing in the rest of the spirits category. Consumers are willing to pay an extra amount to be able to get that beautiful ready to drink spirit cocktails made with real spirits. So if you try to think about our Crown Royal ready to drink, it's made with real Crown Royal it is not a malted something that gives you a funny after taste. It's absolutely delicious, it looks stunning, and it is significantly more premium, but that is what the consumer is gravitating towards. We´ve seen the same on Tanqueray and soda in the U.S., on the Bulleit, Manhattan, the Bulleit old fashion that we have in the U.S. It is an absolutely brilliant liquid. How big will it get? I am not sure, but, what we are definitely seeing is that consumers are willing to pay that extra premium to get the great taste of spirits with the convenience attached to it.

But on the other hand, what I'd also say is that the spirits category continues to be very special. I mean, the art and the craft of being able to make a cocktail at home, is something that consumers really took to during COVID, and that is very much alive and growing. And that's what allows consumers to be able to be creative, make something authentic or that matches their meals. So that magic is by no means going away.

Laurence Bruce Whyatt, Barclays: Three from me, if that's okay. Firstly, on the tequila category. If we look at Casamigos, it grew 125% last year and another 88% this year. Some extraordinary growth numbers. And just your views on how long this sort of extremely high double-digit, triple-digit growth can continue. And on a similar point, what are your levels of Agave supply? Do you have agave contracts that are able to deal with this sort of level of demand? And if you have a view on where the Agave price may go to; there's certainly been some expectations that Agave prices might start to fall, but it doesn't sound like we've seen any of that yet. I wonder if you have a view on the agave price as well.

Secondly, on the A&P spend, just following on from an earlier question, I wonder if Lavanya, you could give us some more detail on the returns you're getting on your A&P or certainly, whether it's continuing to increase? And if so, could we expect the A&P as a percent of sales to actually continue to increase from here if you're getting better returns from it to potentially drive faster top line growth. And then finally, we have...

(technical difficulty)

Ivan Menezes

Should we move to the next and then the next question and then come back when he is on?

Pinar Ergun, Morgan Stanley: Hi, thanks for taking my questions. Two from me. A follow up on the U.S. Could you please help us reconcile the very strong growth you've reported in the U.S. with the softer trends we're seeing in the Nielsen NABCA data in recent months and comment if you're happy with the level of the wholesaler inventories in the channel now, following the restock? And then the second one is, can you please talk a little bit more about the new supply chain agility programme? Is this aimed at replacing aging operations or building new ones? And are you able to give us a steer on the magnitude of the related savings you're expecting?

Ivan Menezes: Thanks Pinar, I'll take the U.S. and Lavanya will take supply agility. So, as you can tell from our release, our U.S. depletions grew at about 14%, really strong growth. And what you're seeing to your point, we should never forget, Nielsen is a tiny piece of the market, in value terms I think it's under 20%, maybe 16%-17%. NABCA is another piece, but then you have the on-premise. And I talked about our momentum in the on-premise is really strong, right across the country. And we have the independent and franchise states and independent retailers of spirits. And you've got e-commerce platforms etc, which typically are served by independent retailers.

We're doing very well in these other channels. And our estimates in last fiscal year, the U.S. spirits industry grew about 6% to 7%, and we're clearly outperforming. So, our growth is broad-based on multichannel, and I just wouldn't overread what's happening in Nielsen; Nielsen tends to be a very promotional channel. We don't like selling a lot of promotional channels because we've got plenty of higher-quality businesses we can build.

The stock levels in distributors, they're perfectly satisfied. There were two dynamics at work. One was with the impact of COVID, we immediately took our stock levels down. As we couldn't forecast future demand when we were in the peak of the COVID storm. So, you're seeing a restocking coming from there. And then the second thing is our imported products. Shipping Johnnie Walker from Scotland to the U.S. now takes 2 weeks longer sitting on the water. Our distributors want to make sure that they are covered. We have daily visibility on depletions and stock levels and a huge sell out culture. I'm very comfortable with where we are. And back to your first point, I am really comfortable about the broad outperformance in share growth that's coming through in the U.S. For many years, we didn't perform that well in the on-premise. What Claudia and the team have done is output a machine in place where we're really executing superbly in the on-premise. I went to see it first-hand a few weeks ago in the U.S. and our whole capability and execution of winning in the on-premise has improved significantly in the last couple of years.

Lavanya Chandrashekar: Thank you for your second question, regarding the supply agility programme, I'll start off by saying that supply is a core capability and a strength for Diageo. This is what has enabled us to be able to grow volume, 10 percentage points in this fiscal on top of 11 percentage points in fiscal '21… I feel like I have said that before today…It is absolutely essential for us to ensure that we keep this capability at cutting edge. And we have an ambitious growth agenda in terms of increasing our market share from 4% of total beverage alcohol to 6% and supply has to be a competitive advantage for us to be able to achieve that ambition.

Our business has changed quite a bit over the last years. We have grown volume, we have reoriented our portfolio, we have seen shifts in category and product mix and market mix. So, we have initiated the supply chain agility program that spans 5 years starting this fiscal '23. The objective is really to strengthen our supply chain to improve its resilience, to improve its agility, to be able to deliver further productivity savings and to make our supply operations more sustainable.

And it's really all around being able to fulfil our share growth ambition by continue to enhance our supply chain to be fit for the future. So we do think it will create significant long-term value. It's not one project, it will be a series of projects. At the right time, after communicating it internally to our employees, we will communicate it externally as well with more details.

The savings will be incremental to our ongoing everyday efficiency program of £1.2 billion that we laid out. So this will be incremental to that. It does not replace or overlap our everyday efficiency program in any way at all. And we do believe, we expect, that this program will have a payback period of 5 years.

Operator: We'll now go to our next question from Edward Mundy from Jefferies.

Edward Mundy, Jefferies: Apologies if you've sort of partly answered this question, but you've come through fiscal '22 with great momentum and you're flagging some normalization rate of growth. I appreciate there's a lot of known, unknowns, but is there anything you're seeing at the moment in either customer or consumer behaviour that would indicate you would deliver below 5% to 7% organic sales for fiscal '23.

The second question is around the inventory picture. I appreciate it sounds like it's quite normalized and you've obviously moved from a sell-in to a sell-out culture, but can you talk about the health of inventories globally. Are there any areas where you're holding back inventory at this stage.

And the third question is around the U.S., I missed your answer around what you think the industry is growing at, at the moment. Could you just confirm what that was? And if you look back to 2008, 2009, a number of suppliers took pricing down to match where the consumer was heading. In this inflation environment, does it make it harder for the industry to use price as a lever to take value out of the U.S. spirits industry?

Ivan Menezes: Yes. So I'd say our estimate that the U.S. industry is about 6% to 7% growth in fiscal ‘22 in value terms. If you go back to the financial crisis, you had the industry grew through it, and you had 3-4 quarters of slight down trading, which then reverses. I would say the industry is in a much healthier place.

Let me talk about the Diageo not the industry, our brands and our connection to consumers, the effectiveness of our marketing and the scale of our marketing dollars.

We've also got a much better portfolio. But don't forget, we've sold a bunch of low-performing brands. We've added this incredible tequila position to our business. Whiskey is hot and those trends will continue. So it's a very different picture from last time around.

I do think if you get trade down, let's say, the premium sector where if you look at the price segmentation, the price points around Smirnoff and Captain Morgan pick up and the Black Label or the Don Julio are down, we've got depth and breadth in this portfolio to be able to respond to it.

I see nothing that suggests spirit share gains of TBA will slow down effect to the contrary to my earlier comments about value. Spirits offer tremendous value. And so you put that all together and we could have a few quarters of down trading, but we'll work our way through it.

On your second question on inventory levels; globally we're very happy. We moved through COVID. We took dramatic action to bring inventories down and we are at very appropriate levels. The sell-out culture is highly embedded, and we track and measure this in every market in the world. Lavanya and I review it in detail at every half. So, I'm very comfortable with where we are, very healthy levels of inventory and receivables, very-very healthy numbers. Diageo is in a really fit shape to respond to shifts because and markets around the world are tracking that for us.

Lavanya Chandrashekar: I can take your first question. I'll answer it in a slightly different way, which is I'll tell you why we are confident in our medium-term guidance Going back a little bit to pre COVID, our guidance was to grow between 4% and 6%. At Capital Markets Day, we issued guidance, which was one point faster. This was really driven by the fact that we now have a much more advantaged portfolio in terms of markets and categories.

The spirits category is growing faster, taking share from wine and beer as Ivan just mentioned. Premiumization has accelerated, and it's really driven by consumers wanting to drink better. We are performing better. We're growing share more consistently. We're executing much better. We have a tremendous suite of tools and people capability and energy. And so that's what led us to have the confidence that we will be able to deliver on our medium-term guidance of top line growth of between 5% and 7%.

Now having said that, that still quite different than where we have delivered at a 3-year CAGR of 9%. But we do recognize that market conditions are changing. We expect category growth in markets such as North America to revert to pre pandemic levels. And we do see the potential impact of the inflationary impact on consumers. But again, put it all together, we do have strong confidence in our ability to deliver consistently on our top line growth of 5% to 7%.

Laurence Whyatt, Barclays:

Continuation from previous technical difficulty.

Ivan Menezes: We got your question. So tequila and Casamigos. Obviously, these kinds of growth rates are not going to sustain as such a big business now. However, the brand is incredibly hot. Brand equity and consumer traction, penetration and recruitment continues to be very strong. We see a good runway of continued exciting growth for Casamigos and Don Julio. By the way, we just taken global leadership in tequila in value, both in the U.S. and globally with these 2 brands.

You've seen the investments we're making in Mexico. So we are counting on continued growth, but the growth rates will clearly slow down. Agave prices, again, in part because demand has been so strong for the category, you haven't seen the softening yet that was predicted 3 years ago. Our advantage is we got scale and we're playing at the top end of the market. So we do expect agave pricing to come down over time but it's a demand supply dynamic. Right now, we're really struggling to fulfil demand which has continued at this accelerated rate. But certainly, in a few years we would expect agave prices to come down.

Lavanya Chandrashekar: I'll answer your question on A&P, whether we're seeing improving return on investment on A&P dollars. The answer is yes and it is because we continue to build and improve our capabilities in this area. You heard us talk about tools such as Catalyst, which we have had for several years now. At Capital Markets Day we talked about a tool called Sensor, which is a proprietary tool that helps us measure the relative effectiveness of our media spend across digital platforms. So within digital, we can understand our effectiveness of our spend between platforms A versus B versus C. It has enabled us to improve our return on investment on our digital spend in the U.S. by about 30%. As we continue to build more capabilities, we are able to get better effectiveness of our A&P spend and the better return on investment. I'll give you another example of Crown Royal in the U.S., again and this was with the NFL. We were able to create multiple versions of the Crown Royal video. By using our data and analytics we were able to deploy the right video content to the right consumer occasion and by geolocation. That could be personalized to target consumers in specific cities where they have individual NFL team sponsorships and with the right messaging. And work like this has contributed to like a 17% improvement on our ROI on Crown Royal digital media which is a large part of our spend in the U.S. And so yes, we do continue to see improvement in our A&P effectiveness. We measure it on an everyday basis, and we will continue to invest behind our brands as long as we see the returns playing through.

Laurence Whyatt: I was hoping to ask a final question about the potential situation in India. There's certainly been a lot more discussion around a potential U.K. India trade deal that sort of heated up over the summer. Obviously, the U.K. government has changed somewhat in the interim, but I was wondering if you'd got any views on what may or may not happen in India and how you might respond to any changes that could take place in that market.

Ivan Menezes: The discussions between the team continue. And clearly, we need a prime minister on the U.K. side before Diwali, I hope. Boris Johnson and the Indian Prime Minister hoped for a deal to get to.

Free trade agreements until they're done, we don't count on them but conditions are more encouraging. The scotch whiskey is on the table. However, there's a lot of give and take on both sides. The trade teams on both sides are working very hard. So it doesn't stall and the urgency that both prime ministers have put on it is working through the system. I would not give you the odds on what's likely to happen. We're just tracking it, supporting it. And clearly, it will be another nice boost to the growth of the category in India. Though I would point out, even with these high tariffs, our scotch whiskey business in India was up 62%, Johnnie Walker, up 66%. We're seeing real momentum on the high end of the business even with the high tariffs. That will clearly add an additional benefit and accelerate the growth of premiumization within whiskey. India is the largest market for whiskey in the world. We'll wait and see, and we'll work very closely with both sides to see if we can get Scotch whiskey addressed in some form. It won't be an overnight change to zero. There will be a staggered change, but every step would be helpful.

Andrea Pistacchi, Bank of America: I have two questions, please. The first one on the U.S. Now it's, of course, hard to say how the consumer slowdown might play out in the industry. But in the event of, let's say, mild recession for a few quarters, do you think some categories may be more impacted than others? I think you highlighted cognac. Do you see categories that could potentially be beneficiaries of a weaker environment? For example, I'm wondering whether prepared cocktails, given the sort of affordable proposition of buying a cocktail in a can just for a few dollars, whether this could if anything, whether a difficult environment could be a further boost to the growth of the category.

The second question is about emerging markets. You've talked about while you sound reasonably confident about the resilience of the industry and your business, of course, in developed markets, how do you feel about emerging markets over the next 6 to 18 months where consumer demand tends to be usually more correlated to disposable income? Are there any sort of hotspots in emerging markets or any areas that you're monitoring quite more closely? And if you could highlight the main differences in your business and portfolio in emerging markets, generally speaking, compared to 2013-14, which is when we saw the last slowdown there.

Ivan Menezes: On the first one, the recession impact on big shifts in consumer preferences across categories and formats, it's not that big. And in part, because it comes back to what consumers are spending on the spirits category is for households that buy spirits it's about $300 a year. It is an occasional purchase. You're buying it 5, 6, 7 times a year. It doesn't cause a shock to kind of downtrade from premium detergent to a private label detergent. We tracked it also to through financial crisis and there were big dramatic shifts. We'll have to watch it. I'm not saying they won't be and they'll be at the margin and we need to be quick. Pack sizes and how the pack mix changing are very important factors which Claudia and the team are tracking daily because you tend to see a little bit of the 175 to pick up as value is more and people shop at clubs and warehouses as opposed to going to the little liquor stores. Those kinds of trends we've track.

On the emerging markets, we have a lot of experience of working through cycles in the emerging markets. I think what's different this time around is our portfolio and brands are in healthy shape. Scotch whiskey is clearly a big player across Latin America and Asia. In Africa, our beer business and Guinness is in a very healthy shape. When you get down cycles and big devaluations it does have an impact. There's more volatility in emerging markets. But again, we're in a healthier position, our stock levels, as I talked about earlier, are very healthy. We're reading the shift earlier. If you look at the numbers in Latin America through, let's say, what was not a great economic period this last year. We've really come through very strongly in Latin America and it's mostly deluxe scotch. That's because our marketing activation, commercial execution, pricing actions, all of that is really working at a far superior level than 5 or 10 years ago in Latin America. There will be more volatility in emerging markets. But again, our focus to just ensure we come out ahead, grow market share and do it in a quality sustained way.

Trevor Stirling, Bernstein: Ivan and Lavanya, two from my side, please. First one, probably for you Ivan, concerning scotch definitely, Diageo scotch has seems to have got its mojo back in great numbers in the fiscal. But also look at the blends tend to do much better with Johnnie Walker up 34%, Old Parr up 59%. And malts just lagging a little bit at 17%, I guess part of that may be a comp effect. But maybe you can talk a little bit about your malt strategy – I know you're putting a lot of money into the visitor centres in Scotland – that will be really helpful. And the second one, I think I is the first time had a chance to chat since the appointment of Debra as COO or rather an announcement about Debra's appointment, I wonder if you could give us a little bit of colour about that decision.

Ivan Menezes: On Scotch historically we've always underperformed in malts, in market share which has always been my biggest frustration for a company that owns these 28 soon to be 30 beautiful distilleries all around Scotland. We were spoiled for choice, and we've been seeing what's changed in the last 3 years. We now have a very focused long-term strategy on malts. So Singleton is a major play for us going at, let's say, the more mainstream malts. We're very clear on Talisker where we want to build it. Mortlach at the high end. Mortlach is a jewel and it's going to be a long play. It's going to be 10 years but I'm really encouraged with what we'll see there.

And then every market depending on the world as specific malts that they're driving. So what's changed? Yes, 17% growth is not good enough. We should be doing better. And I hope to see our malt momentum improve year after year. The strategy is clear. The investment behind it is now clear and those are things we didn't have before that clearly laid out.

On Debra, I'm delighted to have a move into the COO role, October 1. The main focus, and it's actually dealing with a lot of the questions we've had on this call, she will be connecting the market, supply and the brand, and really bringing everything we talked about here, steering the company through the volatility and navigating and delivering the outperformance you've seen us do in the last few years. But I would say, I mean, I'm really delighted about the exec team and the top 100 leaders in Diageo. So Debra will move into that role. The challenges and opportunities are clear, as we talked on the call and really looking forward to it. She's done a terrific job in North America and with our supply team and works very well across the executive committee. So looking forward to that next step.

Chris Pitcher, Redburn: A couple of questions, I'll keep it short. Following on from Trevor's point around blends, obviously, you've seen very strong price mix for Johnnie Walker in the U.S. You gave the global growth rates for Red, Black and Blue, but could you share these for the U.S. as well? You mentioned double-digit for Black and Blue, but how much did Blue grow ahead of Black? Did Red grow? And can you give the mix of the Johnnie Walker portfolio today in the U.S.? And then a very short final question, 7% CapEx to sales is a level we've never seen before. How many years before that sort of steps back down again to the 4% to 5%? Or will it stay high during the whole supply chain investment?

Ivan Menezes: Chris, I don't have at hand the mix of Red, Black and Blue in the U.S. but what I would say is Black and Blue that's our focus, to build Black and Blue. Both are doing really well and really fast. Red benefits from the Johnnie Walker halo. If you step back, our total scotch whiskey business, 70% of it now globally is at Black Label and above in terms of value. This is a very premium business, and we've shifted it over the last few years. The focus areas will continue to be to build Black and above. Blue Label has super momentum. You've seen the global numbers. Roughly speaking, Red Label grew 20%, Black Label grew 40%, Blue Label grew 60%. That's the trade up within the Johnnie Walker trademark business and the U.S. trends are similar.

Chris Pitcher. The second question is about CapEx, the 7% of sales. Even when you were building RTD capacity in the early 2000s, it was never that high. How long is it going to be at this level, do you think?

Lavanya Chandrashekar: I'll take that question. In fiscal '22 our CapEx was £1.1 billion that was really coming off the back of several projects going down [paused] through Covid and the need to support the growth of the business and our sustainability agenda. We've guided to between £1–1.2 billion for the medium term. It's really to continue to support the growth of the business. You've seen the fabulous volume growth that we have on the business. We have an ambitious growth agenda. This will also be required for us to be able to meet our sustainability goals. It is also going to be a portion of it is also going towards supply agility program. So we do expect a slightly higher level of CapEx as we execute this program, and I do expect our CapEx levels to go back to more normal levels as this program completes.

Ivan Menezes: I'm going to close it here. Thank you, everyone. Appreciate your interest in Diageo and for following and tracking and investing enough. I wish all of you a great summer. Lavanya and I look forward to meeting several of you over the next week or 10 days as we get around. Thanks again. Appreciate it, and goodbye.