

CAPITAL MARKETS EVENT PRESENTATION – OUR STRATEGY TO DRIVE GROWTH - Q&A SESSION 1

DEBRA CREW

Thank you for your attention. I will now open the floor to Q&A. This this will be the first of four opportunities that you will have today.

Following this, you will then hear from some of my Executive Leadership Team members, who will share some compelling examples of how we are executing against the strategic growth drivers that I mentioned moments ago.

I think at this point I'll invite Lavanya up, and like I said, there's four Q&As. So just so you know when those Q&As will break and if we can try to keep the questions within the pieces it will just be helpful.

This first part on my section, on the foundational facts, current context. Then we'll have one again after we've got a lot of the Executive Team and Presidents coming up to present the growth strategies. We'll have two in that section; we'll do one that will be more focused on rest of world Q&A and then we have split out a NAM Q&A.

And then we will also have a Q&A to talk about the medium-term guidance after Lavanya and I go through that and talk about that. So that sort of frames it up.

SIMON HALES, CITI

Thanks, it's Simon Hales from Citi, thanks for the presentation, Debra.

I just want to come back to LAC. Again, I'm just still struggling, just to really understand what really changed between the end of September of the AGM Statement and where we are today. Is there something, in terms of the internal management information systems that you have that meant there was perhaps a delay in you recognising a sense of what was really happening on the ground? How do we have confidence that there's not a risk in other markets of a repeat? I appreciate what you said about LAC being an isolated incident, but I'm still just trying to contextualise it all.

DEBRA

Sure, well first of all I will say remember October is a very important month for us, so there is a lot of information that comes into October. I mentioned in the presentation how much of Scotch is sold in LAC in H1 and the vast majority of those depletions all happen in the October, November, December timeframe.

Actually, what might be helpful, because I have talked about it, but maybe... Alvaro is here, we've got the president of Latin America here. So maybe if you want to talk a little bit about what you've seen. You've been on the ground, I think you have 20 years or so in the region, so you know it pretty well.

ALVARO CARDENAS

Hi everybody, can you hear me well? Sorry that my voice is a little bit soft, I have been talking a lot over the last few days.

I think the question is about what has changed. I think in August we signalled some weakness in consumer... some consumer downtrading, more volatility than expected, and some inventory issues as Debra had said, and specifically in Brazil.

So what happened after that? Consumer volatility continues there, but there are two important aspects. One is, spirits has been underperforming TBA, which is the first time we have seen this. For example, in the case of Mexico, during the last two years spirits have been growing between 8% to 10%. Q1 showed a decline of 5%, which was a very rapid change to adjust for us.

In LAC, Scotch is our largest category and 63% of our sales, as Debra said, happens in H1. The depletions of that, the majority is between October, November and December. So the important data point was between September and October, when we got the orders from our distributors and the model trade, which is the first channel that we attend, that were lower than what we were expecting. And at that moment in time, we knew that we had a bigger issue than we were expecting.

How is our road to consumer in LAC? We have distributors, the model trade and a few wholesalers. For that level of our road to consumer we have robust and solid information from sales to stock in trade.

The second layer which is more wholesalers, distributors that goes to the fragmented on-trade and off-trade, we have less information. And that is what is causing the problem for us to really anticipate, to understand the entire value share of the stock in trade that we have.

So we have this ability of this first layer and this is one of the first actions that we are taking, is normalising this first part of our road to consumer, and we are making significant action of that and we confident that by the end of H1 that job is going to be done.

The second action for us that we are taking, is maximising our festive season, which is the most important part of the year for us. And to make sure that the execution happens, to accelerate depletions, to help us to clean what is less clear for us, which is around and is just not for us, it's for the entire industry. That is this second layer of our stock in trade and the stock in trade that is in the market.

In that context we are gaining market share, and the only market that was an exception for that was Mexico and during the last four weeks we have seen early signs that that market share is improving to get into positive.

So I think that was the combination of the volatility after the faster growth, plus the instability that we have in the road to consumer is what we are dealing with at this moment in time to address the issue. We are taking immediate action, as I said, and we are taking this very seriously, to address this first part. And then in January we will have better visibility after the execution of R&D.

DEBRA

Very good, and then your second question on other markets, thank you Alvaro.

ALVARO

Are there any more questions about LAC, no?

DEBRA

No, I'm sure there will be questions about LAC, but we know where you are.

As far as other markets, look, this is quite a unique situation, certainly in developed markets, we've got more visibility all the way through that chain. And then I will say, actually other emerging markets like Dayalan will talk about, Africa at some point, we'll get him up here too. But in places like Africa, first of all it's mostly a beer business, which because of the expiration dates nobody wants to drink stale Guinness. So, it's just a different setup there.

And then the other thing is that that opaque layer is more like a mom-and-pop shop, versus in Mexico where you're talking about other wholesalers. So it's just a different level there.

And then also, of course John, in APAC, that's another emerging market in the world where sometimes you don't have as good visibility but the difference there, it's quite a luxury portfolio in many of the markets like Malasia, where you don't have the same kind of...

Remember, LAC has grown in our business tremendously over the past four years, it's a great business, with great margins, and we've expanded that. So over time you're seeing a lot of growth there, that's really where it can be sometimes difficult to see exactly what's actually true consumption versus anybody building inventory until they stop ordering.

The team is absolutely all over it, we will come back to you in January and give you an update. But we do feel certainly, as we look around the globe, we knew we had an inventory problem in Brazil. Certainly we did also flag that we had weaker consumer conditions, but things like this Mexico thing, I would call it the newer news in that five weeks. And of course, this is an important consumption time period, so we will know more about the status of this in January.

CHRIS PITCHER, REDBURN ATLANTIC

Hi there, Chris Pitcher from Redburn Atlantic. Thank you, Alvaro, for all your answers and everything for the last couple of days. Slightly in your defence, are we missing the real issue here that LAC, let's say it missed by 10%, 10% of the group, that's one point. But you put up a chart saying the US market is growing 3 to 4. Your sequential improvement perhaps doesn't mean you're back into positive territory. So actually, what's happening here is the US has not recovered as quickly as you'd hoped to provide the safety net for all the other regions.

So what happened in LAC, in June we were talking about the risk of a cyclical downturn in LAC, we've been through this many, many times. What we haven't been through is the sort of gap you're seeing between the market and yourselves today in the US. And actually the US is the issue, not LAC.

DEBRA

Well actually, we are still looking at sequential improvement in NAM and remember we did talk about this is a supply chain that has been normalising, it is a consumer that's been normalising. But you look over the last 12 months, in measure channels, what is it, 3.8%, 3.9% growth, so actually we're getting back. You're seeing from a consumer standpoint that normalisation back to mid-single digits.

We had said all along it would be gradual improvement in NAM, so that is what we're seeing. No doubt, as you look at NAM month to month, that's why I say normalising instead of normalised. But certainly we are still seeing that sequential improvement. Of course we would always like to see that come faster, but you also have to remember in NAM we were still cycling, there were a lot of price increases last year, not just us but elsewhere in the industry. So you still have a lot of things that I would say that are normalising out.

But we're exciting about what we see, from consumer sentiment. We're excited to see that point of sale and the consumer really come back. And the rest of the supply chain things will of course follow along.

CHRIS

Can I just dig into the consumer sentiment you put up?

DEBRA

Yeah.

CHRIS

How long have you been running that time series? How efficient has it been proven, and particularly your commentary around quite an optimistic view on the entree going into Christmas. That notoriously can change very quickly. How comfortable are you is that a predictive tool because I come back to it, sequential improvement, you haven't confirmed growth, so you could still be negative. And the gap to the market is 4 or 5 points, which we haven't seen in a long while. So, how confident are you in those predictive tools.

DEBRA

It's sentiment, so as you know consumers, we actually find they usually under say what they're going to spend. Most people plan to spend less and then they end up spending more. That being said, that's why the most important thing is to really look at things year on year is what I would say.

We saw this low point back in February 2022. Actually, if you look at industry and how the industry grew in 2022, there was not a lot of growth. So actually that was, I would say, quite aligned with ultimately what we saw in the market. And we also have external morning consult and these types of things that there, they would have said, kind of July of 2022, was sort of a consumer low point.

So, we've got multiple, both external and internal sources that pointed to that time period of being fairly low for the consumer and that the consumer is actually feeling better. Remember, this is questions about our industry.

So I would say we've got great tools, like demand radar that actually pull in and scrape external stuff plus internal. We see it aligning with what then ultimately, we see in the marketplace. But granted, it is of course sentiment, and there are things that happen, so it's not entirely predictive. But we do find that when we combine these data sources, we tend to get the best view of it, and we are feeling good that it is not giving us a lower number, we're quite pleased to see that it's higher.

LAVANYA CHANDRASHEKAR

And we get it every month, so we're looking at it every month Chris. So if it changes, we will see it right away.

ROBERT OTTENSTEIN, EVERCORE

Robert Ottenstein, Evercore. I was just wondering if you can talk about your exposure to the Middle East, which doesn't look like it's going to get better any time soon? And both, kind of the direct impact. I believe you have very large businesses in Israel and Lebanon, so probably not counting on too much growth there. But also and more importantly as well, how you think other things may happen, things that we aren't seeing today, but if all of a sudden retailers become more cautious, if travel, international travel has started to slow, or any other ramifications around the world that you're monitoring, that you're starting to see perhaps initial changes in trends.

DEBRA

You want to talk about what it means from a group level?

LAVANYA

It's not a huge part of the total growth, but it has had a meaningful impact on Europe. Now, Europe's growth in this half is going to be strong. We were expecting it to be stronger, if not for the impact in the Middle East, and the impact we're seeing there is the direct impact, as you said Robert, in Israel and Lebanon where things have come to a complete halt. But we're also seeing a significant pull back in the business that we have in the rest of the Middle East, that's in the Gulf states.

I think there are secondary impacts definitely that we will see from this. The combination of the Ukraine war and the crisis in the Middle East, you see what's happening in Continental Europe and GB as well. You're seeing the rallies; you're seeing consumer sentiment being impacted by it. That's definitely for sure.

And I don't know if John wants to add something about global travel.

JOHN O'KEEFFE

Just to set some context in global travel, passenger numbers are actually quite good globally, apart from Asia where the Chinese consumer isn't yet travelling at the rate we expected. In fact, in Europe, they're actually higher than pre-Covid levels. But we are seeing a bit of a fallout through some of the Middle East hubs and some travel, so we are watching that. So that is going to be, I would say a secondary impact on what has otherwise been a relatively buoyant channel for us.

CELINE PANNUTI, JP MORGAN

Thank you, Celine Pannuti from JP Morgan. Maybe I would like to go to a bit more of the mid-term Debra. You presented the key points today and some of them, as you said, were already from past strategies. So I wanted to understand what do you think you will do differently. You mentioned that you think you could do better, in terms of execution, so if you could give us a bit of a steer on what exactly that means.

I also noted, I know it might be more of the Lavanya presentation, but within that mid-term, it also means that you are increasing your A&P stand to deliver the same. So, is it you can do more, but you need more resource? How do we think about the return on all of that? Thank you.

DEBRA

You'll get a chance, we will actually take you through some of these key places where we're really looking to invest behind, actually in this next session. So I won't steal too much of the thunder, other than to say, I laid out the four key growth strategies.

The driving on our big brands, that is certainly more of a continue of what we've been doing at Diageo. Many of you would have seen our Scotch presentation back in May. Certainly Tequila has been a big part of our growth and is one of our big brands and certainly Guinness. So activating against all of our big global brands is clearly a big part and our big global categories is certainly a chunk.

The newer areas, I think it's about expanding some of our footprint around the world and I talked about this actually at the end of F23, about taking Tequila around the world. We'll talk a little bit about that today.

There are also pockets of other opportunities for some of our brands and you will hear from our presidents where we see those opportunities to more lift and shift, I would say, and some of the really exciting things that are happening. We are seeing the speed of the consumer around the world really pick up on these trends quite quickly, so we want to be able to be there and be leading in those emerging trends much faster.

Innovation has always been part of Diageo; I think it's a real core strength of ours. If you think about our share, we tend to always overshare on our innovation that we launch. But some of these new occasion areas, and I think our frame of moving to category and very brand out, to really looking at the consumer landscape of occasions and where we can play, so think about all the adjacent areas of which convenience has exploded. But there are certainly pockets already of things like non-alc that we really see an opportunity in and really going after these new occasions that are not just great for Diageo, but really is quite expansive for the category as well.

So, as we look at A&P and we'll talk more about how this rolls up in the medium-term guidance and how this will work. We've been investing as Diageo, we want to continue to do those investments, there are just some things in the world in which we'll be operating in that's a little different going forward but we can talk about that this afternoon.

And then the fourth strategy, raise the bar on execution. That's a newer session. So the final session we will talk about productivity at length. This is key for us. We see great opportunity

here, but these are big programmes, this isn't just the everyday efficiency stuff, we've got some very big programmes.

And then also, I am not going to steal Claudia's thunder and Sally's thunder on what we're doing in NAM as well, on execution, and specifically around addressing how we show up at point of sale and our route to consumer. So stay tuned, and if we don't answer your question by the end of the day, we'll come back to you.

LAURENCE WHYATT, BARCLAYS

Hi, it's Laurence Whyatt at Barclays. Debra, on slide 19, about the power of the middle class, you highlighted some statistics on both India and LAC about the potential of those growing middle classes. When we look at other sector companies, whether in spirits or in wider beverages, often China is highlighted as a key area for the growing middle class. You didn't put it on your slide. Is there a reason behind that? Has your potential growth expectation for China changed recently? How do you interpret that?

DEBRA

So China, of course for us, remember what is it John, 90% or so of TBA is Baiju. Which we're in Baiju and absolutely look at that, we do see the opportunity. It's just by the numbers, the India opportunity is... and that growing middle class is really special to highlight.

And then what Alvaro has been doing, putting the Friday announcement aside, in LAC we have certainly seen just great opportunity in that too.

So, it was more just about size and scope of numbers. We are certainly investing in China, we've got a lot of investments going into Baiju as well as the Chinese malt distillery, which is very exciting. It's an emerging area. We'll see how that goes but very exciting.

ANNE GURKIN, DAVENPORT

Thank you, Anne Gurkin with Davenport. I wanted to return back to LAC and ask about the consumer and the downtrading. Is it different in this economic challenged environment versus past environments? And is the competitor environment also rational as well? Can you talk about the competitor behaviour as well as LAC?

ALVARO

Yeah, so from our consumer perspective I don't think it's that different. I think what we are seeing is during the last three years what we have been doing is we're growing consumers from premium beer and other local beers and spirits. That has been the journey during the last three years.

The downtrading that we are seeing right now is seeing consumers go from Scotch to other categories like vodka or gin, and in some cases to beer, to beer again. But it's not that different versus what happened before, it's just that we are in a much different position right now, from strength, but what we are making sure of is that we are playing with the entire portfolio to make sure that those consumers that are downgrading are coming back and are staying within Diageo's brands.

ANNE

And the competitive landscape?

ALVARO

And the competitive landscape, it's very active, especially on beer, due to the fact that during the last three years we have been recruiting consumers from beer, with beer being very active, coming back to the on-trade, coming back to invest.

From an international spirits perspective we continue gaining share, as I mentioned, and continue to be very active because that has been the case during the last three years about us gaining share.

ANNE

And Debra if I can return to the US, you put up the slide about Diageo US distributor inventory levels within the range, but that data looked like it was through June of '23. Do you have any data that runs through maybe September? What does that inventory level look like in that graph?

DEBRA

Yes, we're still very much in the range. So actually we can look at inventory daily in NAM, and it's because we're so concentrated, particularly in spirits we're concentrated in a couple of key strategic distributors. So, yes, we are absolutely within that range.

ANNE

So no change?

DEBRA

Yes. Unless we get that audited, we can't ever put things up on a slide. And our external auditors look at that before we put that up on a slide.

I will add, because this comes back to how different our LAC business is versus other downturns. The LAC business now has much more premium Scotch in the portfolio versus standard Scotch, and that's a real shift versus other downturns. So certainly, even down turning from premium Scotch can still land in our portfolio. We don't have to chase that down; we've gotten our Scotch ladder in LAC that you've built over the last four years.

JAMES EDWARDES JONES, RBC

Back to the sell out versus sell in again, big components of your variable compensation, both bonus and LTIP are based around sales, so sell in. Have you thought about whether there's a way of adjusting that to more effect sell out, and actually pay people for executing the culture?

DEBRA

On sell out, Claudia can speak to this in NAM, but certainly in our incentives we have individual bonus incentives as well. Literally, when you talk to the teams they will talk about depletions. Looking, no other president is saying no. Like, literally that's what people talk about, so it really is about depletions and NSV.

So that kind of measure on the top line, that's a one Diageo measure, but the individual regions and the individuals that work within our commercial organisation are all about depletions. And in fact, if people end up with inventory that is over, like if it looks like, you actually have to come before, first of all within the region you're going to be standing up in front of the region management team, and then it will even come up to the audit committee. Do you want to talk about that?

LAVANYA

For the people who are actually doing the selling, their bonus structures are predominantly sell out. The group bonus is a very small component of the front-line salesperson's incentive structures. At the total group level the other thing that we do have is what we call the IRC, the Remuneration Committee. Louise and I sit on it and before we pay out any bonus, we do have a quality check where we look at whether the results have been achieved in a high-quality way. So stock in trade is a very large part of that.

Margin progression is another part of it. So if someone is achieving an NSV number or a depletions number in a non-quality way, we use full discretion to pull back on those incentives. So, it's not a mathematical calculation only, there are significant checks and balances that we have internally within the company to ensure that results are being delivered in a high-quality way.

JOHN

Our general managers are focused on one thing and that is market share. We have a significant and the biggest bonus modifier for any country, is the general manager being able to demonstrate that they've grown market share in the year? And that is the delta on the bonus that they get for the entire team in that business, and that's a plus or a minus. So I think that's a really important focus.

DEBRA

So that's even beyond depletions, but actually a sell out, of course, to the consumer. So not all places we have good enough data to be able to fully do that, the depletions, in other words, this is not, and I will just repeat this... We have many people on the senior management team that were here 10 years ago, there's even maybe more than that now, but of that kind of sell in culture, that is not what it is today at all. So we try to measure as far down in the that supply chain as we possibly can as we're putting together incentives for people that are in our commercial organisation, so that there is no adverse incentive there.

JEREMY FIALKO, HSBC

Hi, Jeremy Fialko from HSBC, just one question coming back to LAC again. A lot of us here look at many other consumer staples companies across the food, household products, personal care, etc. etc. And I guess we came through this reporting season and pretty much all of the other companies that we looked at had reported actually pretty robust results from LAC. You can go through these and you get double digit growth for many, many other players with a good volume and price balance.

So, what is it you feel is specific about your categories that have meant that the spirits industry and has just been so dramatically different to what all of these other parts of the consumer staples arena?

DEBRA

I think it's the premium nature of spirits and what it's become Jeremy. I think that's probably the main difference because we are gaining share. So we're gaining share compared to the other spirits and that's because we do have that price ladder of which we've got standard Scotch and we've got other things that people can trade down into. But these are quite premium products and had really been premiumising. Which is why we also remember had really great margins in LAC, which isn't always the case sometimes in some of the other companies that we might be compared to.

MITCH COLLETT, DEUTSCHE BANK

Thank you, Mitch Collett from Deutsche Bank. If I can ask another question on LAC, please. So you said that you only realised October was weak very recently and you've also said that November and December are very important months. So what have you assumed from November and December with the -20 that you pointed to for H1?

DEBRA

So a couple of things. So, we did know the consumer environment was weak, that's how we had built the inventory to begin with, that we were disappointed by the World Cup and what was coming after. We saw a weakening consumer environment; I think what Álvaro referred to.

So in Brazil specifically I think we identified that. I think the Mexico change was the one that changed quite dramatically from our end of year when we had talked about that. And of course we were not aware of really having built a big inventory and stock in Mexico, so that was sitting at lower levels clearly. So that weakening environment, I think that's the big change. I don't know if there's anything you want to add, but we can't talk about going forward.

ALVARO

I think it's that. We are assuming that we want to have better execution during October, November and December, and that is the best assumption that we have at this moment in time to solve, as I said, this second layer issue that we face.

LAVANYA

If I just add onto that Mitch. One of the conscious decisions we have made here as we've come up with this very disappointing issue in LAC is to keep the business still funded, to be able to carry the depletions out, because the best thing that we can do is to ensure that we keep a very healthy category, we keep our brands really healthy. And if the consumption happens at the end point in these very big holiday occasions, through Black Friday and Christmas, that's the best solve for any issue that we have in any market and not the least in LAC at present.

So, that's definitely something that we have kept funded and that's what we're doing. Our assumption is that these are good, strong plans that the team have built and we will keep the business funded to carry the consumption out. And we have seen that come through and our team have weekly data that measures what's happening from a consumption perspective in the tracked channels and we are definitely seeing that.

JON PRIGOFF, ARTISAN PARTNERS

Thank you, Jon Prigoff from Artisan Partners. I'm just curious, the cost of capital has increased, of course, for everyone over time. You talked a lot about the investments you're making, I'm wondering if there are investments you're not making or where the hurdle rate has increased that's caused you to pull back in certain areas, just in an environment of scarce resources for everyone.

LAVANYA

I think we're always making choices. I think as Debra said, there is opportunity for us to grow pretty much in every brand and category, in pretty much every region. So we're always being choiceful about which do we fund first and which do we fund next.

And then to your point on the hurdle rate, as the hurdle rate goes up, what we expect to get from acquisitions or from any Capex expenditure also go up. So we do update the hurdle rate regularly for all of our investment decision making choices.

Anything specific that you want to add that we haven't done?

DEBRA

No, I still come back to, this is a really critical time of the year for us and we are very pleased with the trajectory that we're on in this 90% of the market, and Alvaro has talked more than a bit about what we are doing to try to overcome and get through this LAC issue as soon as we can and really make sure then that we can clear that as we go forward.

Thank you.