Diageo Greater China President's Call with Sam Fischer

Transcript including Q&A - Thursday 25th March

Sam Fischer:

Welcome to Diageo's Greater China President's call.

For those of you who don't know me, I'm Sam Fischer and I'm the President of Asia Pacific for Diageo. I also have responsibility for Diageo's Travel Retail business. However, the focus for today's presentation is Diageo's business in Greater China.

China is an exciting market with fantastic growth potential. Today I'll share my view on the market opportunities and outline our key strategic initiatives.

Greater China has been a strategically important market for Diageo for more than a decade, and it is becoming a much more significant component of the Diageo group. Over the last five years, it has increased from two percent of Diageo's net sales to now five percent.

However, we are still only at the beginning of a very exciting journey in China. It is a very attractive, and profitable growth engine for Diageo, and I see this business growing to be 10% of Diageo's sales over time.

Diageo has two distinct businesses in Greater China. The first is Shui Jing Fang, our baijiu business, and we remain the only international spirits company to own a baijiu business in China.

The second is our international spirits and beer business that spans across Mainland China, Taiwan, Hong Kong and Macau. While the main focus of our international spirits business is scotch, we also have other businesses in brands such as Baileys and Guinness.

Together, baijiu and scotch make up over 80% of our business in China, and I am going to focus today's presentation on these two categories.

Greater China is the world's largest total beverage alcohol market. Excluding 'low' and 'value' price tiers, where we choose not to participate, the size of the market in China is $224 billion. This is almost 40% bigger than the next biggest market, the US, which is $162 billion on an equivalent basis.

In recent years, growth rates in both TBA and international spirits in Greater China have been ahead of global growth rates.

You can see from the chart on the right that a large part, approximately 70% of the TBA market, is baijiu. Although international spirits is just three percent share of TBA sales, the category is growing fast and there is lots to go after!

In the near-term, we are encouraged by the pace of the economic recovery in China in the wake of Covid-19. In the fourth quarter of 2020, China was the first economy to return to its pre-pandemic growth rate outlook.

Longer-term, the fundamentals are strong and consumer spend has been driven by positive macro trends, which are expected to continue through the current global volatility.

Premiumisation is a global trend, and we are strongly positioned in Greater China, just as we are in many other markets.

Globally, China has the largest and fastest-growing 'super premium and above' price segment. It makes up $81 billion of the retail sales value in China, compared to $18 billion in the United States – so nearly four times the size.

Already a premium market, nearly all of the market value growth since 2015 has come from 'premium-plus' price tiers.

The size of the 'super premium and above' price segment is forecast to increase its share of the TBA market by five percentage points over the next five years.

A number of fundamental consumer trends are driving market growth and premiumisation we expect these to continue.

Consumption occasions are growing, as the increasing social and economic power of women has led to a rise in the number of mixed-gender and female-only occasions. Consumers are increasingly exhibiting an appreciation of craft and quality and are more discerning versus previous generations, who were more overt in displaying their status.

Living a healthier lifestyle polled as the top priority for affluent Chinese consumers in 2020, with millennials placing more emphasis on it than their parents' generation. There is also strong demand for China-specific and China-characterised products with greater ties to culture. We expect the demand for these products to grow even faster under the 'dual circulation' policy, as the government places greater focus on increasing domestic consumption.

The 'new generation' of Chinese millennials, estimated to be around 400 million, are well-educated, often with international exposure through travel or study abroad. They have a high level of disposable income and are willing to try new brands and products.

An increase in urbanisation, as younger legal drinking age cohorts move to cities to find work, will lead to the continued growth of the modern on-trade, and the rise of 'low-tempo', 'with-food', 'bistro' occasions. This will support the growth of international spirits, which currently over-indexes in these occasions.

China is the world's largest e-commerce market by far, with double-digit growth over the last three years. Covid has accelerated the importance of e-commerce and there has been a clear shift in consumer purchase behaviour. In a recent IWSR study, nearly half of respondents reported buying more alcoholic drinks online than they did last year.

With favourable demographics, strong premiumisation and consumer trends, we remain excited about the medium and long-term opportunities for industry growth, which will benefit our business.

Baijiu is the largest spirits category in the world, reaching $157 billion in 2019. As the national drink in China, it is typically consumed with food and at large social gatherings and banquets.

Post the anti-extravagance regulations in 2013, the category recovered to grow at a compound annual growth rate of 17% between 2015 and 2019.

Shui Jing Fang primarily participates in the 'super and ultra premium' price tier, through its two core products, Well Bay and Number 8. This price tier has grown at a CAGR of 19% in the last four years. The category has also rebounded quickly post Covid-19 and returned to previous dynamics and trends.

Due to the strong premiumisation trends in baijiu, and the fact that over half of the value of the market is still in the 'premium and below' segments, we expect the 'super premium and above' price tiers to continue to be the fastest growing segment – thus creating an exciting runway for growth.

Moving now to look at the whisky market in China. You can see that in the last few years, whisky has been growing fast and scotch continues to be the largest component within the category.

As status cues are changing, becoming less about what you show and more about what you know, we are seeing increasing interest in the scotch category. This reflects scotch's rich heritage, craft, and traditions and we expect growth to accelerate.

Scotch malts have grown at a CAGR of 26% in the past three years and have been the growth engine for the scotch category.

While the blended scotch category in China has seen modest growth, our brands have been performing strongly. Led by Blue Label, our Johnnie Walker business grew at a CAGR of 26% in the three years to fiscal 2019, significantly ahead of the category growth for blended scotch.

Our ambition is to be the best performing, most trusted and respected international alcohol company in Greater China. The execution of our strategy is based on three core pillars:

- We will continue to premiumise in the baijiu category;
- We will 'win with whisky' by continuing to build powerful brands in ‘super and ultra premium plus’ scotch;
- We will hold our winning positions in Taiwan; and
- We will gain share of international super premium beer.

Underpinning our strategy are a number of enablers, which will support our participation choices. We are ensuring that we are a fit-for-purpose organisation, with best-in-class capabilities, and tools and data that enable us to employ consumer insights that unlock new growth opportunities.

Our business has a strong foundations and has been resilient through the pandemic, and we will continue to invest ahead, accelerate growth, and grow share of TBA.

As you can see, our strategy is working. Our business in Greater China has grown significantly over the last five years, at a CAGR of 15%. While Covid-19 had a significant impact on our performance in fiscal 20, we have seen a strong recovery in the most recent six-month period. We are very confident in our ability to drive strong growth in China.

This strategy and our unique positioning in both baijiu and international spirits, has driven growth ahead of our key competitor in recent years.

As the only international spirits company with a baijiu brand, we have a unique opportunity to play in the world's largest TBA category.

Shui Jing Fang is a beautiful, niche brand, with a legacy that traces back more than 600 years. It ranks eleventh in revenue amongst listed baijiu companies and has been gaining share.

The 28 provinces where Shui Jing Fang has distribution, cover more than 98% of baijiu consumption in China. We have expanded its geographical focus, distribution, and route-to-consumer, establishing Shui Jing Fang as a national brand, with a presence in over 30,000 outlets.

While Shui Jing Fang's growth was significantly impacted by Covid-19, the business rebounded strongly in the second half of calendar year 2020. It is a fast-growing business with a lot of potential and benefits from a strong management team and support from Diageo as a majority shareholder.

Shui Jing Fang has an ambition to grow significantly ahead of the baijiu category and win market share by focussing on four key growth drivers.

First, winning share in the top tier 'core stores' through strong sales execution, including 'international spirits style' execution standards and customer relationships. Higher volume per outlet also reflects the stronger brand equity in core provinces. It is now focused on winning share in eight key markets through a broad range of marketing activations.

Banqueting contributes to more than one-third of 'super and ultra premium' baijiu occasions. Having been significantly impacted by Covid-19, these occasions have gradually returned to become a key battle ground for baijiu brands in these price tiers. Shui Jing Fang has doubled

down investment in the occasion and has been winning share through strong customer partnerships and agility in execution.

Growth will also be driven by innovation, adding new variants, and driving premiumisation. Ahead of Chinese New Year, Shui Jing Fang launched one-litre gifting packs with graphics of lucky icons in Chinese culture – the Dragon and the Phoenix. It has also used innovation to enable its participation in the 'ultra-premium' price tier through variants such as New Classic and Forest Green.

'Corporate Purchase' is another key 'super premium' and 'ultra premium' occasion. In China, most corporates have had a good entertainment and gifting budget each year, so unlocking the corporate purchase opportunity creates significant commercial value, as well as a platform to effectively reach the right target groups.

Moving now to talk about the opportunity in international spirits. You can see from this slide, that the penetration of international spirits is still relatively low – estimated to be only around 3% nationally. However, our studies show that penetration can be up to low double-digits in major cities like Shanghai and Guangzhou.

A 2020 Kantar study on Usage and Attitudes among 21- to 50-year-old spirits and wine drinkers, showed the penetration rate of whisky is now higher than cognac in five major cities.

The growth in e-commerce is helping to drive whisky penetration. Tmall national shopper purchase data shows that the number of whisky purchases in 2020 was significantly ahead of cognac and was growing faster. While e-commerce is still skewed to the major cities in the East and the South, it is a critical channel for reaching other geographies, and we can expect this momentum to continue.

The room to grow penetration in international spirits, and the momentum of whisky within the category, creates an exciting opportunity for our business.

Our focus in Mainland China is on building the ‘super deluxe and above’ scotch whisky category. We have a proven strategy to grow our whisky business, focusing on three key areas.

Building consumers' knowledge of the scotch category and our brands, is the foundation of building our whisky business and route-to-market in China. We are educating the consumer, reframing category perceptions, and creating a buzz around whisky.

Since 2017, we have built 52 whisky spaces, in partnership with key customers in tier one and tier two cities. In addition, we’ve executed 13 Whisky Summits to showcase the strength of our scotch portfolio. There are now over 600 single malts bars in China, with strong year-over-year growth. We have educated more than 15,000 customers, bartenders, and consumers over the past three years through our Diageo Whisky Academy and are now taking it into the digital space.

Through these forums, we are educating our customers and consumers about the quality, provenance and craft that differentiates whisky, and our scotch products, from other international spirits. These steps have helped us position scotch as a genuine discernment category.

We are investing to build whisky ‘power brands’ led by Johnnie Walker Blue and The Singleton.

Through luxury brand mentoring, gifting programmes, and disruptive brand events, Johnnie Walker Blue Label grew at a CAGR of 51% in the three years to fiscal 2019.

The images that you can see here, showcase our exciting new ‘Depth of Blue’ campaign. We partnered with local influencer and renowned photographer and artist, Chen Man, to infuse the brand in local culture. We are also collaborating with local chefs who bring the depth and layered taste of Blue Label alive with amazing food pairings that are rooted in local culture.

Within malts, The Singleton offers us a significant growth opportunity, with its great liquid and unique and appealing packaging. The Singleton's taste profile was specially crafted to be preferable for the Chinese drinking palate. It is replicating the success among Chinese consumers that we have seen in the Taiwanese market, and has one of the highest trial-to-conversion rates in the category.

We are building The Singleton in a number of ways, including high-end mentoring and experiential events, gifting platforms, and banqueting and Chinese meal initiatives. All of these are strongly infused with PR and digital amplification.

The Singleton is now the fastest-growing major single malt brand in China and our ambition is to be the number one single malt brand in this critical market.

Innovation plays a critical role in delivering our ambition in China. Chinese consumers have unique tastes and needs and there is great demand for products that have ties to local cultural elements. We have been leading in this space across many of our brands and our recent innovations are built on local Chinese insights. This slide shows some examples, of our China-for-China innovations.

The special edition Johnnie Walker Blue Forbidden City anniversary bottle celebrates both the 600th anniversary of the Forbidden City, and the 200th anniversary of Johnnie Walker Blue, and it sold out fast.

We have launched The Singleton 21-year-old and 25-year-old Mid-Autumn Festival and Chinese New Year Pack. The Chinese New Year pack, created in collaboration with a modern calligraphy artist, denotes the five elements of good luck and fortune, symbolising the regeneration of your luck for a fresh start in the new year.

We also launched our Johnnie Walker 15-year-old sherry, a sweet and smooth tasting blended malt whisky and the Singleton 53-year-old, which is Diageo's oldest ever, aged single malt. At

over £20,000 a bottle, all stock of the Singleton 53-year-old sold out on pre-orders, demonstrating the strong demand for premium and unique innovations in this market.

Greater China is world-leading in digital capabilities and innovation – and end-to-end digital excellence is critical in such a highly digitised and evolving market. We are expanding our e-commerce capability and execution to capture this increasingly important channel.

We routinely digitise our marketing initiatives to drive scale and efficiency. A good example of where we have done this with great success is with our Diageo Whisky Academy. Having made courses available online, 30% of our new recruits were virtual participants in the first half of fiscal 21.

We have also digitised our 'core store' program, giving our commercial team the means to virtually engage with over 300 core liquor stores nationwide. Through expansion into platforms like Tmall and PinDuoDuo, we are strengthening our business-to-consumer position in e-commerce. And our investment and focus behind the e-commerce channel is delivering results. We have grown market share faster than our peers.

Our recently launched digital CRM tools allow us to communicate directly with consumers, improving the quality of consumer insights and enhancing the quality of our decision-making. Our exclusive customer partnership with Tmall gives us access to rich consumer data so that we can execute targeted recruitment.

Currently, East, South East and South China make up around 90% of the international spirits value pool. The Guangdong and Fujian provinces that make up South China represent more than 70% of that value pool. For this reason, the South is the core battleground for our super-deluxe whisky and we have strong coverage in all 30 cities in the South.

The East region, with its vibrant on-trade culture, has been a trend-leading hub for international spirits. This year, we expanded our presence to all key tier one and tier two cities in the East region, doubling our distribution.

We have also been broadening our coverage within channels, primarily upweighting our presence in on-trade channels in the South. We have increased the number of our 'core store' partners by 40% and established dedicated 'reserve' teams to partner with the top high-end outlets. We continue to recruit tier one and tier two wholesalers. Our efforts to date have expanded wholesaler coverage by more than 30%.

In addition to the three core territories, we are also building stronger route-to-market muscle in North China, West China and Central China. International spirits penetration in these territories may be small now, but the headroom for growth is big given the population and size of the economy.

In addition to these opportunities is Hainan, China's offshore duty-free island. It has recently increased the permitted spending level and now includes liquor, providing another driver for luxury spirits growth.

Chinese consumers are the biggest luxury goods spenders globally and represent 40% of sales across all Travel Retail categories. The runway for growth is strong, with passengers projected to grow almost four times over the next five years and Diageo will be well positioned to meet this consumer need.

Doing business in the right way is embedded in Diageo's strategy and is a core part of our performance ambition. Diageo recently launched our highly ambitious ten-year sustainability action plan for the decade to 2030, which focuses on positive drinking, inclusion and diversity, and grain to glass sustainability.

Diageo China was the first company to promote responsible drinking in China. We played an instrumental role in fostering a positive drinking culture by advocating for the adoption of a

universal market code of conduct, founding the China Social Aspects Organisation under the China Alcoholic Drinks Association and the Foreign Spirit Producer Association, to support the reduction of alcohol-related harm. We are looking to partner with organisations like JD.com to reach millions of Chinese consumers with messages of moderation and responsible consumption.

We will provide business and hospitality skills through our 'Learning for Life' programme. 50 percent of the training recipients will be female or from under-represented groups, increasing employability and improving their livelihoods.

We will bring best-practice sustainability from grain to glass, focusing initially on increasing efficiencies in our supply chain and contributing towards our global goal to ensure that the business is using 100% recycled content in plastic packaging and that 100% of Diageo's packaging will be widely recyclable by 2030.

So in summary, Greater China is an attractive market for Diageo as consumer trends of increased consumption occasions, growing penetration and premiumisation provide a huge runway for growth.

We are the only international spirits player with presence in baijiu, international spirits and beer.

Our strategy has been working, and we have a clear roadmap to drive sustainable, long-term growth with attractive margins.

I am confident that we have the team of people inside Diageo China and Shui Jing Fang that have the commitment, the talent and the energy to deliver sustainable and profitable growth for Diageo. Thank you.

Q&A call with Sam Fischer

Operator:

Good morning and afternoon. Welcome to the Diageo greater China President's Call, hosted by Sam Fisher, President of Diageo Greater China and Asia Pacific. This is a live Q&A session for 30 minutes, following the pre-recorded presentation that was made available on diageo.com earlier today. This call is being recorded. To ask a question, please press star one on your telephone keypad. Please limit yourself to two questions at a time and re-join the queue for any additional questions. Please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star one to ask a question. We are now ready to start the Q&A. Our first question comes from Sanjeet Aujla with Credit Suisse.

Sanjeet Aujla:

Just a couple of questions from me, please. Firstly, you highlighted the exceptional growth of the greater China business around 15% CAGR in recent years. I guess with scotch now starting to accelerate, do you think there could be upside to that over the next few years? And my second question is just around e-commerce for scotch. How significant is that now, as a part of the scotch business? I think a couple of years ago it was around mid-teens. Just like to get a feel for how that's progressed since then.

Sam Fischer:

Hi Sanjeet and hi everybody else on the call, welcome to our Greater China Q&A. Just in relation to our performance in scotch generally, I think, through the presentation, we talked into our confidence around the progression of scotch. It's still relatively small, only 3% penetration rates. But with the work we've done over the last three years, really trying to build the category from a credentials perspective, now I do think we've got confidence in the green shoots that we've seen. We have been working on whiskey summits, whiskey boutiques, Diageo whiskey Academy, which is all about educating people around this category, the credentials of the category, and the craftsmanship and heritage that goes into it. So, we talked about the

enhanced penetration in some provinces that have given us confidence. We've seen interest in online auctions. So, I think the runway is really long and we've got lots of confidence in our future.

In relation to e-commerce, we've been investing in e-commerce also for a long period of time. We're number one with scotch on the e-commerce platform, and we've got about 20 people now working specifically on e-commerce. I think it represents just over 15% of our business today. No reason to think that, that won't continue to increase as e-commerce as a channel continues to be more prevalent in China.

Operator: We'll take our next question from Richard Withagen with Kepler.

Richard Withagen:

I have two questions. First of all, are you using tools like Catalyst and Edge in China, and how useful or effective are these in the country? And then secondly do you see an opportunity for other whiskeys, like Bulleit or Crown Royal given, also strong growth rates for other whiskeys and scotch?

Sam Fischer:

Yes, look, I think we do use Catalyst and Edge, and many more of the Diageo tools to drive effectiveness and also efficiency in our business in China. We talked a little bit about our Salesforce automation, where we've got through the Salesforce the ability to see into some of our core stores, real-time what's going on with our execution, sales and performance, et cetera. So again, these are all technologies that we've learnt from Diageo, we've implemented in China and are making a big difference to our execution.

Now, when it comes to whiskey generally, I mean, scotch is the bulk of the whiskey category, and at only 3% penetration, we've got a lot of work to do to continue to drive that penetration in our core provinces, but also more broadly across the country. So, number one for us, is to continue to build the power brands we have in scotch, particularly behind Johnnie Walker Blue Label, The Singleton, Talisker and Mortlach. And the runway we've got with scotch is huge. We are seeding other brands in the form of Bailey's and Guinness, and our reserve portfolio and Bulleit would sit within that, but the core focus for us remains developing our scotch business, and our scotch power brands, and of course our baijiu business.

Operator:

Thank you. We'll take our next question from Simon Hales with Citi.

Simon Hales:

Can I ask you about the need for investment over the next few years to realize the opportunity you talk about, both from a marketing and from an SG&A and route to market at some point? You talked about how you're building penetration beyond the South and the South East markets and maybe linked into that can you remind us outside of the Sui Jing Fang business, how your route to market operates, given your JV with Moet Hennessy, which brands are still going through that, and which brands and which parts of the portfolio now do you have full control over?

And then secondly, can I just go back to your comments around e-commerce? Can you talk a little bit about the opportunity, perhaps to go more directly to the consumer with your e-commerce business? Do you have much of a presence in that D2C opportunity at the moment? And I'm wondering whether there is really a particularly good opportunity around things like single malts, where you've clearly got a good story to tell and a broad brand portfolio that you

could perhaps take directly yourself to the consumer without going through a third-party platform.

Sam Fischer:

So let me start with the route to market piece and investment. I do think that we're investing ahead in China to support the growth ambition that we have for the market. That will include brand investments and investment in technology and platforms, and of course investment in our route to market. We are looking at expanding the route to market and we've talked about that a little bit. We're strong in the South, and the bulk of the business remains in the South, Guangzhou and Fujian but we are seeing pockets of growth in Shanghai, in Jiangsu, in Beijing and surrounds, and also in the West in Chengdu and Chongqing. So, we're building out our route to market there as well. Relatively small penetration at the moment, but we are seeing those green shoots we talked into around some of the whiskey bars, the super deluxe end of the market, where we're getting specific consumers continuing to ask about our scotch portfolio. So, we do see big opportunities to continue to build on that route to market, to give us more of national coverage.

We've got a great relationship with MH as you know in many parts of Asia and France, we've got a strong relationship and partnership in China. They've done a good job for us on red and black label. And we're pleased with that performance and relationship.

In relation to e-commerce the bulk of our e-commerce is still focused on this O2O, using some of the key platforms Jindong and Tmall through Alibaba. We are a bit nascent in the direct-to-consumer space at the moment, but we do see opportunities, particularly, with the prestige part of the business that we can build up with some high-net-worth individuals in China, the potential of a direct to consumer. But right now, there's still a massive opportunity to drive performance of

our business across some of those core platforms, and that's where the bulk of our investment is going at the moment.

Operator:

Thank you. We'll take our next question from Edward Mundy with Jefferies.

Edward Mundy:

The first question is I think you mentioned in your opening remarks that China's now a 5% business from merely 2%, five years ago, but you think it can get for 10% of group sales. I was wondering whether you are able to share a timeframe on when you think that might take place. And secondly, I think in your presentation you said there were five cities where the penetration rate of scotch is higher than cognac. Can you talk about what's different in these cities? How's the route to market? How's the consumption through the consumers? What is giving scotch a higher penetration rate than Cognac in those cities?

Sam Fischer:

Let me just start with the ambition of 10%. I think we've seen the progression from 2% to 5%, and that's on the back of the work we've done on category development for scotch, on overlaying all the investment around establishment about brands, and I talked about Blue Label and The Singleton the fastest-growing malt business in China and also our other support in malt, in Talisker, and Mortlach. So that 3% penetration and the momentum that we're seeing at a category level gives us real confidence that there's an enormous runway here for scotch whiskey in China. And our brands are perfectly placed to capitalize on that. So, when you project that out into what could happen if penetration continues to improve, and frequency continues to improve, which is what we would expect then again, that gives us confidence that 10% is attainable.

Then we look at baijiu, this massive category that exists in China. We're in a very exciting part of it in the super and ultra-premium segment. A segment that is going to benefit from this premiumization trend that we've been seeing for a long period of time. And we look at the massive volume that sits underneath the super and ultra-premium segment and the premiumization trend. Again, we think there's a massive runway for our baijiu business and Sui Jing Fang is really one of the very few baijiu brands in China that is national. So, when you start to look at the potential of both of those core pillars, than you look at that in the context of what 10% represents to Diageo, I think we've got great confidence. Of course, we can't predict what's going to go on, and we've seen all sorts of volatility in the world at the moment. So, all I can say in relation to the timeframe is that we will continue to make appropriate investments that build the brand and build out our footprint to set us up for the longer-term, and I can’t give you a date for when that 10% arrives, because I don't know.

Edward Mundy:

Got it. Just on that point before I go onto my second question. Just some crude maths. If you grow at around 15% per annum you get there in 10 years. If you grow at 20% per annum, you get there in five years. It sounds like the baijiu category is going to grow at least 10%, and you're going to grow ahead of that. And equally you're quite excited about scotch. Is it fair to think that you are somewhere in between the two? I'd love to get your view on that?

Sam Fischer:

I think that our goal is to continue to grow share in the marketplace on the back of a very considered careful investment that we've proven over the last three years. So, I think when you take those into consideration, some of the assumptions you've used can be correct, but again, I'm not going to put a timeframe on it.

Edward Mundy:

And in which markets has scotch got greater penetration than cognac?

Sam Fischer:

When you look at Hong Kong and Taiwan, right next door, you've got some very influential markets that sit right next to the bulk of the international spirits business in China, in the form of Taiwan, which is right next to the Fujian and of course, Hong Kong. And in both of those markets, scotch is significantly bigger than cognac and that wasn't always the case. We saw that cognac many years ago in those markets was really large but as people got involved with scotch and started to explore and understand the craft, heritage and provenance that interest grew, and scotch became the largest category by a long shot. So again, it's those leading indicators that give us confidence around what we're doing in China.

Operator:

We'll take our next question from Chris Pitcher with Redburn.

Chris Pitcher:

A quick question on Sui Jing Fang. You mentioned that you are making it into national brand. Can you give us an update us on the percentage of sales that's been in Chengdu and then also the challenges to taking it national. Is it, route to market? Is it brand awareness? Just to kind of get a sense of that distribution upside. And then secondly, have you considered using the Sui Jing Fang distribution networks to recruit people earlier into scotch? I'm trying to think how you might get cheaper scotches into the market to capture people or are you really just focused on the premium opportunity?

Sam Fischer:

Let me just start with the Sui Jing Fang piece. I mean, we are based in Sichuan in Chengdu and our factory is in Chong Lai, but actually we've got quite an even split of business across our top 15 provinces. A little bit stronger in our top eight, and we're present in 28 provinces so there's no real one province that makes up a significantly larger portion of our business than anywhere else. So, the national coverage, I think is there, we're in 30,000 outlets, as I mentioned in the presentation. I think what drives that share further, and again, we're very precise in relation to how we do this. We target provinces, we look at our media investment, we support that with investment in our route to market, in our execution, in our core store programs, we build out those banqueting relationships, those corporate gifting relationships.

So, there's a whole suite, if you like, of codified growth drivers that we deploy when we look to drive share disproportionately in target provinces. So, I think again, that's been working and in some instances we've seen strong share growth on the back of that investment. And that's been quite successful for us. The second part of your question, could you just remind me?

Chris Pitcher:

Yeah, so in many other markets globally you're actively trying to recruit scotch consumers early with primary scotches. Do you have the route to market to do that in China? What lessons did you learn with the twelve-year-old scotch category when you tried to see that in early 2000s? What have you learned?

Sam Fischer:

I think, we are looking at recruitment into scotch. We've been very targeted in relation to focusing on super deluxe scotch, really building the category from the top. Blue Label has done exceptionally well over the last three years, growing at a CAGR of 51%. So, this is really helping

us position our brand and the category in that very aspirational, super deluxe segment. And then we worked down from that, as we looked at our 15-year-old Johnny Walker sherry, which again, is more accessible in its price point, still super-premium and super deluxe, and that's again helping us to recruit a slightly different consumer into Johnnie Walker and into the category. So, we've got very targeted investment to ensure that we position the brand and the category where we want, and that's super-premium and then how we add to that through innovation and the rest of the portfolio to recruit drinkers into it. The same goes with what we're doing on single malt. I'm just given you an example with Johnnie Walker.

In relation to the synergies and what we've learned from Sui Jing Fang, you might remember some years ago, we did look in a province testing, whether we could put the routes to markets together, unlock some synergies, and learn from each other. I think what we found was that they were quite distinctive partners and customers that we had in each one of the chains, and different jobs that we needed for them to do in relation to the development of the various businesses. So, it's been quite successful for us to be very focused in relation to our route to market and our customers, and really trying to educate them, and help us to develop the categories that we operate in. In the future, maybe there's an opportunity to unlock more synergies, but right now that focus is what's key to the success that we've had so far.

Operator:

Thank you. We'll take our next question from Olivier Nicolai with Goldman Sachs.

Olivier Nicolai:

Two questions, please. First of all, regarding the Hainan province. Could you tell us how big it is today as a potential for your sales for China? As you said it was likely to become much bigger going forward, can you give us an idea of the profitability? Is it more profitable than the rest of

your business for instance? And then the second question, I was wondering if you could give us a bit of an update on the Zhong Shi Ji which is an issue I am thinking about launching new local collaborations?

Sam Fischer:

Hainan's a duty-free island today so it's not really part of our domestic business, it's part of our GT business. And again, we're very excited about what that's going to provide in relation to a runway for luxury spirits growth. It's benefiting from the change in government policies, which is increasing the quotas for the purchase of liquor. And liquor has been included now very recently. It's still very small in relation to the overall volume that Hainan is generating, but we're very excited about its future. We've got boutiques going up in Sanya and Haikou. So, we're investing through the GT business to make sure we access what we see is a huge opportunity for duty-free. And also, a huge opportunity for brand building, because there's lots of customers who are going to Hainan, who are engaging online before learning about products and they're absorbing content, in some instances, they're pre-ordering. So again it's a matter of the domestic business, working with the global travel business to ensure we've got the content online, we're working with the customers in Hainan so that we've got that online and offline opportunity. And there's even an opportunity for the customers who've gone to Hainan to purchase, when, I think it's within 180 days and they return. So, this repatriation of the travel dollar that's going on in Hainan, I think is huge. And I think it's going to be terrific for luxury spirits and we're right in the middle of it.

I've spent too long answering that question and I've forgotten the second question. I think it's Zhong Shi Ji which was an experiment to sort of, marry a liquid with scotch and baijiu to try and bridge that taste barrier to tap into international and local culture and take kind of master distillers from the baijiu business and the scotch whiskey business. So, I think the performance

has been only okay, so far. I think we've had trouble inserting that into the meal occasion which is a big opportunity in China. So, we'll continue to experiment, and to learn and to see if that opens up any more innovation opportunities. But I would say the performance of that business was always very small is only okay at the moment.

Olivier Nicolai:

And just to follow up on that so in Hainan, if I understand correctly, it's very similar to a normal duty-free business in terms of margin structure. And then just the second part on this other question. Are you thinking about launching more local whiskies, for instances, not necessarily mixed with baijiu, but more local collaboration and local whiskey? Or is it just going to be essentially, scotch?

Sam Fischer:

In relation to the Hainan margins, yeah, I think they remain attractive. We will continue to invest because there's so much infrastructure being built there, that content online is being built. So, this will be an investment market for us as well, but certainly, our margins are attractive. We'll continue to look at insights from markets We'll feed those into our innovation machines, and we'll see whether or not there's opportunities for us to localize liquids or to infuse culture into our innovation, which is what we've been doing for many, many years and what we continue to do. So no, right now we really are focused on scotch whiskey, but if there are opportunities to localize whiskey, we will consider them, but they're not on the table at the moment.

Operator:

Thank you. We'll take our next question from Mitch Collett with Deutsche Bank.

Mitch Collett:

You give a slide where you talk about territory expansion, channel expansion, and customer network development. I mean, is there any way to quantify how much each of those three components contributed to your growth over the last five years, and how much of a contribution you'd expect each of them to make going forward? And then just a very general question on e-commerce. You said that most of your business, the majority of your business in e-commerce is not direct to consumer. Can you perhaps give us a comment on the economics of selling through e-commerce through third-parties, and whether it's comparable to the rest of your business in China or perhaps more or less profitable?

Sam Fischer:

In relation to the contribution of that route to market expansion. I think very difficult for me to quantify that. We are seeing momentum building as we extend our route to market into new territories as we drive distribution. And as we sort of, bring the whole suite of assets to play, when we start to invest in brand-building, in A&P, in our commercial drivers, we start to educate those customers, because the customers play a very important role in helping us to educate their customers and their consumers. So, again, this whole suite of boutiques, the Diageo whiskey Academy, we do bring summits now out to some of these regions again, and those summits we bring in, some of the influencers, we bring in media, customers, and consumers to provide if you like, a very intensive education of Diageo scotch whiskey business, and scotch whiskey as a category.

So, what we've seen so far, particularly in the East has been extremely positive. We're seeing interest, again, I mentioned the North and the surrounding provinces in the North, and that Sichuan province in the West. All of those are showing very positive signs off a relatively small base. And I think we'll continue to invest, and learn, and educate like we've been doing for the last three years. And my expectation is that business will continue to grow on the back of the

momentum that we've already seen. In relation to e-commerce and the economics in e-commerce, I mean, we're very careful actually, to ensure that the e-commerce channel is an investment channel, but one that is invested in brand-building, in content creation, in recruitment. We put innovation down there, and those channels are about the same margins as we have in the rest of our business. So, they're not eroding our margins at all They're about the same.

Mitch Collett:

Understood, maybe just one related follow-up. I think you said that Sui Jing Fang reaches 30,000 outlets. Are you able to comment on the number of outlets reached by Diageo, Moet Hennessy, and also Diageo China limited?

Sam Fischer:

I won't comment on the MH number because I don't have it to hand, but certainly, the number of outlets that we reach within the international spirits business is smaller than 30,000, by virtue of the fact that the bulk of that business at the moment is still concentrated in Guangzhou, Fujian, Shenzhen, that Southern area. We continued to expand into provinces, bringing in more wholesalers, sub wholesalers, direct coverage by our consumers. I don't have the number to hand but from a coverage perspective, I think, we're well covered in those Southern provinces, and we're expanding our coverages in the provinces I mentioned previously.

Operator:

Thank you. We'll take our next question from Lawrence Wyatt with Barclays.

Lawrence Wyatt:

A couple from me. Firstly with China having emerged from COVID now for a number of months, I was wondering if there are any learnings that you weren't expecting or not seeing anywhere else in the world that are happening in China with regards to change in consumer behaviour. And secondly, a number of years ago, counterfeiting of these sorts of luxury drinks products was fairly widespread in China, how much of an issue is that now? And is it something you need to keep a handle on?

Sam Fischer:

In relation to COVID, I think like everywhere, there has been some shifts in consumer behaviour, and China's no exception. But we should remember that in China, they really did get hold of COVID very quickly. And whilst there was two, three, four, five, six months of impact, the rebound was very strong, particularly in the on-trade where we've seen almost total recovery. But what we haven't seen recover quite so quickly, has been kind of, the banqueting large gatherings. They seem to have gone into slightly smaller gatherings, those gifting occasions through key periods of the year. So, but again, even banqueting we're starting to see that come back now, which is very encouraging. The at-home occasions became more prevalent through COVID. We could see online and convenience support that at-home occasion. And we saw indulgence actually pop up where people stuck at home were looking for a treat to have, whether that be a discerning scotch or kind of using Baileys, for example, to cook up nice treats for themselves. So, we very quickly responded to that when we saw it and started to put recipes out with Bailey's in it, and serves out for Bailey's, and again had wonderful online discussions with consumers around how they were using that. So, I think the intelligence that we got allowed us to move quickly into some of the opportunities, particularly the off-trade, particularly convenience channels, the national key accounts, and of course e-commerce. And then when you look at the consumer behaviour, with some of those trends with people at home, smaller groups, and how we were able to tweak what we were doing without product portfolio and

activation to tap into it, I think helped us as we navigated through it. But I would say, you know, the thing to remember is that it recovered faster than anywhere else in the world. And we've seen a strong rebound which has been very encouraging.

Lawrence Wyatt:

And just to follow up on that specifically, where you saw premiumization among Chinese consumers, and then the return to the on-trade happened, did the premiumization in the off-trade be retained or the people trade down as they return to the on-trade?

Sam Fischer:

I think the dynamic of premiumization has been prevalent all the way through, whether people were at home looking for a discerning moment with a single malt, or still trying to ensure that they were able to gift or enjoy something a little bit more special than what they would normally have. I mean, this is something that we've seen in the market for a long period of time. So, this premiumization trend, I think has been very encouraging, and continued all the way through. My expectation is that will only accelerate now, as markets go back to normal. The on-trade premiumization, particularly the modern on-trade, which is really driven by urbanization, where people want to go into the on-trade and celebrate and show what they can buy their friends. I think it has been something that's been in the market for a long period of time. That has returned. We're seeing that in the on-trade. The interesting dynamic between the two is the fact that many people go to the off-trade to buy products for the on-trade, particularly restaurants and so forth. So, it's difficult to separate those trends because they're kind of interlinked. The modern on-trade, we're seeing it, my expectation is that as traditional on-trade opens up the off-trade will support that and the continuation of the trends that we saw at home.

I didn't answer the counterfeit question. I think counterfeit is something that we need to be aware of in China. We've been working with your authorities across many provinces for a long period of time. We've been helping educate them in relation to understanding where they see a counterfeit problem. And right now, I would say that in all of the samplings that we do, the prevalence of counterfeit on our products is relatively low.

Operator:

Thank you. We'll take our final question from Trevor Stirling with Bernstein.

Trevor Stirling:

In the presentation you say that Sui Jing Fang is a disruptor in baijiu, can you maybe just give us a little more colour about how you think the brand is disrupting the Baijiu category and perhaps also comment on the relative weight of baijiu and western spirits inside the portfolio at the moment?

Sam Fischer:

In relation to how we're disrupting, when we started to think about the cost or program, for example, which was all about execution and how we identified core stores with specific trading terms and incentives around execution and engagement with consumers, and we had QR codes that allowed us to track their sales, gave us real-time information that we were then able to respond to whether that be with innovation or tweaked execution standards or activation. I mean, I think a lot of other baijiu players looked at that and said, Oh, wow, that's interesting. It was extremely successful for us. I think we're up to now core store version 4.0. So again, in relation to how we thought about the five plus five, plus five, focused expansion strategy on our route to market, and the core store program, I think, was quite different for the rest of the baijiu category.

Many of them have followed us into that space now and have really started to lift their execution standards. If you look at our packaging as well, we've got some wonderful packaging on Sui Jing Fang. We've got beautiful designs on the bottle, carvings on the bottle, the outer package is quite stunning. So again, when I think about, what we're doing on a packaging front, even with our museum series, compared to the rest of the category, I think it's quite disruptive and much different from everyone else. So, is there more that we can do to disrupt? Yes, but there's just two examples of how we've gone in there with some of the things we do elsewhere in relationship innovation and execution, that have been quite different to what has been in baijiu for some period of time

Trevor Stirling:

Can you comment on relative weight of baijiu and western spirits inside the portfolio at the moment?

Sam Fischer:

It is not a number we would disclose Trevor, I guess the way I would comment about that is I'm equally excited about both. I think that the runway we've got on Sui Jing Fang is truly exciting. We've seen some wonderful growth, industry-leading growth over the last four years. And we still got so much more to do in relation to the opportunity that exists in baijiu with Sui Jing Fang, and that premiumization trend, which we think is going to drive growth many, many years. And the same with scotch. We've worked hard over three years to build a scotch category that's genuinely aspirational for Chinese consumers. I talk about the summits, and the boutiques, and super deluxe, auctions and 600 whiskey bars. I mean last time I spoke to you all, it was 300, it's doubled, and they're spread over the country. So just those two pillars, I think, give us massive

compliments and opportunities. So, I like to talk about the relative weighting, I'll just talk to you about how excited I am about both.

Operator:

That will conclude our question-and-answer session. I'd like to turn the call back over to Mr. Fisher for any additional or closing remarks.

Sam Fischer:

Well, thank you very much, as usual, very probing questions. Nice to speak to names that I recognize from the past, and hope we've given you an insight into how excited and confident we are about our position in China and the runway we've got the growth long into the future. I look forward to coming back with a progress update at some point in the future. Thank you very much for attending. Bye.

Operator:

That concludes today's call. We appreciate your participation.