2021 Half-Year Results Presentation

Wednesday, 12th May 2021

Business Review

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Welcome

Operator: Thank you for standing by. Welcome to the Stock Spirits Group PLC Interim Results conference call. At this time all participants are in a listen-only mode. After the speaker's presentation there will be a question-and-answer session. To ask a question during this session you will need to press star and one on your telephone. Please be advised that today's conference is being recorded. If you require any further assistance please press star zero. I would now like to hand the conference over to your speaker today, Mirek Stachowicz. Please go ahead.

Agenda

Mirek Stachowicz: Thank you. Good morning everyone and thank you for joining us for our 2021 interim results. As usual I'm today by Paul Bal, our CFO. Moving to slide two and the agenda for today, I will start by providing a brief summary of the period and give you an update on the current status of COVID-19 in each of our core markets. I'll take you then through the business review for the period including an update on the performance in each region before handing over to Paul to talk you through the financials in detail. I'll then come back to give you some closing remarks after which you have the opportunity to ask questions.

Ongoing Resilience

Turning to slide four, I'd like to start by summarising our performance during the first half of the year. In terms of our financial performance we delivered revenue growth of 0.3%, adjusted EBITDA growth of 1.7%, both at constant currency, and a reported adjusted EBITDA margin of 24.3%, which is up 20 basis points on last year. And basic earnings per share growth of 90.4%. Given the backdrop against which we are trading I believe this is a resilient performance. Our markets have been more impacted by the recent lockdowns than the previous ones and we've also – we are also up against strong comparative numbers, particularly given the on-trade was open in the same period last year but was closed for almost the entire first half of this year. Our longstanding focus on the off-trade has continued to stand us in good stead as has the continuing momentum that we are delivering in new product development.

Our core markets of Poland and Czech Republic remain strong. In Poland we have delivered our highest value market share in five years in the off-trade vodka category and it is still too early to assess the impact of the small format tax as the increased pricing effectively only impacted the consumers for one month due to trade loading. In the Czech Republic whilst our financial performance was impacted by the closure of the on-trade our market share in the off-trade has grown despite increasing competition from local copycat brands in the rum segment. Our brands in Italy have grown their share across all of the categories in which we operate there.

Elsewhere we have also seen a good performance from the recent acquisitions and from our other markets. Distillerie Franciacorta in Italy which has now been successfully integrated is making a significant contribution and Bartida in the Czech Republic continues to perform well despite the closure of the on-trade. We have seen an improved delivery in our Slovakian unit and our distributor in Germany has delivered significant growth by gaining increased listings in the retail segment for our Polish brands.

Cash conversion remains strong due to careful working capital management through the pandemic and we also recently completed our refinancing ahead of schedule. We are proposing an interim dividend of 2.98 €cents per share which is 7.6% up on last year's half-year dividend. The continuation of our progressive dividend policy should be taken as a clear sign of our confidence in Stock's future prospects and viability of our business model. Overall the outlook remains unchanged as actions to mitigate the impact from the small format tax get underway and assuming no further tightening of restrictions in our core markets. Finally, we reaffirm our commitment to M&A once business travel within Europe normalises.

COVID-19 Update by Market

Turning now to slide five I wanted to give you an overview of COVID-19 and the current state of play in each of our main geographies. Firstly the recent lockdowns in all of our markets have had a much bigger impact than the previous lockdowns in the first – in the last financial year with more stringent lockdown measures in place and higher number of COVID cases, as shown in the four charts here. By comparison of course the first half of last year was hardly impacted at all. This time last year the UK was facing far tougher restrictions than our core markets were. The situation has now been reversed and the UK is now several weeks ahead of our core markets. In each of our geographies we are expecting that lockdown measures will start to ease during May as vaccine programmes are rolled out but unlike in the UK there are few provisional dates for the reopening of the on-trade. As before, we expect an on-trade rebound as soon as it reopens and we are well-positioned to benefit from it. We are also working on the assumption that it will be another summer of staycations. We will now go through the performance on a market-by-market basis starting with our core market of Poland on slide seven.

Poland

Overview of the Polish spirits market

The overall Polish spirits market is now worth €4.1 billion, up 9.5% at March 2021 versus March 2020. Total off-trade spirits volume increased by 1.6% and 9.5% in terms of value. And consumer demand was robust despite the impact of COVID-19. Growth in the higher margin flavoured vodka category outperformed that of the clear vodka category. Also in the small format pack size flavoured did better than clear. Premiumisation has continued despite the pandemic which has led to the premium price segment delivering the greatest growth rate in the clear vodka category at 14.2% MAT growth. Although the top premium and ultra-premium segments were negatively impacted by COVID-19. Whisky continued to be a particularly fast-growing category delivering growth of 19.6%, although the absence of the on-trade – although in the absence of the on-trade this has mainly been driven by the discounters.

Mainstream Vodka Pricing

Further evidence of pricing stability

Turning to the mainstream pricing on slide eight. As you can see from this chart which covers the last 18 months, that there is an upward pricing trend on core vodka brands. Krupnik, which is now owned by United Beverages after it acquired the Polish operations of Marie Brizard, has reduced its pricing but still remains above Zubrowka and Zoladkowa Gorzka Czysta De Luxe.

The small format tax has been successfully passed on to consumers for the relevant pack sizes. I would also make two other observations. Firstly, this slide shows that there is still real price competition in the Polish market and secondly, when a new owner entered the market in November and December last year we at Stock Spirits reacted effectively and have established a strong pricing position.

Vodka Category Share Trends

Stock Spirits 30.7% value market share is a five-year high

Turning now to slide nine, there are three key points to make here. Firstly, the number three mainstream brand in the Polish market, Krupnik, continues to be less and less of a factor in the competitive landscape. Secondly, Stock is now taking market share from both Roust and United Beverages. And thirdly, Stock now has its highest market value share in five years. 30.7% despite our continued focus on profit pools outside of the mainstream clear and vodka segment.

Stock Spirits Continues to Take Share in Flavoured Vodka

Turning now to slide ten, Stock has outperformed both the clear and flavoured vodka segments but the key focus for us continues to be on taking share in the attractive flavoured vodka category. As before, we have achieved this through product innovation and premiumisation. Flavoured vodka now represents around 30% of the total vodka market in Poland and is growing faster than clear vodka at 8.2% rather than 6.2% for clear. This segment offers greater margins than the clear category. Our flavoured brands are around 18% more expensive than our clear portfolio in terms of brand retail price and there is a cost of goods benefit that comes from the typically lower ABV. Against that backdrop we achieved an 11% growth in the retail value of our flavoured vodka brands and 6.2% growth in our clear brands.

Small Format Tax

Turning now to slide 11 and an overview of the new small format tax. In summary on this subject it remains too early to assess its full impact on the performance of the overall vodka category. The initial indications are that there has been no visible shift in consumption from spirits to beer or wine, the flavoured vodka has been less impacted than clear vodka and that the 100ml pack size has been less impacted than the 200ml version. From our point of view there has been no impact on our results in the first half of fiscal 2021 due to trade loading prior to the tax increase. We have also implemented a range of commercial and operational actions to mitigate any impact. These include deploying NPD for 25% abv products at 100ml bottle format, testing of 45% abv 'pot-shots' in a 40ml format and a 350ml format to be deployed shortly.

Poland – Further Updates

COVID-19 and on-trade

Turning now to slide 12 and the snapshot of the latest developments in Poland for Stock Spirits. Firstly the most recent wave was far more severe than the previous waves. However, the on-trade in Poland is now scheduled to reopen at 50% capacity on 29th May. The on-trade now represents only around 1% of market sales versus 10% before the pandemic and it accounted for only 15 of Stock Polska sales versus 3% before the pandemic. As before, the decline in the on-trade has been fully compensated for by the increase in the off-trade and trends towards staycations.

Lublin distillery

Our new Lublin distillery is facing slight delays as a result of COVID but it is still on track to be completed in fiscal year 2023. As we have communicated previously, there's a planned five-year payback and we are making it as sustainable as possible with additional investments in innovative technology aimed at producing maximum energy efficiency.

Czech Republic

Overview of the Czech market

Turning now to the Czech market on slide 14. The off-trade spirits market grew by 15.3% to €0.6 billion with particularly strong performances from rum and vodka, up 22.7% and 19.8% respectively. Indeed all of the major spirits categories were in growth. We also saw a boost to off-trade consumption due to the closure of the on-trade. However, unlike in Poland, the off-trade growth did not fully compensate for the contraction of the on-trade which was shut for the vast majority of the period. As in Poland, we have seen the premiumisation trend continue despite the impact of the pandemic.

Czech – Operational Highlights

Prioritising profit growth

Turning now to slide 15, competition in the Czech market has intensified in the imported rum sub-category but at the same time it has eased in herbal bitters. We continue to lead the spirits market and are investing in brand equity growth and margin enhancement for the long-term. During the period we grew our total spirits share from 33.3% to 33.5%. In rum, which is the largest spirits category in the Czech Republic, share gains from Bozkov, Tuzemsky and Legendario were offset by losses in Bozkov Republica which came under pressure from local competitor copy brands. We also were pleased to deliver very positive share growth in Fernet Stock as a result of the relaunched range and revised pricing architecture. Elsewhere growth was also achieved on Bozkov and Prazská vodkas and Bartida is performing well despite the on-trade closure.

Czech – Further Updates

COVID-19 and on-trade

Turning now to slide 16 and a snapshot of the current developments in the Czech market for us. As in Poland, the most recent lockdown measures in the Czech Republic are much stricter compared to those in the previous lockdowns. In addition, the on-trade was open for just 15% of the period so this decline was only partially offset by increases in the off-trade. To put it in another way, that's the equivalent of bars and restaurants being open for only one day per week during the entire six-month period. The only on-trade – excuse me. The on-trade now accounts for around 5% of market sales versus 32% before the pandemic and around 8% of Stock Czech revenue comes from the on-trade versus 30% before the pandemic. We have continued to invest in systems and training in the on-trade and as a result we feel well positioned for its reopening.

Italy

Overview of the Italian market

Turning now to Italy on slide 18 which as a reminder accounts for around 10% of our total Group revenue. During the period the total value of the spirits market declined by 8.2% to

€1.5 billion. Within that the on-trade declined by 32.9% in terms of value and the off-trade grew by 13.6%. Italy is the market in which we have the highest proportion of our sales in the on-trade by comparison to other markets. As a result off-trade growth did not compensate for the on-trade decline. Additionally, the categories that we are in, shaded in colour on the chart, declined by 9.3% whilst the rest of the market declined by 7.2%.

Italy – Operational Highlights

Turning now to slide 19, the key point to make here is that despite the difficult backdrop our business in Italy grew its market share position in every category in which it operates due to increased home consumption. In brandy Stock 84 and its premium Stock XO variant continued to grow market share. Elsewhere following our investment – increased investment in Keglevich, we grew overall share in clear and flavoured vodka. However, volumes in Keglevich declined in absolute terms due to the impact of COVID-19 – that COVID-19 had on higher energy social drinking occasions in the on-trade. Our growth in Grappa was well ahead of the category, driven by an increase in home consumption and building on strong contribution from the Distillerie Franciacorta 2019 acquisition. And finally the Beam Suntory portfolio which we now have been distributing for over a year, predominantly whisky and gin, has also performed well.

Italy – Further Updates

COVID-19 and on-trade

Turning now to slide 20 and the current market developments for Stock Italia. Measures in the recent lockdown have included restrictions on the sale of alcohol in the off-trade as well as night-time curfews. And the on-trade was never fully open during the period. The on-trade now accounts for around 28% of the market sales versus 53% before the pandemic and around 22% of Stock Italia's revenue versus 40% before the pandemic. As a result the decline in the on-trade was only partially compensated by the increase in off-trade especially as a number of our brands are focused on higher energy occasions which therefore declined to a greater extent than other categories. With that context in mind we are very pleased with the performance of our brands in the off-trade. Finally, Stock Italia moved to fourth from fifth position in the modern trade channel. We have integrated and reorganised our salesforce structure from the Distillerie Franciacorta acquisition in 2019 and from obtaining the Beam Suntory portfolio last year. Hence, as in Czech, we believe that we are also well positioned to benefit from the return of the on-trade.

Other Markets

Other markets – operational Highlights

Turning now to slide 22 and the highlights from other markets. In Slovakia our total spirits value share declined to 10.6% due to the impact of COVID-19 on premium categories. However, there was share growth from Bozkov Republica, Amundsen and 1906 vodkas. The reduction of higher energy drinking occasions during COVID-19 impacted brands such as Fernet Stock, Golden fruit spirits and the Beam range. Finally, the management team of our Slovak business has been combined with our Czech operations which has led to a strong profit recovery.

In our International division Croatia has continued to be heavily impacted by COVID-19 given its reliance on tourists and the on-trade. However, we continue to grow our brand leader Stock 84 share of imported brandy in absolute volume and value. In our export markets we grew sales in both Germany and the UK and there was particularly pleasing growth of our Distillerie

Franciacorta brands. And with that I will now hand over to Paul to talk you through the financials in detail.

Financial Results

Paul Bal

Chief Financial Officer, Stock Spirits Group PLC

Financial Highlights

A resilient performance

Thank you Mirek. Good morning ladies and gentlemen, both on the webcast and on the call. It's my pleasure to present the financial results for the six months ended 31st March 2021. I'll start with slide 24. Our results show a picture of resilient financial performance, notwithstanding the challenges Mirek has referred to. In addition to the COVID-19 pandemic, copycat competition in the Czech market and since the month of March the small format tax in Poland, we were also impacted by weaknesses in the two currencies that are key to our results. Consequently, reported revenue, EBITDA and the adjusted basic earnings per share were down by low single-digit. However, in constant currency terms revenues and EBITDA were up and adjusted EBITDA margin rose to 24.3%. And in the absence of any exceptional items during this period the basic earnings per share almost doubled.

Cash flow and working capital management

Beyond the profit and loss account, our financial position remains as robust as ever. Given the continuing uncertainties created by the pandemic we closely manage our working capital. In this period we converted nearly 85% of our EBITDA into cash. This has enabled us to maintain prudent leverage during these times. Just recently we have renewed our financing facilities. More on that later on in this presentation.

Proposed dividend

Under our upgraded progressive dividend policy we are today announcing a 7.6% increase in our interim dividend compared to the 2020 interim. This is a payment of 2.98 €cents per share. The dividend is proposed having considered our strong performance, our solid financial position, our outlook and our responsibilities to all stakeholders despite these challenging times.

Group Consolidated P&L

So moving to slide number 25 and the Group's consolidated profit and loss account. The reported 3.3% reduction in revenue arose because of adverse currency movements with revenue slightly up in constant currency terms. Gross profit was down 5.1% and the gross profit margin down 90 basis points, largely reflecting top line dynamics as changing mix across our geographies, channels and brands, mostly driven by the pandemic, impacted average pricing. Lower selling expenses reflect the changed market dynamics experienced in this period as less marketing investment was required, especially in the on-trade channel. Lower overheads also benefitted from lower share scheme costs and an insurance recovery. We include our 25% share of the results of our associate Quintessential Brands Ireland Whiskey Limited which is improving.

Overall these cost benefits mitigated the lower gross profit, such that the operating profit before exceptional items was only 2.3% lower, driven by the negative currency movements. The absence of any exceptional items in this period boosted operating profit by a very strong 51.8% and the operating profit margin rose 750 basis points. Lower net finance costs reflected less drawings during the period as well as lower market interest rates. The slightly higher tax charge reflects a change in the mix of markets that generated the period's taxable profits, with Italy now a bigger part of that mix. And finally our resilient performance is best reflected in the improved adjusted EBITDA growing 1.7% in constant currency terms, though down 2.4% at actual exchange rates.

Volume and Revenue

With slide number 26, let's now look into the component of our results in a little more detail starting with the top line. Our overall volume grew 2% notwithstanding the absence of the on-trade channel for a very large part of the period as Mirek mentioned. Understandably, the market mainly driving this growth was Poland with its momentum continuing over from last year and being the least exposed to on-trade.

Turning to our revenues, it is pleasing to report that despite the significant drag of adverse currency movements on a constant currency basis our top line remained resilient even growing slightly despite the very challenging trading environment that we experienced during the period. Average prices were lower, mainly reflecting increased competition in the Czech Republic as well as more recently the impacts of the new small format tax in Poland. Though that tax was fully passed on in terms of consumer pricing, it did negatively impact average pricing as format mix changed within effected brands. Being only a couple of months in, given the trade preload and in the midst of the pandemic that is curtailing socialisation, it remains too early to conclude on what lasting impact this tax will have on consumer purchase behaviour as well as on our results.

Brand mix was less of a driver than in the past, possibly as consumers experimented less during the pandemic, staying with brands they knew and trusted. It is specially pleasing that our 2019 acquisition, Distillerie Franciacorta, provided some of the growth even though it is very exposed to the effectively closed on-trade channel.

Impact of FX Movements

If we now move to slide number 27 since the pandemic first broke out currency movements have been a negative influence, reflecting the sudden economic uncertainty felt in Poland and the Czech Republic. Weakness in the Polish Zloty and the Czech Koruna negatively impacted both the top and bottom line to a marked degree in the period. In Appendix I to this presentation on slide 42 we have set out the key exchange rates over recent periods. And for those of you who still remember it we reconfirmed that Brexit did not have a material impact on our business.

Poland Financial Performance

Looking then specifically at our Polish business in the next slide, slide number 28, revenue grew 4.3% at constant currency, really benefitting from continued positive volume momentum that is fuelled by a good run of successful new product developments. Average pricing has lately been negatively impacted by the advent of the small format tax. We expect our mitigating actions to recoup much of this as they come to the market and gain traction. I remind you that

Poland is very much an off-trade market, especially for us. This meant that we actually gained from the closure of the on-trade during the period. As we now anticipate on-trade reopening we are now investing more to penetrate this channel than we have traditionally. EBITDA grew 6.8% in constant currency terms, demonstrating once again our capability to grow value in challenging conditions. The EBITDA margin was up 70 basis points, taking us ahead of our usual guidance of 26-27%, helped by a lower investment in the disruptive marketplace.

Czech Financial Performance

Turning in the next slide, slide number 29, to our Czech business, our second-biggest after Poland. The business has faced the toughest challenges in the period, evident from the 13.6% decline in revenue in constant currency. Not only is this the business with the greatest on-trade exposure in absolute terms, it also experienced an uptick in competitive activity, as Mirek mentioned. Both factors drove down volumes. Average pricing declined due to the disrupted channel mix but holding on to pricing has also been challenging as local competitors copied our successful offers in imported rum but at lower price points. Recall also that last year intense competition prevented the January 2020 excise increase being fully passed on in higher pricing. Bartida being an on-trade focused business was particularly impacted by on-trade's effective closure for most of the period. Nevertheless it has limited this exposure by extending the reach of its brands into the off-trade. Given the pressure on the top line, EBITDA was down 21.2%. Nevertheless this business is still delivering our highest EBITDA margin in the Group giving it the resource to combat the competition it currently faces. I move now to slide number 30 and our Italian business.

Italy Financial Performance

For some time we have mentioned that this business has suffered from insufficient scale. The investments and developments of recent years are now resulting in a business that is broader-based than before. As a result of this and notwithstanding the terrible pandemic conditions in the country, this period saw significant top line growth of 26.3%. This was driven by the contributions from the Beam Suntory portfolio being distributed since April last year as well as from the Distillerie Franciacorta business acquired in 2019 and now fully integrated and making distribution gains through a larger salesforce. However, this strong growth masks the significant challenge that was faced with the closure of the on-trade for the entire period. Recall that the Italian market and our business also traditionally had the highest proportion of sales coming from the on-trade channel. Consequently those of our brands that are usually enjoyed in more social settings saw decline.

Pricing did advance, notwithstanding the pandemic but average pricing rose significantly with the addition of the Beam portfolio. Pricing was therefore the single biggest driver of the stronger top line performance in Italy. Besides benefitting from the increased scale there were cost savings, especially in the on-trade. Therefore there was a considerable increase in the adjusted EBITDA generated by the business, 171.4%, and a significant advance in the EBITDA margin into double-digit territory.

Other Segments Finance Performance

Slovakia, Croatia, Bosnia & Herzegovina, our export activities and our Baltic distillery

Turning now to slide number 31, I now move to the rest of our operations. The small revenue contraction of 3.4% was the net result of challenges in our businesses in smaller and more on-trade driven markets such as Croatia and Bosnia, combined with disruption to some export markets as the pandemic took hold again. This was however significantly offset by a turnaround in our Slovakian business and continued success in our focus markets of Germany and the UK. There was also a positive contribution from the Distillerie Franciacorta's export sales. Despite the lower overall revenues, EBITDA and the EBITDA margin improved markedly by 39.8% and 570 basis points respectively. This was driven by improving trading margins as well as lower costs. One driver for the latter is the combining of our Czech and Slovak teams as previously reported.

Net Finance Costs

The next slide, slide number 32, sets out the net finance costs. Falling interest rates over the period combined with lower drawings resulted in much lower financing costs being incurred. Cash levels are monitored more closely since the pandemic began. Our financing arrangements were due to run to late 2022 but we have just renewed them on largely similar terms, notwithstanding a recent tightening of the debt markets. We continue with access to €200 million of revolving credit facility with the flexibility of an additional €100 million accordion facility. These facilities will now run to May 2024 with the possibility to extend them up to May 2026.

Tax

I now move to slide number 33 turning now to the subject of corporate taxation. The decline in the current tax expense comes from the lower taxable profits resulting from prior period accruals and adjustments. But there is also some offset from a correspondingly higher deferred tax charge. The effective tax rate picture is therefore relatively stable, in the low-to-mid 20%s over both periods with the market mix being the real driver of the small increase. The tax environment remains challenging with authorities continuing to take an aggressive approach.

As previously reported, we have felt this especially in Poland. There have been no material developments in respect of our 2013 corporate tax return litigation, expected to be heard before the Supreme Administrative Court in the next 2-3 years. Based on the updated professional advice received we remain confident that our position will ultimately prevail on the main issues. As previously reported, the Polish tax authorities commenced an audit of our 2014 corporate tax return and this continues. In addition and also as previously reported, in December 2020 we were assessed for a withholding tax liability of €4.3 million relating to 2015. Based on professional advice we have initiated a second round appeal against this assessment to the District Administrative Court and expect to recover the sum paid over.

Most recently we have lodged an appeal against an assessment from the Czech authorities in respect of the 2011 tax year. There is no additional financial exposure in respect of this as the sum assessed was paid over in 2018 and no receivable was recognised. The Group has provisions totally €3.5 million where, based on professional advice, future settlements are likely or expected in respect of historical positions. Nevertheless, in some other circumstances the Group may have to pay over sums assessed as due by authorities and then seek their recovery through appeal.

Free Cash Flow

Moving to the next slide, slide number 34, we come to cash flow. Strong cash generation is a hallmark of the Group and during this period free cash flow was up 40.7%. The implied conversion rate was a healthy 84.9% which is significantly up on the prior period. The main driver for this increased cash generation is working capital, including excise payables. The Lublin distillery project is now underway and still scheduled for completion during the financial year ending 30th September 2023.

Net Debt

I click now to slide number 35, turning to our strong financial and cash position. Net debt increased by €15.6 million to €38.3 million over the period. This is predominantly due to the payment of corporate income taxes, dividends and share schemes' share purchases. Balance sheet leverage has risen to 0.55x as a result. This is prudently within our desired range of 0.5-1.5x leverage. The Group has significant liquidity available to it and is very well funded for the future and the inevitable recovery in the global economy and our markets. This provides financial flexibility which has always been our aim. Ordinarily this has been to pursue our strategic growth aspirations and to reward our shareholders with progressive dividends. In these uncertain times it also serves to protect the continued operations of the Group. We are well within the covenants of our financing arrangements and with significant unutilised facilities. And we forecast to remain so.

Dividends

I turn now with my final slide, slide number 36, to the subject of dividends. The Board today has announced an interim dividend of 2.98 €cents per share. This is a 7.6% increase on the 2.77 €cents per share interim dividend for the previous comparable period and is consistent with our aim of providing progressive dividends while maintaining our ability to build scale through potential future M&A. Our robust balance sheet and continued strong cash flow generation provide us with a capacity for further M&A should suitable opportunities arise. However, as we have said previously if no meaningful M&A activity materialises then we will as a matter of course consider returning cash to investors via additional shareholder distributions.

The dividend has been declared having considered our forecast future cash requirements and position under several scenarios. It is also mindful of the need to consider all of our stakeholders in our business. It is declared recognising that no colleagues have been furloughed, laid off or had salary cut. No state assistance has been sought in any market and we continue to work collaboratively with suppliers and customers as required to carefully mange the challenges of the pandemic. And now to navigate the path to lift the restrictions on everybody's lives. Going forward we will continue to focus on providing our shareholders with progressive dividends where our cash generation and financial position allow. And with that I thank you and I hand back to Mirek.

Concluding Remarks

Mirek Stachowicz

Chief Executive Officer, Stock Spirits Group PLC

M&A Continues to be a Key Strategic Pillar

Thank you Paul. Moving to slide 38, before concluding today's presentation I want to touch on both our M&A strategy and our plans for the all-important area of ESG. Firstly, nothing about our ambition in this area has changed. We remain focused on the vodka and bitters belt and on opportunities for adding value to fundamentally sound businesses by leveraging our combined scale. However, cross-border projects have continued to be postponed due to travel restrictions but we will pick up this work once business travel normalises. Furthermore, our finance facilities have been recently refinanced giving us the firepower for our work in this area.

Planet, People, Processes: Announcing our ESG Strategy

A solid foundation of commitments on which to build

Turning now to slide 39, our ESG strategy can be summarised by three Ps: planet, people and processes. We will be providing more detail on our work in this area later in the year but in the meantime I wanted to give you an overview of the areas that we have been focusing on for some time. Firstly, we are focusing on renewable energy and recyclable packaging in order to reduce the impact that we have on our environment. We are also focusing on better waste management and on developing a roadmap to carbon neutrality. Secondly, in the growth area of people we are working to ensure that we are a positive contributor to all of the societies and communities in which we operate and are developing a culture of engagement among our people. And finally in the area of processes we are focusing on implementing the strongest possible governance practices in all areas of the company and on using our resources as efficiently as possible. There's plenty still to do on ESG but we believe that we have a very solid foundation from which to build. I look forward to updating you further on our specific ambitions and progress later in the year.

Summary & Outlook

Summary

So moving to our final slide, slide 40, just to summarise what we have just heard. This has been another period of resilience despite the on-trade being closed for almost the entire six months. Our underlying business is in good shape. Our local focus across our operations, supply chain, employees, customers, brands and consumers have continued to ensure that our business model remains resilient. In addition, all of our production plants and logistic centres have continued to operate as normal with no interruptions.

Outlook

Looking forward the on-trade in our key markets will start to reopen as the vaccine rollout gains traction. We are always – we are well positioned to benefit due to the investments which we have made. As with last summer, we are also expecting to see a positive impact from staycations especially in Poland and Czech. Whilst the introduction of the small format tax in Poland has not had a material impact on these results, we expect that it will inevitably negatively affect the appeal of these products in the market. Our plans to address it are currently being carried out and we will get a better sense of its possible impact on our business as the market normalises. Overall, our plans remain on track and the outlook remains unchanged assuming no further tightening of restrictions in our markets. M&A remains a key strategic priority and later in this year we will be providing more detail on an updated strategy for the next period of Stock's growth.

That concludes the presentation today. I will now hand back to the operator to open the lines for questions. Thank you.

Q&A

Operator: As a reminder, to ask a question you will need to press star and one on your telephone. To withdraw your question please press the pound or hash key. And your first question comes from the line of Doriana Russo from HSBC. Please go ahead, your line is now open.

Doriana Russo (HSBC): Yes, good morning, can you hear me?

Mirek Stachowicz: Yes, we can, thank you.

Doriana Russo: Yes.

Mirek Stachowicz: Good morning Doriana.

Doriana Russo: Good morning everyone. I have a few questions that I'd like to touch on if it's possible please. First of all, there was a mentioning that there was a lower level of marketing investment in the period because of the impact of lockdown. Is there a chance you can give us a sense of how much that implicitly improved your margin year-on-year? Second of all, focusing on Poland I noticed that there is a new direction to focus on flavoured vodka as a way to improve your mix. Does it mean that you see the opportunity to further improve your margin now that that's gone beyond the historic range of 26-27% over there? And lastly in terms of the performance in Italy that was obviously quite exceptional given the additional Beam portfolio and the integration of Distillerie Franciacorta. Can you give us some numbers in terms of performance of the legacy business and whether there has been any underlying improvement on that one from the integration of the – of the Distillerie Franciacorta acquisition? And if I may, I've got one very last question. What are the – what is the outlook on actually delivering a positive return from the investment in Quintessential given the fact that you have virtually written off the investment? But I noticed that the losses from that participation have decreased. Thank you.

Mirek Stachowicz: Doriana, so I will – I will give the first three questions to Paul and I will try to respond to your question on Quintessential.

Doriana Russo: Thank you.

Mirek Stachowicz: So Paul, over to you.

Paul Bal: Thanks, Doriana. If we look at the marketing investment period-to-period there has obviously been a saving, if you can call it that, given the disruptions in the on-trade. It's tricky to sort of estimate sort of roughly how much that is and what we're sort of talking about but I would imagine if I was sort of giving a sort of a guide to what we think we have potentially saved it would be somewhere I would have thought in the sort of €1-€2 million range. It wouldn't be any more than that, as a rough indicator of what's been saved. In the – and of course that would be predominantly across the businesses in Czech and Italy, yeah.

In terms of the flavoured vodka and the emphasis on the EBITDA margin as a result of that, it is, yes, pushing us into sort of territory which is sort of at the upper-end or just exceeding the guidance that we have given for the EBITDA margin in Poland but I think before we get too carried away with this I think we just need to be mindful of how the small format tax plays out. Because we – as we said, you know, it's too early to gauge what impact that will have and the market remains disruptive. So if we don't see much disruption then yes, we should see a sort of a positive impact coming from our continued success in flavoured vodka and that should drop through to the EBITDA margin line. But I think we just need to get through the immediate sort of impact of that tax first before we can really call it.

And then finally your third question was regarding the legacy business in Italy and whilst we're very happy with the results that we have seen from the Italian business, you know, we're absolutely clear that this has been driven by the increased scale that we have enjoyed through the investments we've made and the consequences of the Distillerie Franciacorta acquisition. But that doesn't take away from the fact that there is still work to be done in respect to our legacy portfolio in Italy. We remain with the challenge that we are concentrated on categories or sub-categories of the spirits which are facing longer-term decline. And that is something that we still need to address. So there is still work to be done in the Italian business. And we're confident that the team, you know, will be able to address that.

Mirek Stachowicz: Right. Now, moving to your first question regarding the outlook for the Quintessential, we tend not to give any outlook forward looking statements so just let me comment on where this business is. You have seen that the losses have declined and I can say it from looking as a minority shareholder in this business, this business has turned the corner. It has gone through the worse period of pandemic successfully to the extent that it has actually limited losses this period. So I would expect that this positive trend will continue. It is a small part of our business. I don't expect there that we would change – we would change the view on this business. We will wait and see how it performs under the changed conditions and the initiatives that were put on place to improve performance of the branded side of this business should bring benefits. I can't be too specific on this, I'm sorry, but no forward-looking statements.

Doriana Russo: Okay, thank you very much.

Operator: Your next question comes from the line of Matthew Webb from Panmure Gordon. Please go ahead, your line is now open.

Matthew Webb (Panmure Gordon): Thank you very much, good morning everyone. I wonder if you could just talk a little bit more about the competitive environment in Czech, both in rum and also in herbal bitters? I mean, in rum it says in the results statement that you're responding with brand building. I wonder whether you think that's going to be enough or whether you might have to consider more promotional spending or even headline price reductions there. And then in herbal bitters where it looks like things have got better, I'm just wondering what has driven that. Is that a change of approach from Jägermeister? Is that, you know, the positive impact of the work you've done on your own portfolio perhaps? Anything there would be very helpful. And then the second and last question, I'm sure you'll appreciate it's quite difficult to understand what's going on in Italy with all the moving parts but what would be really helpful if you're willing to disclose it is what sort of benefit you got from Beam in volume terms? Which I think would then perhaps help us to understand the – you know, the very strong pricing which I presume was predominantly mix improvement from the Beam brands coming in. Thanks very much.

Mirek Stachowicz: Thanks Matthew. So this time I will take the first two and Paul the last one. Is that okay for you, Paul? Now, competitive situation – I should say that the Czech I will take and Paul will take the Beam in Italy. So competitive situation, do we – how do we deal with this? And you were right to identify herbal bitters and rum as the two key areas. But I would also like to point out that we have improved our competitive position in vodka as well, which is the third important category. Now, where do we see this heading? You do know Matthew that as we said that we see local copycats to our very successful Republica imported rum brand. And there is a number of these copycats coming in the market undercutting pricing. So our response is to increase investment in our brand because we believe that this brand should occupy a premium end of this segment. We are not limiting our response to this area only. As you know, we are the largest player in the – in the market. About three times bigger than the nearest competitor. So that gives us possibility to leverage our scale in category management which allows us to intensify our promotional activity. So participation in promotions with our customers where customers are willing and happy to co-finance these promotions. Which effectively means that we can see a decrease in retail selling price without seeing a decrease in our selling-in price. That's the benefit flowing from being a category captain.

Finally the point I would make on this area, there is one more tool we have in our – at our disposal and that is aside from the Republica imported rum we also have another imported rum which is called Key Rum and it's been in the market for a long time. And now we repositioned this Key Rum at a – with change of packaging and communication to the consumer in such a way that we can – we can position it straight head-on against the local competitors. So if consumers decide that our Republica rum is too expensive they can choose a Key Rum instead of – at a lower price point instead of products of our competitors. Again our ability to manage the category means that this Key Rum we can position in such a way that it doesn't cannibalise sales of Republica but attacks head-on our competitors. That makes me optimistic that with all these tools at our disposal we can drive – we can be successful in fending off this competitive threat. It's going to take time though because these things don't happen overnight and you can see that it's taken us time to reverse our fortunes in the herbal bitters category.

Herbal bitters we were attacked by Jägermeister and this has lasted about two years before we were able to re-establish – I should say establish a new brand architecture based on different levels of pricing for various segments in which the herbal bitter brand – our herbal bitter brand operates. But you can see that we have seen a recovery of our market share and I expect this to continue because it's a more permanent solution we have put in place. It's a – it's an architecture of brand that allows to cover three price segments, economy, mainstream and premium. And it actually affectively limits the ability of Jägermeister to attack us further on price. So I remain optimistic that we will continue to gain benefit from this. I think that the work that we are doing in the imported rums is not going to take two years because it's a bit different exercise. It's about leveraging our scale in the category playing between Republica and Key Rum and leveraging our ability to be the category captain. It's going to take shorter than in the case of herbal bitters. Hopefully this answers your question. Handing over to Paul for the second question.

Paul Bal: Thanks Matt. It probably won't come as much of a surprise Matt, you know, obviously because of commercial considerations we can't sort of disclose too much about the relationship that you're referring to. Suffice to say, you know, as we have said in the past, you know, our third party distribution partnership business is not a significant part of our business. It's – they typically sort of generate less than 10% of our profit and certainly our business relationship in

Beam will sort of fall into that sort of magnitude. It has not provided a material increase in our volumes. The disproportionate effect is in the pricing because of the relative pricing of the Beam products and portfolio versus our [inaudible].

Mirek Stachowicz: I would add one more comment here if you don't mind Paul, which is that Beam is important for us from another standpoint. Beam is a door-opener for the all-important on-trade territory in Italy. We did not have this before the pandemic and, you know, we know from other markets that once having a portfolio of premium and ultra-premium Beam brands allows us to drive penetration of our premium and mainstream brands into on-trade. That makes a package that is much more attractive to [inaudible] outlets. So that is a benefit which is more difficult to quantify by simply volume increase but it's important, yes.

Paul Bal: And whilst obviously we have gained the year-on-year benefit of the Beam business, it's fair to say that that business, you know, alongside, you know, other premium businesses has been impacted obviously during the period [inaudible].

Matthew Webb: Okay, yeah, that's really helpful. Thank you both very much.

Mirek Stachowicz: Thanks, Matthew.

Operator: Yeah, our next question comes from the line of Fintan Ryan from JP Morgan. Please go ahead, your line is now open.

Fintan Ryan (JP Morgan): Good morning Mirek, morning Paul. Two questions from me.

Mirek Stachowicz: Morning.

Fintan Ryan: Two questions from me please. Firstly, you mentioned that, well, with the on-trade starting to reopen in Poland I appreciate that you've under-indexed that channel historically and you've probably done well in the market because you've under-indexed in that over the last 12 months. What investments are you putting in to sort of reinvigorate your business in the on-trade in Poland specifically and like would you hope to be at least sort of getting back to par share within that market? And like what means would you need to get there so we don't see necessarily a volume de-leverage as the on-trade reopens versus the off-trade? And then secondly just in regards to import costs more broadly, appreciate some of the high level global commodities like glass [inaudible] have picked up in recent months. Was this expected to have any impact on your business in the short room or is there anything that's worth calling out as you look at FY22? Thank you.

Mirek Stachowicz: Well, let me take the on-trade and then I think Paul and myself will comment on cost and the commodity price impact. Now, in terms of on-trade in Poland what investments are we hoping to get at par? I think that Poland is an area where we have made very significant investments over the last 3-4 years. But this hasn't been as visible as the work that we have undertaken in Czech and Italy. Both in Czech and Italy we have done it through very visible moves like acquisition of Bartida or tripling of the size of our salesforce in Italy, operating in on-trade through acquisition of Franciacorta. What we did in Poland was over the last 3-4 years – it can be – I don't really remember specifically when we started but we have essentially quadrupled the size of our salesforce operating in on-trade. That gives us the capability to grow when the on-trade recovers. We have been – the – our share of on-trade in Poland was below our overall market share. Do I expect this to recover? I think the recovery will take longer than it takes in off-trade because the speed with which on-trade market moves is slower. It also changes they are taking time to – more time to affect. So it takes more leg-work to change market share in on-trade but I think we are well positioned to achieve improvement in on-trade as well. Handing over to Paul regarding the commodities.

Paul Bal: Yeah Fintan, thanks for your question. I'm not surprised, to be honest with you, it's quite a topical issue at the moment and the concerns being raised about import costs, inflation. The short answer to your question is in the short-term we don't see a material impact to us and that really reflects the long-term nature of our contracts for the main sort of inputs that we have of obviously glass and grain and alcohol and so forth. So we don't anticipate a short-term sort of pressure from that. But obviously, you know, further out it will depend on how the sort of negotiating rounds go for the next round of contracts that we will do later in the year.

Mirek Stachowicz: And I would add that because of our scale in procurement we were able to put in place longer-term contracts which is not typical for the industry. And I believe we are the only ones who have long-term contract for glass, for example. That has benefitted us. We are also able to leverage our scale in procurement of alcohol and grains. Now, it will impact us, the commodity prices. I believe there is a super-cycle which is – which is happening now and we will see an uplift. But I think that we will also – if it's a super-cycle then everybody else will have to take this into account so I anticipate that in the end it will result in increasing consumer pricing. And, you know, the track record of passing on consumer pricing is particularly – has been particularly good in Poland. I think it's improving in Czech Republic and it's been good in Italy. So I think it will have limited impact on us.

Fintan Ryan: Great, thank you both. Very clear.

Operator: Yeah, our next question comes from the line of Damian McNeela from Numis. Please go ahead, your line is now open.

Damian McNeela (Numis): Yeah, hi, morning gents. A couple from me please. Just in terms of just continuing with the on-trade theme but in terms of the Czech Republic and Italy. Can you give us a little sense of what the – what your customers are expecting in terms of opening? Is there a strong latent demand similar to the one that we've seen in the UK? And then also what's the competition experience – or the competition's experience of the lockdown been? I.e. do you expect to be in a stronger position competitively for the reopening than perhaps you were pre the pandemic? And then just on the M&A environment, can you qualify Mirek firstly, did you say you were going to give us an update on the M&A strategy later this year or did I mishear that? And then secondly can you just give us a sort of an update on the M&A environment in general and see whether sort of any more opportunities have come to market or whether sort of there hasn't really been much change in the – in the last six months please?

Mirek Stachowicz: Thanks Damian. I think these three questions are to me so let me just start at the M&A strategy. I think I need to – I need to clarify. What I meant, and my apologies for misunderstanding if I caused it. I meant we will give an update on the overall strategy, not just M&A. The reason why we need to do this is you may remember that we – our strategy which was revised in 2018 was running for three years. So it's high time we updated if only – we need to update the ambitions, the objectives. We have overachieved on our objectives so the question is, what do we do next? We have – we have been going through a process of revising our strategy but we felt that it wasn't appropriate time in the midst of the pandemic to talk about the strategy if only because we want to assess if the strategic landscape hasn't been reshaped by the pandemic. So later in the year we will be giving an update on strategy overall with new objectives and we – M&A clearly is going to remain a strategic pillar for us.

Now, you also asked a question can I comment more about the M&A environment. But the M&A environment is – you know, there's lots of businesses that suffered through the – through the pandemic but we've already said that a few times so I'm just at the risk of repeating myself. We are interested in sound businesses. Sound businesses usually did well in the pandemic or did not suffer terribly. So we don't anticipate to have a significant discount opportunity in buying businesses that will be undervalued. What we want to find is businesses that are sound and doing well. And by combining our scales we can generate synergies. That is what we are looking for.

You were asking what do we expect from the on-trade opening. Well, the on-trade opening will depend on the success of vaccinations really. Some of our markets have experience going back and forth in on-trade opening. We had a week in Czech Republic beginning of March when the trade was reopened for one week. And then it was opened – closed down again. So the authorities are actually quite militant in this and it is not completely clear that the road ahead of us is easy, yeah. I would – I would caution on taking it for granted that the on-trade will reopen aggressively everywhere. Once it does reopen we think that the consumers will react positively, like here in the UK where there was a lot of enthusiasm and, you know, I have to confess I also contributed to this enthusiasm. The – I think that the best chance of on-trade reopening clearly is in Poland. Keep in mind this is the area where our exposure to on-trade is the lowest, yeah.

Do we expect to have stronger position in on-trade once we reopen? Well, we have been stressing that we have been investing in on-trade during the lockdowns. So we strengthened our position and systems in the market where we have biggest exposure by size, which is the Czech market. We believe we are in a different place in terms of quality of our presence in on-trade. I think we also – and systems. The same goes for Italy where we have taken time of the lockdowns to restructure our salesforce, better cover the geography. The combined portfolio of the legacy brands, Franciacorta and Beam gives us completely different set of capabilities. Now, this should have positive effect on our competitive position. So I guess that's – I hope that answers your questions, Damian. Would you add anything to this, Paul?

Paul Bal: No, I mean, you know, I think, you know, we have taken the time to invest behind the scenes, as we said, in our capabilities. And obviously we also take benefit from the acquisitions from 2019 which were both biased towards the on-trade. So, you know, we think we're in better stead as the on-trade channel opens up.

Mirek Stachowicz: There's maybe one more thing that, you know, I just saw that today Diageo are publishing their update on results and they're expecting to see a 14% growth in operating profit in 2021 fiscal year. I think it's important because it's natural that we get compared to big global companies like this. We are different. Also in the sense that when these guys were suffering because of their exposure to ultra-premium brands and to on-trade, we were doing well. We were resilient. When the on-trade rebounds we will see them doing much better but we will continue to be resilient and we will continue to grow. They will grow rapidly from a lower base. Well, we didn't lower our base and we consequently don't expect to click the same type of growth rates which doesn't mean that our business will do worse than them. In fact, I believe we – by steady going we are actually doing very well.

Damian McNeela: Yeah, thank you Mirek, that's very clear.

Paul Bal: Thank you Damian.

Mirek Stachowicz: Thanks Damian.

Operator: There are no further questions at this time. Please go ahead.

Mirek Stachowicz: I think that we have come to the end of the allotted time so unless there are any more questions I would like to thank everybody for your participation and I look forward to having opportunity to speak with you in person.

Paul Bal: Thank you everybody.

Mirek Stachowicz: Thank you everybody. Goodbye.

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

[END OF TRANSCRIPT]